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ASSESSMENT OF THE CRISIS IN INDONESIA

A report prepared by USAID for the Senate Appropriations Committee in response to a request for a comprehensive assessment of the situation in Indonesia. The report is based on extensive interviews by USAID staff, analysis of assessments and analyses included in the bibliography, and recent appraisals of the financial crisis in Asia preparatory to development of the Accelerating Economic Recovery in Asia Initiative.

November 9, 1998

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Executive Summary

Indonesia is enmeshed in a complex crisis with mutually reinforcing political, economic and social dimensions. The sudden onset of the crisis and the scale of the changes it has wrought have created deep uncertainties, great pain, and surprising opportunities. The country faces extraordinary challenges for which there are no simple solutions.

The crisis first appeared with the worst drought in 50 years, imposing great hardships in the easter islands, reducing food production and encouraging rampaging fires that cast a haze across southeast Asia. The crisis grew with the fall of the Thai bhat as investors began to lose confidence in the Asian miracle. It was compounded by Japan's failure to move out of its own recession. The economic crisis exposed the fundamental weaknesses of Indonesia's institutions, political as well as financial, and triggered social unrest that erupted in May, killing 1,200 people, threatened ethnic Chinese Indonesians, and encouraged the flight of billions of dollars. It toppled Asia's longest serving president, Suharto, and freed Indonesians to speak their minds. It challenged Indonesian thinking about the structure of the economy, the historic and future role of the military, and the right to govern in East Timor and Irian Jaya. It unleashed a momentum for reform--but at real costs--enormous numbers of newly poor, widespread and growing unemployment, a fraying social fabric and the potential for a sweeping breakdown in law and order.

The crisis is felt throughout the archipelago, 17,000 islands stretching across more than 3,000 miles. But its impact cuts differently across different sections of the population, different sectors of the economy, and different geographic areas. It is imposing real burdens and hazards, spreading pockets of poverty and brushfires of social unrest, but its reach is uneven. The hardest hit are the urban areas, largely on Java, where unemployment has grown dramatically as construction, manufacturing, real estate and service sectors have imploded. Some 20 million Indonesians have lost their jobs. In Jakarta nearly a third of the labor force is out of work. And the numbers of poor are escalating as unemployment meets an inflation rate approaching 80 percent. The poor are changing their diets, cutting back on meals, or going hungry. Malnutrition is on the rise, and growing desperation comes just as political uncertainties mount and the capacity of the government--and armed forces--to maintain law and order is stretched thin.

Recovery will require the building of a political consensus that can restore a modicum of confidence in Indonesia's future. USAID's strategy responds to the immediate humanitarian needs of the crisis through work on the social safety net--food, health and jobs--while simultaneously using new opportunities offered by the reform impetus to strengthen foundations for the recovery. The program includes a large food program and efforts to maximize the government's own food delivery effort. It works closely with local governments and NGOs on public works for job creation. It develops a new health program targeting the most vulnerable--mothers and children. It provides technical assistance aimed at the economic recovery--to help Indonesia unravel corporate debt and failed banks and to put in place the policies, laws and institutions to assure confidence in a restored system.

The Crisis and its Consequences

“No country in recent history, let alone the size of Indonesia, has suffered such a dramatic reversal of fortune.”

-- The World Bank, 1998

Indonesia's economic collapse is without recent precedent. The national economy is expected to contract by 15 percent this year, following three decades of annual growth exceeding six percent. The rupiah is now worth roughly 30 percent of its value a year ago and inflation may exceed 80 percent by the end of 1998. Banks have ceased lending--commercial banks haven't made a loan since September 1997, and two-thirds of the corporations on the Jakarta Stock Exchange are bankrupt. Forty percent of the population now live near or below the poverty line, a figure expected to swell to 65 percent by early next year. Unemployment, now estimated at 20 million, grows by the thousands daily. What began as an economic crisis has quickly developed into a crisis of complex social and political dimensions with dramatic humanitarian implications.

THE IMPACT

Poverty and unemployment: Indonesia has seen a remarkable increase in "newly poor." Where last year annual per capita income was \$1,200, this year it is estimated to be \$400. The International Labor Organization estimates by the end of the year as many as 80 million people will be earning less than one dollar a day; unemployment could rise to 20 million and underemployment far higher. Nearly a third of Jakarta's workforce is unemployed.

Food: For the first time in years food availability has become a major concern. The problem is not so much supply as ability to buy. Inflation, unemployment, growing poverty, and the disruption of traditional distribution systems have reduced access to food, particularly in urban and peri-urban areas. Rice scarcity and price hikes contribute to social unrest. Prices spiked in September, triggering riots and burning of rice in a number of small towns, particularly on Java.

Health: Growing poverty has meant that people eat less. The government estimates that as many as 60 million Indonesians may not be able to meet their minimum food requirements. Recent surveys are showing disturbing signs of increasing anemia (particularly on Java), and cases of kwashiorkor and marasmus are beginning to appear in urban hospitals. UNICEF estimates that eight million infants are undernourished. Helen Keller reports a significant drop in young women's bodyweight and growing signs of vitamin A and iron deficiencies. The government's health budget, already one of the world's lowest, has been cut by 15-20 percent, and the government cannot afford the increased costs of imported pharmaceutical and family planning commodities. The private sector, responsible for servicing 50 percent of health needs, is at risk. Nearly 100 of 224 pharmaceutical manufacturers are technically bankrupt,

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for example, and three out of ten of the largest distributors.

Education: Poverty has begun to affect school enrollments as parents can't afford school fees. The government estimates that nearly three million students are at risk.

Political: Demonstrations and riots forced Suharto to exit in May, unleashing a political reform movement of unquantifiable dimensions. There has been a flowering of debate and new institutions to carry the debate forward: more than 140 new newspapers and dozens of radio stations, 11 new unions, and more than 90 political parties. New election laws are being debated, and, for the first time since 1955, the government has pledged to hold free and open elections.

At the same time, the dramatic change has brought great uncertainties and concerns about a backlash as political groups and interests vie for power in an environment where new rules of the game are not yet established or even agreed-upon. Continued ethnic tension, a long-delayed investigation of last May's events targeting Indonesia's ethnic Chinese, the recent attack on a legal aid organization, and the "ninja" killings of 160 muslims in East Java, all support these concerns.

Economic: The collapse of the rupiah, growing inflation, mounting unemployment, failed companies, closed banks, all revealed clearly the institutional weaknesses of Indonesia's financial sector. The crisis did not affect all parts of the economy equally, however. Certain sectors--such as agriculture and natural resource-based exports--have profited from the rupiah's weakening, and certain parts of the country, particularly on the outer islands where coffee, copra, cocoa, palm oil and logging are important, continue to do reasonably well. Real recovery, in terms of significant new investment, awaits some confidence in reasonable security and a resolution of political uncertainties. In the meantime, however, the depth of the crisis has ushered in new interest in reform and remarkable opportunities for restructuring the financial sector and working out corporate debt while attacking major areas of weakness relating to governance, institutional supervision and accountability.

Environment: The economic crisis has brought new pressures on natural resources and the environment. Desperation among the rural poor has provoked rising conflict over access to land and other natural resources. In urban areas, increasing costs of energy and deteriorating urban infrastructure have added to the misery of the newly unemployed. But the crisis has also opened doors to democratic discussion and the possibility of improving transparency and governance in natural resources management--an area where corruption has been particularly severe.

THE RESPONSE

The international donor community has mounted a major rescue effort for Indonesia. Under the leadership of the International Monetary Fund (IMF), a \$40 billion economic reform and recovery package, to be disbursed over three years, includes: IMF stand-by credits of \$10.14 billion, \$3.5 billion from the Asian Development Bank (ADB), \$4.5 billion from the World Bank (WB), and pledges from bilateral donors as follows: Singapore, \$10 billion; Japan, \$5 billion; the U.S., \$3 billion; and Australia, Hong Kong, Taiwan, and Malaysia, \$1 billion each. The program is to stimulate

domestic demand by careful deficit spending; restart the shattered financial sector; resolve corporate sector debt issues and assist restructuring efforts and strengthen economic governance. Given the magnitude of Indonesia's crisis, with more than \$60 billion in private sector debt alone, the donors' financial package provides an important lifeline, but not the answer to Indonesia's recovery.

In addition, donors are seeking to mitigate the impact of the crisis through programs focused on social safety net concerns. The World Bank and ADB are financing labor intensive works public works. The World Bank is funding a stay-in school program and has restructured its health program to help the GOI preserve basic health family planing services. The ADB is providing loans to decentralize and manage social services for the most vulnerable sections of the population, women and children, and Australia's aid to support the IMF, to help with labor intensive public works, and to provide drought relief. Many of the other donors are involved in programs related to the drought or to the last year's fires in Kalimantan.

Since the fall of Suharto and the announcement of elections, a growing number of donors are expressing interest in work related to the elections. Few have actually begun any work on the ground, but several, including USAID, the European Union, France, Germany, Norway, the United Kingdom, and Australia, are discussing future assistance as part of an ongoing donor forum on elections under the aegis of the UNDP.

USAID'S STRATEGY AND PROGRAM

USAID's strategy responds to the immediate humanitarian needs of ordinary Indonesians through work on the social safety net--food, health and jobs--while simultaneously using the new opportunities offered by the momentum for reform to build foundations for a healthier, more productive and democratic Indonesia. It includes a large food program and works with the government, NGOs and donors to maximize the effectiveness of the government's relief efforts. It reshapes USAID's urban program to support NGOs and local governments in creating labor-intensive public works. It develops a new health program targeting the most vulnerable--mothers and children. It provides technical assistance aimed at economic recovery--to help Indonesia unravel corporate debt and failed banks and to put in place the policies, laws and institutions required to assure confidence in a restored system.

At the same time, it recognizes that although external factors played a role, fundamental problems of governance accrederated sharply exacerbated Indonesia's oasis. Systematic misgovernance and abuse of power created the conditions for economic collapse and the potential for a humanitarian disaster. The fall of Suharto and the impetus to democracy offers an opportunity for improvement. The upcoming elections and the wave of reform represent a remarkable opportunity to create a new consensus on how Indonesia is to be governed. Such a consensus is key to the restoration of confidence in Indonesia's future which will allow economic recovery to begin. The development of strong civic institutions to demand improved governance is critical if economic recovery is to be sustained.

Because the political transition scheduled for this year is so crucial and so uncertain, the strategy puts civic and community participation--elections support and free and open debate on critical issues--at the center of its program. USAID has been and will continue to be one of the largest and most active donors in civic and community participation (democracy and governance sectors). The USAID Program, more than any single donor program, has been instrumental in laying the groundwork for political reform and will continue to support and facilitate the active engagement of donor groups in strengthening democratic reforms. It will coordinate closely with other donors because the task of preparing 100 million voters on 17,000 islands across a 3,000 mile archipelago is so vast. A broad and active support from international donors will be important in responding to concerns about sovereignty and impartiality. Our work in this area will involve more than 200 new partners, Indonesian NGOs, political parties, media, legal authorities, academics and civic organizations.

We are currently developing a proposal with the support of the State Department and Department of Treasury for a five-year, \$520 million program, "Accelerating Economic Recovery in Asia," AERA, for which work in Indonesia will be a central part. AERA's focus will be on job creation, better targeting of social safety net instruments and strengthening of the foundations for a sustained economic recovery.

Finally, because of continued USG interest in global issues such as biodiversity and global climate change and Indonesia's unique role in these issues, we will maintain an active presence in natural resource management. We will respond to crisis-related pressures on the environment and new-found opportunities for reform to focus on decentralization and support for community-based management of natural resources, including forests and coral reefs. The objective will be to strengthen NGOs advocating community-based management and reform of natural resources management.

USAID's strategy responds to the immediate needs of the crisis while simultaneously using new opportunities to build foundations for long-term, sustainable development. The program has two phases. Phase I (FY 1999 through FY 2000) the core of the strategy, responds to the immediate crisis. It focuses on immediate needs--the social safety net through food, jobs and health, while placing at the center of its program as its major emphasis, work with NGOs on the development of civic institutions and preparation for carrying out, monitoring and building on free and fair elections. At the same time, it initiates long-term work on economic reform, particularly corporate debt and bank restructuring, and maintains a strong base of support for natural resources management and the environment. During Phase II (FY 2001 to FY 2003), the strategy emphasizes recovery, long-term programs for economic growth, the strengthening of civil society, health and family planning and protection of the environment.

We have already made distinct shifts in our program strategy and are requesting budget changes to reflect them. We are asking to increase our allocation for civic and community participation (democracy and governance) to more than 40 percent of our budget. To support social safety net activities, we are adding funds for technical assistance on food policy and for monitoring, increasing our emphasis on health and

designing a new program for women and children, and realigning our urban program to focus on job creation. We are requesting a doubling of our allocation for economic reform to take advantage of new opportunities for major changes in key economic policy areas.

USAID is using a variety of sources of funding and mechanisms to implement its activities. They include development assistance, food assistance, economic support funds, international disaster assistance, and urban environmental credits. We are employing grants, cooperative agreements, experimental combinations of contracts and grants, umbrella arrangements and are working with more than 200 local NGOs. Through US NGOs and contractors, we are working extensively with indigenous groups, including muslim and community-based organizations engaged in activities ranging from primary health care and feeding programs to protection of natural resources.

Humanitarian and Social Concerns

A social safety net is critical to ease the effect of the crisis on the most vulnerable and to allow time to build consensus on political and economic reforms necessary to achieve sustainable and broad-based growth. USAID's response to the humanitarian and social dimensions of the crisis includes technical assistance, commodities and training to create jobs, increase access to food, and provide critical health and family planning services, specifically:

Poverty and Unemployment

- o \$25.5 million in urban environmental credit to the GOI for emergency public works programs, creating jobs and building urban infrastructure.
- o Technical assistance to municipal governments and local NGOs to develop public works. (220,000 person-days work created since March; an estimated 7,600,000 person-days of employment by March 2000.)

Food

- o \$50 million in PL 480 Title II food through the World Food Program (WFP) and US NGOs working with Indonesian NGOs on the eastern islands, Kalimantan and central Java; nearly 10,000 tons have been delivered; 10,000 more is en route. The food is for food-for-work programs, supplementary feeding of vulnerable groups and targeted feeding for the poor.
- o Support to an Indonesian NGO to monitor food delivery to five major cities.
- o Planning with USDA on distribution or monetization of up to 1.5 million tons of wheat through WFP and NGOs.
- o Work with Donor Food Group to maximize effectiveness of GOI food program.

Health and Family Planning

- o Support for NGOs and local health providers on delivery of health and family planning services to meet crisis priority needs.
- o Technical assistance to the Ministry of Health for its new crisis planning and response center and to the National Crisis Response Center for crisis impact monitoring.
- o Donation of medical supplies and contraceptives.
- o Fortification of wheat with iron.
- o Support for midwives including emergency supplies, contraceptives, training and operational support.
- o Support to NGOs and GOI working on prevention of sexually transmitted infections, including HIV/AIDS.

Civic and Community Participation

Indonesia's most urgent political challenge at present is to hold free and fair elections that bring into office leaders committed to continuing the process of political and economic reform. Significantly, much of the current reform movement has flourished largely because of President Habibie's political weakness prevents him from resisting change. Should a 'strongman' take the Presidency, the reforms made to date could be summarily reversed. (Such turnabouts are not unknown in Indonesian history. The country did experiment with democratic reform under Sukarno in the 1950s, an endeavor that was sharply curtailed with the then-President's move to 'Guided Democracy' in 1957). Delays in holding elections would also afford the current administration time to consolidate its power base.

A free, transparent election is also essential to maintaining the public enthusiasm currently buoying 'Reformasi'. The continuing economic hardship may sap much of this enthusiasm as the benefits of political reformation are slow to manifest themselves in the economic realm. A tangible achievement within the political arena, namely a free election, will be vital to maintaining the momentum of the reform movement. In Phase I, USAID will encourage transparent, inclusive, and legitimate parliamentary and presidential elections. USAID's Office of Transition Initiatives (OTI) plays a special role during this period with short-term activities, including support for the media, voter education, human rights, and civil-military relations. In Phase II, USAID will develop responsive public institutions, stronger civil society organizations and effective mechanisms for oversight and accountability. USAID's response includes:

- o Support to 45 advocacy NGOs working on elections and political reforms. (This should grow to 150 to 200 in the run-up to the elections.)

- o Grants to NGOs for democracy, civil society, human rights and work related to the elections.
- o Establishment of NGO and donor working groups on the elections.
- o Voter education, independent media and election management and administrative needs assessments.
- o Support to groups working on human rights and violence against women, with specific reference to the rapes of Indonesian Chinese women in May.
- o Support for NGOs working on investigating human rights abuses in Irian Jaya, E. Timor, and Aceh.
- o Support for election law reviews and discussions on election laws, procedures, and regulations to the GOI, NGOs and political parties.
- o Development of the nationwide public service announcement on interfaith tolerance.
- o Support to media groups developing or reviewing laws governing freedom of expression.
- o Expanded support to Indonesian umbrella organizations working on political reform.

Economic Reform

USAID is focusing on providing U.S. technical expertise to support achievement of the economic and financial reform agenda set under the IMF/GOI agreement and supported by all members of the Consultative Group for Indonesia. In the financial and corporate sectors, this allows Indonesia to benefit from U.S. experience related to such situations as resolution of the U.S. S&L crisis of the mid-80's and U.S. support to economic and financial restructuring in eastern Europe. Given the strength of the U.S. economic system, provision of U.S. expertise related to corporate governance, economic law and regulation, and macroeconomic policy, is also especially appropriate. The program is carefully coordinated with other involved U.S. institutions, such as the U.S. Treasury, as well as the IMF and the other multilaterals. It includes:

- o Bank restructuring in a joint activity with the US Treasury through advisors working at Bank Indonesia (central bank) and the Indonesian Bank Restructuring Agency.
- o Strengthening of Bank Indonesia's system of bank supervision.
- o Corporate restructuring through technical assistance on laws relating to bankruptcy, competition, secured transactions, arbitration.

- o Support for debtor-creditor negotiations under the Jakarta Initiative.
- o Training and technical support to the new commercial court.
- o Assistance in developing the new independent competition agency (Federal Trade Commission) required to implement the new competition law.
- o Support to the GOI, civic organizations, NGOs, university groups, and think tanks working on the removal of barriers to trade and investment, focusing on obstacles to free and open trade and fair competition for small businesses.
- o Technical support to Bank Indonesia on monetary policy and exchange rate regimes heavily affected by the crisis, in coordination with the IMF and US Treasury.
- o Technical support to the Ministry of Finance to deal with changes in fiscal policy and tax reform to respond to the crisis and its impact.
- o Support partnerships between US NGOs and Indonesian universities, think tanks or NGOs to encourage discussion and debate on key reform issues.

Environment

The economic crisis has brought new pressures on natural resources and the environment. Desperation among the rural poor has provoked rising conflict over access to land and other natural resources. In urban areas, increasing costs of energy and deteriorating urban infrastructure have added to the misery of the newly unemployed. But the crisis has also opened doors to democratic discussion and ushered in a wealth of opportunities for debate on policy and regulatory issues with broad implications for Indonesia's economic recovery and the future of its environment. During Phase I, USAID will strengthen local capacity to manage natural resources, and restructure and reform the energy sector. This work will serve as a foundation for USAID's Phase II efforts to preserve Indonesia's biodiversity and reduce the generation of greenhouse gasses.

- o Support and strengthen 15 Indonesian NGOs working to redress human rights abuses stemming from confiscatory land use practices.
- o Technical assistance to local governments and NGOs to identify, articulate and arbitrate local resource conflicts.
- o Provide assistance to NGOs working on efforts to rewrite laws affecting natural resource use and management in an effort to eliminate sources of corruption and misdirected exploitation of natural resources.
- o Assist local communities in developing alternative income sources in coastal areas hardest hit by the economic recession and drought.

Cross-cutting Issues: There are four cross-cutting issues common to most activities in USAID's portfolio: transparency in decision-making and anti-corruption, women in development, the role of NGOs, and decentralization. USAID is actively exploiting synergies between activities to emphasis impact on these issues.

Appendices

I. HUMANITARIAN CONSEQUENCES, NEEDS AND RESPONSE

A. Humanitarian Consequences of the Crisis

The ILO has estimated that by mid-1998, 75 million Indonesians were living below the poverty line--37 percent of the population. The number is expected to grow to 100 million by year end, and by the end of 1999, two of every three Indonesians--140 million people--will be living in poverty (*see figure 3.1*). These numbers represent a serious set-back for Indonesia which by 1997 had managed to reduce poverty to about ten percent of the population, down from fifty percent in 1970. The rise was caused mainly by a dramatic increase in unemployment and high inflation--which drove food and medicine prices beyond the reach of many. The crisis was exacerbated by droughts caused by El Nino, which devastated last year's rice crop.

Food Shortages: Last year, El Nino's extremely dry weather, particularly in eastern Indonesia, caused widespread crop failures and delayed rice planting. El Nino, together with reduced food imports due to financial straits, diminished Indonesia's food supply late in the summer. By October 1998, however, although isolated shortages existed, there appeared to be adequate food supplies in-country (*see fig. 3.2*). In early 1998, a sharp currency devaluation and rumors of price rises created a food rush that depleted stocks of staples such as rice, sugar, and cooking oil temporarily. Many households began hoarding food, fearing that these staples would not be available in the future at affordable prices.

Fears of food shortages--and the sharp increase in inflation--led to soaring food prices. The depreciation of the rupiah and the collapse of the Indonesian banking system hindered food imports, as many international banks refused to accept letters of credit (LCs) issued by Indonesian importers. To respond, the government set up a financing mechanism to guarantee food imports using international reserves.

The riots in May 1998 damaged distribution chains and destroyed stores that provided daily supplies. While distribution infrastructure appears to be in working order, the psychological impact of the riots continues to affect distribution. Consumers and farmers hold larger-than-normal stocks in anticipation of a breakdown of law and order, future shortages and increased prices. Traders limit the size of their stock, fearful of being charged with hoarding, an offense with heavy penalties, or out of concerns about looting of food stocks, which continues in isolated incidences, often with little protection from police. Thus, little food moves, and while adequate food stocks exist in-country, food prices remain high.

Food availability: Despite conflicting reports, an FAO September assessment estimated the rice crop deficit at 5.14 million tons for the period April 1998 to March 1999. By mid-September, Indonesia's national logistics agency had imported 2.42 million tons and contracted another 525,000 tons. Food pledges from donor countries added a further 765,000 tons, leaving a shortfall of 1.43 million tons to be secured on commercial terms or through grants.

Prices: The crux of the crisis is not food supply, but prices and consumers' ability to pay. Spot shortages still exist, but the main problem is access to food. Inflated prices and growing unemployment have put a large portion of Indonesia's population out of the reach of sufficient food. Inflation is expected to reach 80 percent this year and food prices have risen even faster. The FAO reports that the Indonesia Food Price Index has more than doubled between August 1997 and July 1998.

Basic Food Staples

(Rp per kg)

	<i>Jul 97</i>	<i>Apr 98</i>	<i>Nov 98</i>
sugar	1,550	1,800	3,590
cooking	1,700	3,600	3,600
eggs	3,000	5,200	7,000
milk	19,409	31,150	32,000
flour	-	1,150	3,500
beef	-	16,000	23,000

Production: The 1998 rice crop is estimated to fall by eight percent this year to 45.38 million tons—the smallest harvest since 1991. The reduction is caused by a delay in planting due to the drought, pest attacks, and a dramatic reduction in fertilizer and pesticide use (due to rising costs). Planting started in October for the next major harvest in March. Other food crops seem to have increased their outputs over the past year, including corn, up nine percent; soybeans, which increased eight percent, and cassava, which rose eight percent. Soaring prices of imported feed have created severe shortages in the supply of livestock products. Poultry output is estimated to have fallen by 30-50 percent.

The drought did not hit the country uniformly. Unfortunately, some regions which experienced the largest decrease in rainfall, such as East Timor, East Nusa Tenggara, and Irian Jaya, are also among Indonesia's poorest. Even before the crisis, the number of poor households in these provinces was three times the national average (see fig. 3.3). In general, the outer islands have the highest incidence of poverty, but Java with about 120 million people or 60 percent of the population, has the largest absolute number of poor (See fig 3.4) and the largest absolute number of unemployed. Food insecurity and malnutrition will have a different impact in urban areas than they do in rural areas, where alternative, less expensive foodstuffs may exist.

Mid-year reviews show regions producing and selling dollar-earning commodities faring better than others. Areas with export crops such as shrimp, coffee, rubber, cocoa, seaweed, etc. are experiencing unprecedented increases in income, which have generally outpaced food price increases. The government has tried to ensure supplies of basic foods at affordable prices across the country through direct subsidies, export taxes on food commodities and bans on their export. This has led to smuggling of subsidized foods to countries where they can be sold at international prices, a problem which may have diminished as the rupiah strengthens.

The future is unclear. Rice prices may fall by the end of the year. A recent World Food Program assessment, for example, suggests that the demand for rice in the urban sector may, in fact, have fallen more than the supply. WFP officials noted the conflict between this finding and continued high prices which they attributed to farmers' keeping stock on hand and flaws in distribution. The end of the year could produce a steep rice price decrease as farmers begin to release stocks in anticipation of a healthy harvest.

Unemployment rises: The Ministry of Manpower estimates that as a result of the crisis, the number of unemployed will reach 20 million by the end of the year. Measuring Indonesia's unemployment has always been a difficult task. Although official unemployment was fairly low (less than 10 percent) before the crisis, combined with underemployment, the total now approaches 40 percent. Combined unemployment and underemployment was estimated at more than 30 million as of February 1998 (see fig 3.13).

Underemployment, defined as work in ill paying jobs to earn enough to survive and/or working less than 35 hours a week, has always been extremely high in Indonesia. In 1996, 37 percent of the workforce was underemployed. The crisis has increased this figure because so many formerly full-time employees now share underemployment opportunities to avoid open unemployment.

Indonesians have displayed an impressive resilience in times of crisis and hardship. Extended families and entire communities pull together to weather tough times. In the past, in times of rural hardship, they have sought urban opportunities and in times of urban crisis, they have returned to the village to ride out the storm. In this crisis, Indonesians have had to cope with twin shocks—financial crisis and drought, so neither cities nor villages provided the traditional safe haven, and customary strategies for dealing with unemployment are not functioning normally. The repatriation of Indonesians working overseas has blocked a third option in times of hardship. Malaysia, also in a deep economic crisis, is sending home increasing numbers of the 250,000 Indonesian workers there.

Labor intensive projects: Although labor-intensive projects can help some to cope, the GOI has been overwhelmed by the growing number of unemployed. With the support of World Bank, ADB and other organizations, the GOI has begun several labor-intensive projects for village improvement and public works, but the programs have been unable to absorb the huge number of newly unemployed nor to accommodate the recently unemployed white-collar employees.

Women are as affected by the crisis as men. While the majority of lay-offs for men occur in construction and manufacturing sector, women bear the brunt in the trade, hotel, and restaurant sectors as well as sub-sectors like textiles industry (see table 3.6). Unfortunately, the government's labor intensive projects are failing to create opportunities for females, leaving unemployed and destitute women vulnerable to commercial sex.

“There is indeed some merit to the view that employment of women should be given preference, because income in their hands tends to increase household welfare more than if it were in the hands of men.” - The World Bank (3.9)

There are regional variations of unemployment according to the National Statistics Agency (BPS). The highest unemployment rates in 1998 are in Jakarta (32.7 percent), North Sulawesi (24.6 percent), and Riau (23.9 percent), while the biggest increase in unemployment rates since 1996 are found in some of the outer islands such as West Nusa Tenggara (533 percent), Jambi (521 percent), and South-East Sulawesi (405 percent).

Health costs: The impact of the crisis on health is largely due to increasing unemployment, the drop in real income and purchasing power, and inflated prices due to the depreciated rupiah and a shrinking government budget. Many families simply lack funds to pay for goods and services essential to health, such as food, medicine--vaccines, contraceptives and other medical supplies--and health care. A survey quoted in the World Bank's *Indonesia in Crisis* indicated that in Jakarta and West Java, drug prices have increased two-to-three-fold since the crisis started. A shortage in drug supplies has forced some health centers in more remote areas to close. Indonesia's national health budget, just two percent of GDP, has long been one of the world's lowest. Further reductions could cut into critical public services.

Despite a previous objection, medical subsidies have been allowed to offset the soaring cost of medicine, which has high import content. The rising price of imported medicines and medicine components weighs heavily on the local pharmaceutical sector. According to the Indonesian Pharmaceutical Association, 100 of 224 pharmaceutical producers are technically bankrupt, three out of the ten of the largest distributors are beyond salvation, and 600 of 1,200 small, regional distributors are bankrupt.

Increasing maternal and infant mortality: Reductions in purchasing power have reduced the likelihood that mothers will use preventive health services, such as immunizations. Pregnant women seem likely to turn to untrained traditional midwives to reduce prenatal care and delivery costs. This would raise health risks for mothers and babies, possibly increasing Indonesia's already high maternal and infant mortality rates. Maternal mortality, already the worst in ASEAN, was estimated at 334 deaths per 100,000 births in 1995. Recent data from urban hospitals in East Java indicate that maternal deaths may be increasing and UNICEF estimates that by 1999 the rate could double (see fig 3.5). Infant mortality rates are now 53 deaths per 1000, with two-thirds of all infant deaths occurring within the first month of life. The rates are expected to rise 20 percent by 1999, based on current projections (see fig 3.6).

Reduced contraception: Family planning statistics show that the usage of modern contraceptives declined five percent between January 98 and June 1998, despite the GOI's efforts to ensure availability of sufficient stocks of injectable and oral pill contraceptives. This means at least 1.5 million women have ceased using contraception and are now using traditional herbal or rhythm methods, cheaper but less effective, as alternatives. The usage of oral contraceptives could drop more than

60 percent and injections 37 percent among current users due to shortage of supplies and price increases. This could push the Total Fertility Rate (TFR) up nearly 25 percent over the 1997 rate. Some experts are even expecting a future baby boom as families struggle to cover the costs of daily necessities, including birth control. The result--unwanted births and abortions. Although comprehensive data on the abortion rate is not available, social workers believe abortions are on the rise..

"...if they have to make a choice between buying food and birth control devices, they will certainly prioritize food," Former Chairman of the Indonesia Planned Parenthood Association. (Jakarta Post Oct 18, 1998)

Commercial sex: Reduction in real incomes and unemployment, particularly among females, have resulted a doubling of prostitution. Indonesia now has an estimated 650,000 prostitutes, including 150,000 registered sex workers. By comparison, there were 72,000 registered prostitutes in 1995. Many of these prostitutes are new to the trade with little or no understanding on sexually transmitted diseases (STDs). Social workers worry that the rising number of prostitutes could spark an explosion in STDs and abortions. Before the crisis, 10 percent of family planning clients in Surabaya carried sexually transmitted infections. Today, it is three times that.

Malnutrition: Reduced food consumption has led to reduced average calorie consumption and lower quality diets. As a result of low quality diets, acute nutritional deficiencies are making a comeback. Research conducted by Helen Keller International up to June of this year found significant reoccurrence of malnutrition in Central Java. The prevalence of maternal malnutrition increased from 15.1 percent to 17.5 percent (see fig 3.10). The average bodyweight among women of reproductive age fell by about one kg between June-August 1996 and June-August 1998. The Body Mass Index (BMI) of these same women dropped by 0.45 kg/m² almost equivalent to the 0.50 kg/m² achieved over the last 30 years. Lower BMI can lead to increased morbidity and mortality, greater risk of pregnancy complications, and reduced quality of breast milk.

Vulnerable infants and children especially feel the impact of the health crisis. According to UNICEF, there are 8 million undernourished infants who face threats from diseases that had previously been drastically reduced if not alleviated. Social workers have found reoccurrences of severe protein malnutrition--kwashiorkor and marasmus--unseen in Indonesia for years.

Despite the fact that the percentage of malnourished children is highest in the Eastern Islands, the absolute number of malnourished children is seven to ten times higher in Java, and three to five times higher in Sumatra than on other islands (see fig 3.7 & 3.8). A study in 1998 by Helen Keller International (HKI) and University of Diponegoro showed a dramatically reduced intake of micronutrient-rich foods such as eggs, meat, and milk due to the increase in the price of basic commodities and reduced purchasing power of the population. The reduction is especially drastic in South Kalimantan, South Sulawesi, East Java, and Central Java. Across the country, more than four million children are affected.

The study showed a significant increase in mothers and children who had not been drinking milk during the crisis because it was too expensive. In Sulawesi, the occurrence of mother and children not drinking milk rose from around 40 percent in 1996 for both to almost 80 percent in 1998. In Kalimantan the figures for not being able to afford milk rose from less than 20 percent to more than 40 percent. Such changes in diet, especially Vitamin A, increase vulnerability to disease and increase mortality. (see fig 3.9)

There are alarming signs that micronutrient deficiencies are on the rise--in particular Vitamin A Deficiency (VAD) which can cause blindness and damage to the immune system--and iron deficiency which can cause anemia. Vitamin A is naturally found as retinol in breastmilk and foods from animal sources, and as carotene in foods from plant sources. (Graph on Childhood blindness and maternal blindness). Before the crisis, VAD in children over the age of one was no longer considered a public health problem in most provinces in Indonesia. Over the last 30 years, the country has successfully alleviated the VAD threat among pregnant women and children. Data shows that the incidence of childhood blindness in Central Java jumped from less than 10 percent in June 1996 to more than 20 percent in June 1998 (see fig 3.11).

Anemia is an increasing concern. Results of the 1995 National Household Health Survey found that 40.5 percent of under-five children suffered from anemia. Approximately 30 percent of female workers and 24 percent to 35 percent of school children were found to be anemic. Overall, as many as 50-70 million out of Indonesia's total population suffered from IDA. IDA impairs immunity and reduces the physical and mental capacities of population. In infant and young children, even mild anemia can impair intellectual development. Anemia in pregnancy is a significant cause of maternal mortality. Infants born to anemic mothers often suffer from low birth weight and anemia themselves. (HKI Bulletin 2, Issue 3, 1998). The post-crisis survey indicated that anemia in children in Central Java has increased from 40 percent in June 1996 to about 65 percent in June 1998. The prevalence of anemia among women of reproductive age has increased from 20 percent to 30 percent in 1998. These numbers are expected to rise further as the crisis continues (see fig. 3.12).

Children born into families that cannot afford micronutrient-rich foods due to the crisis may become a 'lost generation', sowing the seeds of today's problems to be reaped in an uncertain future. - Helen Keller International, Oct 98

Education

School leavers: The Minister of Education projected in June that at least 30 percent to 40 percent of all pupils will drop out of school due to the crisis. To cope, many households have pulled their children out of the school, both to save on educational expenditures and to get their children earning additional income. Government estimates suggest that about 6 percent of primary school students and 13 percent of junior secondary school students are at risk of dropping out (approx. 1,650,000 and 1,100,000 student respectively). While an additional 400,000 primary school students are unlikely to continue onto junior secondary school, the drop-outs among female students are expected to be higher.

"Evidence from other developing countries suggests that parents' decisions to send girls to school are more price sensitive than for boys." – the World Bank (3.8)

The government, with WB and ADB support, is launching a nationwide campaign to reduce the number of drop-outs this school year. WB and ADB have agreed to fund a nearly \$400 million program to help an estimated 25 million children to stay in school. A national scholarship program has been launched to target children most at risk of dropping out of junior secondary school based on poverty criteria. Nationally the program will cover 17 percent of the enrollment of 9.7 million during the first three years of the program. One of the many criteria of the program is that female students will constitute at least 50 percent of total recipients. (*Tempo*)

For the GOI, education is not only a matter of economics but of culture as well. For many years the GOI has put an emphasis on the need and importance of education. Still, in many areas of rural Indonesia, education has never been a priority. Parents in poor households would rather their children contribute toward the families' livelihood than go to school. Therefore, the Minister of Education is convinced that educational issues are intertwined with cultural issues.

Social Problems

Social tensions: Ethnic tension has been growing for years. Indonesians of Chinese descent account for 3-to-4 percent of the population yet they are dominant players in the economy. During the Suharto years, tension was exacerbated through blatant favoritism and cronyism. Recent hardships, continuing uncertainties, and a dramatically more open society have encouraged a surfacing of anger and frustration. Sporadic unrest, often targeted at ethnic Chinese, has become a common occurrence. It peaked during the May riots in Jakarta and Solo which produced an exodus of an estimated 100,000 ethnic Chinese--some of whom have yet to return.

The May riots produced in a heavy loss of life, widespread damage to property and businesses, and a dramatic drop in public confidence, both domestic and foreign. The National Human Rights Commission estimated that 1,188 people died, many looters trapped in fires set by rioters at shopping centers. Property damages have been officially estimated at almost \$400 million. More importantly, a critical part of the population--ethnic Chinese Indonesians and expatriate managers--has yet to return to business, posing a real obstacle to recovery of Indonesia's commercial sector..

Political riots: The joint fact-finding team established by the government concluded in their report released November 3 that the May riots were not spontaneous but organized by Suharto's son-in law in support of a political agenda. The team reported that the riots had a clear political objective--to secure extraordinary powers for President Suharto to overcome a temporary emergency situation. The report states that preparation for the riots, including the shooting of four students at Trisakti University, was made at "the highest decision-making level." The report mentions Suharto's son-in-law, Lt. Gen. Prabowo, and then-Jakarta military commander, Maj. Gen. Sjafrie Sjamsoeddin, as the probable organizers but mentions that further investigation is needed.

Protests and demonstrations: Since Suharto's resignation, unrest across Indonesia has increased in two basic forms: organized protest, often involving students and professionals against government officials who have allegedly been involved in corruption; and spontaneous disturbances, often driven by economic desperation. Typically this involves land occupations, commonly by people who have been displaced by projects associated with Suharto and his friends or family. Other participants include those who, after losing jobs in the city, have returned to rural areas to find the situation there no better.

Lawlessness: Indonesia has seen a general breakdown in law and order, including sporadic occurrences of looting and robbery--some organized with political motivation, as poverty grows, the military and police reexamine their role, and political interests begin to vie for power. The main target has often been businesses such as shrimp farms, coffee plantations, and food warehouses, linked to the skyrocketing price of goods and unemployment. Other incidents, however, such as the recent spate of mysterious killings in East Java, carry a darker, more political tone to them. The response of police and armed forces to declining law and order is unpredictable--they are often unable or unwilling to assert control.

B. Humanitarian Needs Arising from the Crisis

A viable social safety net includes:

1. Affordable supply of food:
 - o supplying basic food commodities to hard hit areas;
 - o monitoring to identify the changing needs and location of the poorest, giving priority to the hardest hit areas;

- o timely food imports and distribution, especially to remote areas;
 - o halting illegal exports of subsidized commodities;
 - o coordinating activities between various relief agencies and the government.
2. Provide access to basic health care services:
 - o supporting the distribution of basic medical needs;
 - o increasing access to affordable contraceptives to maintain family planning and preventing STDs in the commercial sex industry;
 - o providing education to encourage the use of health services despite rising costs;
 - o enhancing the capacity and efficiency of private sector suppliers of medical supplies, to reduce the reliance on imported drugs;
 - o establishing a nationwide monitoring organization to identify the areas with greatest need for medical supplies;
 - o continuing pilot projects on a private nationwide health care system.
 3. Maintain current educational enrollment levels:
 - o reducing the current drop-out rate and encouraging new enrollment;
 - o improving public awareness on the value of education;
 - o establishing a nationwide program of scholarship and grants to offset the cost of tuition;
 4. Create employment generating activities:
 - o developing labor intensive projects aimed at creating a large number of jobs;
 - o giving special attention to ensure that women benefit equally from these programs.
 - o developing credit mechanisms to stimulate job creation.

C. The Response

Food Availability: The USAID response to Indonesia's food crisis focuses on two areas: strengthening the GOI's food policy and management and improving accessibility to food. USAID responded quickly to Indonesia's drought-induced food crisis with \$53 million in emergency food aid. Approximately 84,842 tons of commodities is being distributed through food for work and vulnerable groups feeding programs, targeting 982,620 beneficiaries, primarily in the eastern islands. As the crisis has developed, however, food insecurity has grown more severe in highly populated areas in and around cities, particularly on Java. We have begun to shift our food program to these areas, beginning in November with a feeding program in central Java. There will be a need for continued assistance to meet the needs of "the new poor" in Indonesia's urban areas.

Because the government's food program is so much larger than that of the donors, it is important that donors work with the government to increase its effectiveness. USAID is playing a strong role within the Donors' Food Group coordinating aid to the government and to NGOs monitoring the government's program. We will also provide technical assistance to the GOI to strengthen GOI policies and management systems for food prices and food stocks, targeting methodologies for subsidized food programs, and internal and independent program and nutritional monitoring capabilities.

Other donors continue to play an important and varied role in Indonesia's food crisis. Food donations, principally the U.S. World Food Program, Japan, Canada and Australia are sizeable. Data, provided by WFP, on the current commitments of food aid from other donors is as follows:

	<u>Commodity</u>	<u>Quantity (MT)</u>
<i>WFP</i>	<i>Rice</i>	<i>114,664</i>
<i>(Total)</i>	<i>Wheat</i>	<i>214,900</i>
	<i>Blended Foods</i>	<i>17,000</i>
<i>Japan</i>	<i>Rice</i>	<i>60,000 (donation)</i>
		<i>500,000 (concessional sale)</i>
<i>UNICEF</i>	<i>Blended Food</i>	<i>8,500</i>
<i>Others:</i>	<i>Various</i>	<i>7,000</i>

The World Bank, in coordination with USAID and other donors, has begun work to strengthen GOI food policy. This work is being done in conjunction with the Bank's planning efforts for a large agriculture structural adjustment loan that seeks varied reforms in GOI food policy. The Bank, with USAID, and AusAID support, has started a nation-wide early warning system (the Social Monitoring and Early Response Unit) to collect, monitor and analyze previously unavailable information on food prices, availability and affordability, in addition to nutritional indicators, on a monthly basis. With this information and in coordination with USAID and other donors, UNDP is helping the GOI identify additional areas of greatest need in the country, and match these with future GOI and donor programs for all crisis-related activities, including food.

Health, Population and Nutrition: USAID and its partners are working to ensure that key primary health care services continue to be available throughout the crisis. This is accomplished through: attention to the nutritional status of key populations; ensuring that public health service outlets continue to function; maintenance of service quality; keeping private service providers operational, ensuring availability of products and services; and maintaining high demand for family planning and other primary health care interventions.

With USAID support, the GOI and NGOs play an active role in collection, analysis and dissemination of data required for crisis monitoring and surveillance. Policy-makers and program managers use these comprehensive crisis monitoring and surveillance data to mount appropriate responses. Over the long term, ad hoc assessments will take on less importance, and be supplanted by reliance on more functional, less frequent, and more streamlined monitoring mechanisms.

USAID interventions will contribute to reversing trends of lower demand for family planning and basic health services and eventually restore positive trends in utilization. Health workers, policy makers and the media are being mobilized to reinforce health messages. Knowledge among poor families about appropriate nutrition and cost-effective options will increase. As the crisis subsides, families will also have comprehensive information about service availability in the private sector.

Other Donors

- ADB** Through two loans (\$300 million) to finance a Social Protection Sector Development Program (SPSDP), the ADB aims to alleviate projected deficiencies in government provision of health, education and nutrition services, particularly among the poor. The loan package will provide: basic health education materials to six provinces; medical supplies in eight provinces, including a \$14 million loan for contraceptives; block grants to health centers to cover operational costs and to cover high-risk mothers requiring hospital services; and block grants to village midwives to cover operational costs for pre and post natal care for poor women, including iron tablet distribution for pregnant women and vitamin A capsules for children 6-60 months.
- Australia** As part of a \$17.3 million humanitarian assistance programme coordinated by Australia's Ministry of Foreign Affairs, \$2.6 million in essential drugs, medical supplies and equipment is provided to NTT, NTB, Maluku, South and Southeast Sulawesi. We understand that Australia intends to announce a \$200 million economic governance package at APEC in mid-November.
- Canada** The CIDA will donate \$3 million worth of oral pills to the GOI.
- EU** The EU procured \$17 million worth of contraceptives (injectables, oral pills and implants) for Indonesia.
- Finland** The Finnish Government has approved a loan for \$29 million for Norplant implants.
- Japan** JICA assists the GOI in maintaining essential blood bank and transfusion services in Sulawesi. JICA contributes to the SPSDP program in Sulawesi and NTT (See ADB). Early this year, JICA provided a donation of about \$16 million to the MOH for medicines and disposable medical supplies.
- UNFPA** UNFPA donated \$3 million worth of contraceptives (injectables and implants) for nationwide distribution to prevent shortages of contraceptive supplies which would interrupt and severely hinder the national family planning. UNFPA provides assistance to strengthen blood supply management and improve the availability of and access to emergency obstetric care in 77 district hospitals.
- UNICEF** UNICEF initiated a child feeding program. Cereal, fortified with micro-nutrients, will be distributed at low cost to poor children through integrated health posts at the village level. The program will begin in seven provinces and will expand to other provinces depending on the level of assistance from other donors. UNICEF will also continue the

Universal salt iodization program and food fortification for wheat. UNICEF will assist the GOI in coordinating a household food security and nutrition surveillance program in 9 districts. UNICEF will continue to play an important role in coordinating donor crisis response efforts for the GOI.

WHO WHO assists the GOI to coordinate crisis response efforts, particularly those related to safe motherhood.

World Bank: The World Bank provides loan support to the SPSDP (see ADB above) in 19 provinces.

Unemployment

Employment Generation Activities: According to a mid-October 1998 Citibank report, 2.7 million people are being added to Indonesia's 95 million labor force this year. The increase is dramatic: in early 1997 4.9 percent of the workforce was unemployed; by the end of 1998, it will be about 20 percent. Because most factory, bank, and service-industry workers who lost their jobs have stayed in the cities, the most volatile areas of unemployment are in urban and suburban areas. Through both donor (Asian Development Bank, World Bank and OECF) loan funds and state revenue, the Government of Indonesia has targeted more than Rp 6 billion through 20 different programs to urban employment generation in the next 18 months. More than half of the funds remain unspent mainly due to difficulties in identifying good employment generation projects and in matching good projects with funds. We are working with municipal governments and local community groups to identify appropriate projects.

The USAID response has been to:

- o shift existing project resources for decentralized financing of urban infrastructure projects to work with local governments and community groups to identify employment generation projects and secure Government of Indonesia funding;
- o assist NGO's to work with local governments to stimulate community participation in planning and implementing small urban infrastructure projects to be funded by Government of Indonesia programs;
- o provide technical assistance to marry donor and Government of Indonesia funds with good projects;
- o use technical assistance to expand the institutional capacity of local governments and NGO's to design and implement job creating public works projects;
- o work with BAPPENAS to implement, manage and monitor donor and government-financed employment generation programs.

Preserving Urban Water Supplies: The Government of Indonesia realizes that the provision of piped water is as important to the urban poor as the provision of rice, cooking oil, soybeans, and sugar. Skyrocketing costs of inputs such as electricity and chemicals, combined with fixed tariffs have produced a cash crunch making almost

one-third of Indonesia's 300 municipal water enterprises insolvent. As a last-ditch measure, some are putting untreated water through the water mains. The closing of water enterprises can result in poor sanitation, acceleration of poverty, and rise of epidemic diseases. The Government of Indonesia has established a Water Enterprise Rescue Team to target subsidy CGI-committed funds tied to management reforms in ailing water enterprises. But the enterprises are spread all over the country, and financial data available in Jakarta is unreliable.

The USAID response is to:

- o provide teams of water efficiency experts to visit ailing water enterprises and recommend solutions to keep the water flowing through increased efficiency and accessing foreign assistance Water Enterprise Rescue funds;
- o through the water efficiency teams, help the Government of Indonesia to recommend policy steps and preconditions for releasing tranches of assistance for water enterprise development in a program loan being prepared by the World Bank for approval in 1999.

Other Donors

- World Bank** There are three major new initiatives including the Kecamatan Development Program (KDP), \$225 million, Urban Poverty Alleviation Program(UPAP), \$100 million and resources from the Integrated Urban Infrastructure Development Program (UIDP) \$60 million. KDP is a national program which targets communities at the Kecamatan level for small enterprise, public works and other community activities. UPAP targets communities at even lower levels of government (RW level). UIDP provided reprogrammed loan funds for investment in employment generating infrastructure projects. The Village Infrastructure Program is a \$140 million employment generation program over five years targeted for rural areas.
- ADB** There is one major program called the Community and Local Government Support Program, a sector development program amounting to a program loan of \$200 million to finance grants to local governments for public works projects. There was a re-allocation from four urban sector projects amounting to \$40 million in resources to jump-start employment generation activities.
- OECF** The Japanese government is providing an additional \$80 million for public works beyond the \$40 million that had been allocated. The emphasis is on financing labor intensive projects with a 70 percent labor content. The first phase focused on directing resources through the Ministry of Public Works while the second phase will be directed to local governments where investment, planning and implementation decisions will be made.

II. ECONOMIC CONSEQUENCES, NEEDS AND RESPONSE

A. Economic Consequences of the Crisis

Macroeconomic impact External and Internal factors: When the Asian currency crisis first appeared in Thailand in July 1997 and began spreading to other Asian countries, few people imagined that the regional crisis would be the beginning of Indonesia's economic collapse. Analysts cited Indonesia's sound macroeconomic indicators: high annual growth, large foreign exchange reserves, strict fiscal stance, and inflation rates long held to manageable levels (figure 1.1-1.6). Over the previous three decades the country had achieved rapid growth, political stability, self-sufficiency in rice, and a large reduction in poverty. A slow-down had been predicted by some observers, but not the total collapse of a seemingly sound economic system.

Before the crisis began, the central bank had been keeping the rupiah within an eight percent trading band. In July 1998, in response to increasing downward pressure on the currency, the band was widened to 12 percent. On August 14, the currency was floated, completely free of the trading bands. With the flotation, the internal and external factors that had been pressuring the rupiah set off a prolonged devaluation over the remainder of the year. By December 1997, the rupiah had plunged by 110 percent, an extreme drop, but roughly equivalent to the decline of other Southeast Asian currencies. Then in mid-December and early January 1998, political and economic uncertainty sent the rupiah plummeting, leaving other regional currencies far behind (*figure 1.7*).

Many factors have contributed to Indonesia's currency crisis, including external factors. Disinvestment by foreign financial institutions, caused by regional financial problems, put considerable pressure on the rupiah. The growing strength of the U.S. dollar against most other global currencies added to this pressure. The contagion effect from the fall of other regional currencies also exacerbated the currency's decline. Internal factors contributing to the rupiah's weakness included perceptions of growing political risk in Indonesia, rampant corruption, substantial bad loans by Indonesian banks and financial institutions.

Investor panic: The rupiah's initial decline was accelerated when panicked foreign investors, many of whom had insufficiently studied the risks of investing in Indonesia, began rapidly withdrawing capital. The currency's decline was further propelled as Indonesian companies, many with massive unhedged foreign short-term borrowing, rushed to buy dollars to service dollar-denominated loans.

A subsequent series of political and economic missteps by the Indonesian government, some made under the guidance of international finance institutions, further eroded confidence in the rupiah. The closing of 16 ailing banks as part of the initial IMF agreement in November 1997 sparked a massive loss of public confidence in the banking system. Many Indonesians realized that the number of troubled banks was far higher. Concerns over the banking system were exacerbated by memories of the

nationalization of bank funds under President Sukarno in the 1960s. Such concerns, combined with the already tenuous condition of most Indonesian banks, induced many individuals and businesses to convert savings to dollars held in foreign banks or to hold cash.

Perceptions of President Suharto's failing health and the looming question of Presidential succession added to the atmosphere of high political risk. The May 1998 riots in Jakarta, Solo, and other cities sent the currency to an all-time low on May 19 of Rp 17,000 against the dollar, a massive overshoot in real terms. In addition, El Nino brought unusually dry weather that caused crop failures, creating a need to import food supplies, especially rice, and increasing the possibility of social unrest due to food shortages. (Specific details of the food shortages are covered in Section II—Humanitarian Consequences of the Crisis.)

As of the end of October 1998, the rupiah has strengthened somewhat to Rp. 8,000 – Rp. 9,000 to the dollar. Volatility remained a concern, however, as the daily volume on the rupiah foreign exchange market was so thin that even a million-dollar transaction could move the rate considerably. In addition, uncertainty regarding the short-term feasibility of the government's reform agenda added to the risk of future currency fluctuations. Analysts have suggested that the lack of supporting institutions make implementation of the economic reform agenda difficult. In addition, there are still many factions in the government resistant to economic liberalization.

Inflation: The rate of inflation soared to 75.5 percent between January and September 1998. Rates have been driven upward by the currency depreciation, as well as by an increase in the real money stock. From November 1997 until February 1998, the central bank, acting as a lender of last resort, had been providing money for a range of crisis-related activities, including liquidity assistance for ailing banks. This excess liquidity fueled inflation as it was not being soaked up by the main government money market instrument, Bank Indonesia Certificates (SBI), despite rates of up to 70 percent.

The consumer price index (CPI) peaked in June and July of 1998 after riots and looting the previous month paralyzed the distribution system. (Chinese-Indonesian merchants, who are central to Indonesia's distribution industry and who were one of the chief victims of the riots, have in many cases chosen not to reopen businesses, fearing further attacks) (*figure 1.8*). The biggest contributors to price increases have been clothing, food and processed food, drinks, cigarettes and tobacco. It is widely acknowledged that the CPI is not catching the full scale of price rises, especially for middle income household expenditures. Surveys conducted by various newspapers suggest that for part of the year prices rose much faster than was stated in the official figures.

There is still significant government intervention holding down the price of key commodities in order to provide assistance to the poor. A tax on the export of crude palm oil, for example, has kept the local price artificially low. Other foodstuffs still

receive targeted government subsidies that keep their prices below market rates. The timing for halting such intervention and allowing these prices to return to market rates is a key strategic decision facing the government.

Staple Prices (Rp per kg)			
	<i>July 97</i>	<i>April 98</i>	<i>percent change</i>
Maize	650	1,000	53.8
Rice	1,450	2,000	37.9
Sugar	1,550	1,800	16.1
Cooking Oil	1,700	3,600	111.8
Chicken	3,500	6,500	85.7
Eggs	3,000	5,200	73.3
Milk	19,409	31,150	60.5

The distribution system damaged during the May riots is largely back in working order. Many economists estimate that inflation will soon stabilize at around 20 percent per year.

The energy sector has experienced particularly high price increases, owing to its heavy dependence on dollar based inputs. The IMF-mandated repeal of subsidies on fuel and electricity prices in May 1998 is widely thought to have contributed to the unrest and riots in that month. The government subsequently reinstated those subsidies, although they are being gradually reduced. Despite subsidies, electrical power tariffs have nearly doubled from the pre-crisis rates. (Even after doubling, the current tariffs are still substantially below market rates).

Inflation has declined substantially since September 1998, and the government projects monthly rates of under three percent for the rest of the year. The decline is attributed to the fact that earlier currency spikes, most extreme in January 1998 and May 1998, have made their way through the economy. In addition, the exchange rate has been relatively stable for the past month. The government's tightening of the real money stock since February 1998 has also contributed to bringing inflation under control. The required adjustment through inflation is by no means complete. Although initial shocks have passed through the economy, more than 50 percent in additional inflation shock remains to pass through the economy in the next 18 months to two years, even if the real exchange rate stabilizes.

Interest rates: High interest rates are another factor reining in inflation. In an effort to support the rupiah and reduce inflation, the central bank has increased the rate of SBIs several times since early this year, reaching a high of 70 percent and currently averaging 55 percent (*figure 1.9*). High interest rates are also considered necessary to induce businesses and individuals to hold savings in Indonesian banks and to compensate for Indonesia's country risk premium. The government sees high interest rates as necessary until the exchange rate stabilizes, at which time rates can be

gradually reduced. In real terms, interest rates have remained negative, as they lag the current 80 percent year-on-year inflation rate. Nonetheless, recent expectations of lower inflation seem to have made the current interest rates more attractive, and many individuals and businesses have begun to move funds into rupiah savings accounts. Many economists have stated that the current tight monetary policy has contributed significantly to the rupiah's recent stability. Stern criticism, however, has been sounded from private businesses, which claim that the high rates inhibit the access to finance needed to restart economic activities. Balancing the macroeconomic benefits of tight monetary policy with the business-side advantages of lower interest rates will be one of the greatest challenges facing decision-makers in the months ahead. For many years before, and throughout the crisis, small finance institutions (SFIs) have played a valuable role in delivering credit to small businesses. SFIs are small, often village-based, lending institutions that make loans to small business and entrepreneurs at competitive rates. SFIs are capitalized both by individual deposits and by a regulation that requires commercial banks to make 25 percent of their loans to banks engaged in micro-finance. Active for over three decades, small finance institutions have been a leading source of credit to small-scale business in Indonesia. Evidence indicates that many SFIs have continued to perform reasonably well amidst the current financial turmoil. Bank Rakyat Indonesia (BRI) reports that in its microfinance units there has been during the crisis have a 97 percent payback rate (down from 99 percent before the crisis) and a mild increase in nominal saving deposits. This minor increase is a substantial decline in savings in inflation-adjusted terms. SFIs serving urban areas and making larger loans seem to be having more difficulty than rural and village SFIs.

GDP growth: With the exception of the early 1980s when the price of oil dropped suddenly, Indonesia has maintained a consistently high economic growth rate over the past three decades. This growth, averaging 6-7 percent a year, transformed Indonesia from a lower-income country in the 1960s to a middle-income country with estimated income per head of almost \$1,055 in 1996.

Gross Domestic Product 1996	
(percent real change)	
Agriculture	1.9
Mining and quarrying	7.1
Manufacturing	11.0
Utilities	12.8
Construction	12.4
Trade, hotels & restaurants	7.6
Transport	6.4
Communications	19.0
Financial, rental & bus. services	10.5
Public administration	4.1
Other services	7.6
GDP	7.8

Manufacturing has led GDP growth since the mid-1980s, expanding from a low base of eight percent of GDP in 1965 to 25 percent of GDP in 1996 (see figure 1.10 & 1.11). Manufacturing taxes have increasingly contributed to government coffers, reducing the past reliance on depleting oil resources and the mining sector. This initial acceleration in the manufacturing sector created a need for better infrastructure development that, in turn, stimulated further growth in construction, utilities and supporting services. In order to perpetuate this virtuous circle, the government made increasing non-oil exports a key priority.

The government predicts that GDP will shrink by 15 percent in 1998. GDP per capita is expected to decline to below \$500 by the end of this year. The swing is largely due to a drop in domestic demand, corporate bankruptcy and debt problems and weak regional and worldwide demand. (see figure 1.12)

Gross Domestic Product 1998 (Jan-Jun)	
(percent real change)	
Agriculture	0.3
Mining and quarrying	-7.6
Manufacturing	-13.0
Utilities	0.3
Construction	-36.8
Trade, hotels & restaurants	-17.5
Transport & Communications	-6.4
Financial, rental & bus. services	-16.9
Other services	5.1
GDP	-13.2

USAID-sponsored analysis of national levels of electrical power usage suggests evidence that the actual contraction of GDP may be modestly lower than the government projection. The analysis found that as of August 1998 industrial electricity usage was only 5.5 percent lower than the previous year's level. Because industrial production is closely tied to electrical consumption, these findings suggest that industrial activity may have declined substantially less than anticipated. Even after adjusting the data for factors such as private power generation, the study still found evidence that industrial activity in the first three quarters of 1998 had declined only 6-9 percent from the 1997 level.

The change in GDP has been far from uniform across various sectors. The biggest losers this year have been manufacturing, construction, hotel & restaurant, and financial services. The agricultural sector, meanwhile, remained relatively resilient and did not contract even in the wake of El Nino. (Despite El Nino's devastating effect on rice production, many other agricultural areas grew significantly, offsetting the poor

rice harvest. Plantations' output for example, rose by 6.5 percent, while forestry grew by 2.5 percent growth and fisheries by 6.7 percent.) Some export-oriented industries, including a few areas of manufacturing, have also fared well, buoyed by the weaker rupiah.

In general, the industries hardest hit by the crisis are the ones that developed more recently (and were less established), that were most dependent on foreign inputs, or that were dependant on domestic demand without options for export. The biggest winners of the crisis are industries that generate dollar revenues and require minimal imported inputs.

Because of this varied sectoral impact, the economic effects of the crisis have been quite diverse in different regions of Indonesia. Heavily industrialized areas in Java, particularly West Java and Jakarta, seem to be the hardest hit, while some agrarian regions in the outer islands have been less affected. Areas such as North Sumatra and North Sulawesi, which export agricultural commodities, have experienced mini-economic booms.

USAID-sponsored analysis of national electrical power data indicates that a substantial disparity indeed exists between the current economic activity in various regions. This analysis examined regional levels of industrial, commercial, and domestic power usage. The results indicated that industrial and commercial electrical usage in 1997 and 1998 dropped most significantly in Jakarta, followed closely by West Java. East Java experienced a more moderate decline. In the rest of the nation, power usage for commercial and industrial activities actually increased (*Figure 1.13 & 1.14*). While electrical power is only one factor contributing to regional GDP, these figures suggest that the crisis has had widely varying consequences for economic activity in different parts of the archipelago.

Current account: The government projects a current account balance surplus this fiscal year of US\$ 1.4 billion, up from last year's deficit of US\$ 1.7 billion. The surplus is due mainly to a higher balance of merchandise trade surplus driven by the steep decline in imports. Some private economists estimate that the surplus may now be substantially higher than the government projection.

Capital account: The capital account has been in deficit since the last half of fiscal year 1997/98 when net inflows of official capital were not sufficient to compensate for a hemorrhage of private capital fleeing the country. The capital account went deeper into deficit after the riots in May 1998 accelerated capital flight and temporarily stopped the inflow of IMF aid.

Real incomes: The rupiah's depreciation and the subsequent high levels of inflation have caused a collapse of real incomes and purchasing power within Indonesia. As noted, income per head is thought to have declined to below \$500, from a 1996 level of \$1,055. The decline in real incomes, combined with rising unemployment and uncertainty over the country's future economic course, have resulted in a substantial

reduction in domestic demand. The continuing tight money policy has also affected interest-sensitive sectors such as the property and automotive sectors, which have been largely paralyzed by the interest rate hikes.

Regional variations in GDP growth (see above) are reflected in the fact that the crisis has not affected real incomes uniformly across the country. As noted, agrarian areas of Indonesia, traditionally the poorest regions, have generally suffered the least economic slow-down, and hence the smallest contraction in real income. It is important to note, however, that several poor areas, notably sections of East Nusa Tenggara, East Timor, and Irian Jaya, bore the brunt of last year's drought and have experienced some of the greatest drops in real income.

FINANCIAL SECTOR IMPACT

Private banking: Following the deregulation of the banking sector in October 1988, the number of private banks operating in Indonesia expanded rapidly. With limited banking expertise and weak regulation from the central bank (BI), many private banks were already in serious financial trouble by 1997. Even before the crisis, many of the 200-plus commercial banks were either undercapitalized or insolvent. The financial turmoil in Japan's banking sector exacerbated this situation as the Japanese banks began calling in their loans in Indonesia.

Following the closure of 16 insolvent banks by Bank Indonesia in early November 1997, many depositors began to lose confidence in the private banking sector. The ensuing withdrawal of deposits compelled the government to provide liquidity support to keep many banks afloat. (This support was finally curtailed in February 1998 amid concerns over the risk of high inflation.) Additional deposit withdrawals occurred following the May riots and the government's suspension of an additional 54 private banks considered to be near insolvency (*figure 1.15 & 1.16*).

Under the Suharto regime, the central bank held little actual authority to enforce banking regulations, especially in cases involving politically well-connected banks. Consequently, the banking sector was rife with delinquency and banking regulations were openly flouted. Political pressure was regularly applied to state banks to make loans to politically-connected businesses. BI itself was often pressured not to investigate or intervene in collusive lending practices.

Financial sector reform is essential to sustainably restore the flow of credit which is now largely stopped to the productive sector of the economy. Observers have identified four basic flaws that helped send Indonesia's banking system into crisis:

- the credit supply had expanded very rapidly with a concentration on short-term private debt;
- BI's practice of classifying loans by repayment performance rather than collectability masked the actual condition of loan portfolios;
- accounting and provisioning rules did not keep pace with the changing banking system;
- inadequate enforcement of BI regulations meant that rules covering intra-group

lending, loan concentration, creditworthiness criteria, transparency, were regularly violated.

IBRA: The Indonesian Bank Restructuring Agency (IBRA) was set up in January 1998 to supervise and manage the restructuring of the banking sector. Banks with liquidity support from the central bank beyond certain levels are required to surrender their management to IBRA in successive stages. IBRA is empowered to restructure the banks placed under its control in order to remove bad assets. Non-performing assets are removed from these banks and placed in the Agency's Asset Management Unit. In addition to eliminating bad assets, IBRA is tasked with recapitalizing banks and eliminating old management as well as old equity partners. Non-salvageable banks are to be dissolved, and their assets sold at market rates, or merged with other banks under IBRA.

Since the inception of IBRA, all Indonesian banks are undergoing due diligence audits and 54 insolvent banks have been put under the Agency's supervision. Several concerns regarding IBRA have already been voiced, including the risk that corruption and political pressure may compromise the Agency's impartiality in restructuring or disposing the substantial assets set to come under its control.

Another worry is that, with virtually all private Indonesian banks in financial trouble, the entire private banking sector may come under IBRA's control, leaving no banks operating on a private, independent basis. It is important to recognize the difficulty and magnitude of the task undertaken by IBRA. While the Agency has drawn criticism for its generally slow start, most critics recognize that, given the challenges organization faces, it may require some time to begin operating efficiently.

The Jakarta Stock Exchange: Prices on the Indonesian capital markets have fallen sharply during the crisis. From a historic high of more than 700 in early 1997, the Jakarta Stock Exchange (JSE) Index has plummeted to around 300 in recent month (*figure 1.17*). The markets have been affected by a massive loss of confidence in Indonesia as well as by the depreciation of the rupiah, which has increased the losses in dollar terms. The market capitalization of the JSE has fallen from about US\$ 100 billion in June last year to about US\$ 11 billion in the early October. The Jakarta market was heavily dependent on foreign investors. Many of these investors had only a limited understanding of Indonesia, which may explain the 'herd-like' exodus from the market. Bearish regional markets also put pressure on Indonesian bourses. Herd-like withdrawal of capital from the JSE is not unique to Indonesia but has occurred in many emerging bourses around the world. Much of the continuing debate about reforming global financial systems centers managing on this problem of swift and unpredictable capital flight. By mid-1998, almost 80 percent of the listed companies, especially those in property and banking, were technically bankrupt. Under current supervisory rules, an estimated 88 percent of active stocks may be de-listed next year, dealing a harsh blow to some of Indonesia's most important companies.

There has been some mild interest in the market lately, as the price of underlying assets has become extremely low in dollar terms. Most local investors prefer to keep their money in the banks, however, which currently pay up to 55 percent for time

deposits. The government plans a gradual reduction of time deposit rates, which may eventually generate renewed local interest in the stock markets.

Corporate sector: Before the crisis, Indonesian companies found overseas borrowing an attractive source of finance. The vast differences or spreads between domestic and international interest rates made it more desirable to borrow overseas, where large projects funds were more readily available. Meanwhile, the predictable policy of the government to devalue the rupiah at around five percent per year made hedging the currency risk appear to be an unnecessary expense (*figure 1.18*). Overseas lenders were eager to loan to Indonesia, often without proper risk assessment, as the country was perceived as a very lucrative market. Recognizing the dangerous exposure created by excessive offshore debt, the government sought in 1995 to restrict large-scale overseas borrowing, but well-connected businesses were able to skirt this restriction.

When the rupiah began to plummet, the potential losses from unhedged overseas borrowing became glaringly obvious. Downward pressure on the rupiah was heightened as Indonesian companies rushed to buy dollars to service their interest and principal due and also to purchase needed foreign inputs. By the beginning of 1998, most corporations were unable to continue servicing overseas debts, and creditors became unwilling to continue extending loans to Indonesian companies. Growing perceptions of political and economic risk in Indonesia made capital scarcer still. The crisis has left the corporate sector with a considerable debt overhang. According to official figures, private corporate debt stood at \$65.5 billion in July this year, about \$20 billion of which comes due this year. Total amortization payments falling due for calendar year 1998 are estimated at US\$32bn (before any restructuring) (*figure 1.19*). Although not an immediate concern, an underlying problem facing the private sector is the lack of access to long-term capital. Some pension and life insurance funds were started recently and acquired significant assets over the past five years, but such funds are expected to be stagnant in the current crisis environment. Few other financial instruments exist in Indonesia for financing long-term debt. This raises the danger of companies continuing to borrow short-term funds for long-term projects, a practice partly responsible for the current debt overhang.

New bankruptcy law: One of the first new laws to be implemented, in line with IMF directives, is a new Bankruptcy Law which was enacted on August 20th. The law modifies the previous bankruptcy code based on the 1905 Dutch insolvency ordinance, which had been deemed too outdated and inefficient in resolving contemporary commercial cases. Until now there has not been any effective mechanism to help creditors recover their outstanding debts. Under the new law, companies entitled to call upon a 270-day suspension of payment period during which time they could work with receivers to develop a plan or composition, including an offer to pay creditors in full or in part. The rush of new bankruptcy cases is being handled through a new commercial court system set up for this purpose. The Ministry of Justice has provided training for lawyers, receivers, and judges to make the new system run. The new law is intended to bolster investor confidence in Indonesia, although early signs are not good. The court's first verdict in October 1998 was met with a hail of criticism from bankruptcy lawyers who faulted the judge for being inconsistent in implementing the

proceedings. Modernland, a property developer with assets of about Rp. 1 trillion, was declared bankrupt for the relatively small claim of Rp. 94.13 million (about US\$ 11,750). One other early decision has also attracted criticism as the judge set the fee for the court-appointed administrator of the assets at five percent of the defendant's total assets or Rp. 65 billion (about US\$ 8.1m). This administrator's fee was four times higher than the disputed amount and an additional burden to a company already in trouble. The bankruptcy law has also drawn stern criticism for its lack of a US-style "Chapter 11" provision that would encourage work-outs to take place prior to legal action.

Jakarta Initiative: The Jakarta Initiative was launched by the government in September 1998 to serve as an umbrella organization under which to structure the overall effort to respond to corporate sector problems. The Initiative also serves to help debtors and creditors to come to agreement over restructuring financing through out of court settlement. The restructuring process is expected to involve debt forgiveness, extended maturity periods, debt-for-equity conversion and swap of assets. Under the framework, debtors will be required to reorganize their companies under an appointed advisor and to provide accurate and timely financial information. In return creditors will extend working capital and agree to "standstill" and not charge default interest and other penalties while restructuring negotiations are occurring. The plan assumes that, upon reaching an agreement, debtor companies will apply to INDRA (see below) in order to buy dollars at subsidized rate in order to begin debt repayments.

There does seem to be some initial interest from the corporate sector although creditors will have to be willing to write off some of the loans and debtors will have to show more intent to pay the loans. Previously, the government had set up the Indonesian Debt Restructuring Agency (INDRA), under central bank supervision, to bear the exchange rate risk by selling foreign exchange to debtor companies at a favorable rate. The Frankfurt Agreement, signed on June 4, 1998 by the government and 13 foreign banks with extensive outstanding loans in Indonesia, establishes a framework for Indonesian companies and their creditors to reschedule loans by up to eight years (*Box 1 on Frankfurt Agreement*).

As became clear once the initial euphoria over the agreement subsided, these terms are of little help to the many indebted companies now on the verge of bankruptcy. The agreement requires companies to continue making interest payments and makes no provision for debt discounts or write-offs. These problems are exacerbated by the weak rupiah.

Undoubtedly, many companies are facing bankruptcy. Factors such as weak domestic and export demand, difficulty in obtaining credit, and many other factors mentioned previously have been contributing factors. On top of this, some production activities are disrupted by sporadic riots and labor strikes demanding wage increase to make up for high inflation. It has been suggested that some companies would not be inclined to pay debts even if they were financial capable to do so. The seeming ineffectiveness of the bankruptcy law has induced many firms to continue operating without making provisions for debt repayment.

Exports: Early expectations of an export-led recovery have not yet been realized. Overall exports are expected by the government to increase by just 0.7 percent in dollar value in 1998/1999 based on a 18.6 percent dollar-value fall in oil and gas exports and a 5 percent rise in the value of non-oil exports. Export demand from Japan, South Korea, Singapore, and other Asian countries which typically account for approximately 50 percent of total exports, have declined drastically due to the regional economic crisis (*figure 1.20*). Flagging worldwide demand projected for 1999, combined with the risk of more protectionist policies in Europe (Indonesia's third largest trading partner), may further inhibit export growth next year. As a percentage of GDP, net exports (defined as exports minus imports in GDP terms) have risen some 500 percent. While the real rate of growth next year remains in doubt, it seems clear that export industries will continue to be a vital contributor to GDP growth. In addition, the limited rise in exports is largely due to the substantial drop in oil and gas exports, which resulted mainly from external factors, particularly oversupply on the world market. The fact that non-oil exports managed to rise even amidst last year's turmoil suggests that this area may become a stronger contributor to the country's economic recover.

Exports with limited imported inputs in industries such as agriculture and natural resources have brought a windfall to several areas of the country. However, many of Indonesia's export industries, notably manufacturing, are heavily import-dependent. With the rupiah's depreciation, the cost of importing raw materials has risen sharply. Obtaining trade financing to purchase these inputs is problematic as overseas banks have refused to recognize letters of credit (LCs) from Indonesian banks. Indeed, US banks are barred by law from having financial dealings with foreign banks whose international credit rating falls below certain levels. At present, no Indonesian banks meet the minimum credit rating for dealing with US lending institutions. Under the Frankfurt debt-restructuring agreement, foreign banks were asked to maintain trade finance lines at current levels (estimated around US\$ 2-3bn) provided Indonesian banks repaid the US\$1.2bn in overdue credit lines which has been done. The scheme is backed by the central bank.

Natural resources: Indonesia is endowed with substantial natural resources, including oil and gas, a wide range of minerals, marine resources, and tropical forests. Its forests and biological diversity also hold an important place in global ecosystem. Indonesia has the most extensive forest reserves in Asia, representing ten percent of the world's tropical rainforests and harboring biodiversity among the richest in the world. The country's waters harbor over 8,500 species of fish, or 25 percent of the world total. In addition, there are 1,600 bird species in Indonesia. Many species of plants and animals are endemic to the archipelago, appearing nowhere else on earth. Natural resource sectors have traditionally contributed significantly to the Government's revenue. The three natural resources related industries (agriculture, forestry, and fisheries) account for approximately 20 percent of non oil GDP and for over 36 percent of non-oil export earnings. The current economic crisis following the collapse of rupiah has highlighted the importance of the natural resource sector as a major dollar earner. Fears have been voiced that increased reliance on natural resources as major revenue generation may further reduce forest cover due to an expansion of agricultural lands, expansion in mining areas, and increased timber

cutting. Strong export demand gives incentives for government to expand the agricultural sector, potentially threatening forest cover further.

Mining, like agricultural exports, is very attractive during the crisis because most of its revenue is in dollars while the operating costs are largely in rupiah. The Ministry of Mines and Energy has stated that its top priority at present is to improve the investment climate in order to boost the government's earnings from this sector. Meanwhile, international demand for Indonesian plywood is expanding due to reduction on Chinese log supply. Recently, Chinese government implemented a new policy requiring that logging in China be reduced by 60 percent. To fulfill the international demand for plywood, many Indonesian logging and processing companies have started to hire back workers.

Further pressure on Indonesia's natural resources has come from the return of many recently unemployed workers to agricultural activities. Research indicates that the number of small-holder plots in several areas has grown substantially in the last year. Many fear that this largely uncoordinated expansion of farming activities will pose significant dangers to the ecosystem.

Last year and early this year, Indonesia was plagued by devastating forest fires with as much as 264,000 ha of forest lands burned to ashes in 1997 alone. In 1998, up to September, another estimated 515,000 ha were burn down. Many of these forests are actually production forest and reserves forests. Financial losses from the fires have been estimated at US\$4.4 billion alone, excluding the indirect health, transportation, and reforestation costs (*Tempo*, 11/2/98) (*Figure 1.21*).

Environmental NGOs: On the positive side, the growing political openness has allowed more freedom to NGOs, many of which are active in environmental issues. Increased assertiveness of environmental NGOs in demanding greater accountability and transparency from civil servants and private business has accelerated and deepened the process of redressing long-standing governance and corruption issues which have constrained responsible management of Indonesia's natural resources. Environmental policy changes under the IMF agreement include :

- Increasing timber stumpage fees;
- Creating new resource rent taxes on timber resources;
- Reducing land conversion target to environmentally sustainable levels and implementing a system of performance bonds for forest concessions;
- Incorporating the reforestation fund into national budget so that it is used solely for reforestation purposes.

The Habibie government has promised to limit the size of timber concession management units to 39,000 ha. At present, there are nine ownership holding companies that have total concession in the range of 1.3 to 3.5 million hectares. Timber concessions that have been obtained through collusive practices will be cancelled and no new forest concessions will be awarded in order to prevent further deterioration. The government will seek to return reforestation funds previously loaned

to politically connected interests. In addition, proposals have been made to extend the duration of forest concessions above the current 30-year lifespan. Extended ownership of concession lands is expected to encourage concessionaires to pursue long-term reforestation programs.

Public sector impact: One of the key conditions of the IMF agreement is to promote pro-competition policies. The IMF program specifically targeted several high profile monopolies and cartels granted to relatives and friends of President Suharto. It is not clear to what extent these moves have resulted in the creation of free markets. There is evidence that the cancellation of the clove monopoly has led to a boom in cloves sales in certain areas. Sales of sugar, previously monopolized, also seems to have expanded. However, a close colleague of Suharto, still appears to retain considerable influence over the plywood industry. Other monopolistic practices have been able to avoid public scrutiny because their owners operate as cartels rather than as formal monopolies and can therefore claim to be operating in a deregulated environment. The cement industry is a case in point, being overwhelmingly dominated by three well-connected companies. Politically, the most serious problems facing the country relate to the production and distribution of food. From the point of view of consumers, the reforms thus far announced have had little practical impact on the market. Potential competitors in the wheat milling industry are reluctant to invest in new plant and equipment in the current monopolistic environment.

Anti-monopoly: In October 1998, the House of Representatives began deliberation of an anti-monopoly practices bill which would outlaw monopolies, cartels, vertical integration and other kinds of market distorting practices. The bill advocates the establishment of a Commission for Business Competition that would investigate and advise on the monitoring of the laws' implementation. Passing the legislation is just the first step however, as the implementation of the law will require a strong base of human resources, including trained judges, lawyers and legal, and economic experts. A danger has emerged that the anti-monopoly movement could be directed specifically against Chinese-Indonesian businessmen, who control many of the largest monopolies. The Minister of Cooperatives has proposed that control of some Chinese-controlled monopolies be transferred to the cooperatives system, which is dominated by indigenous Indonesian businessmen or *pribumi*. Some observers fear that such sentiments may result not in the dismantling of monopolistic practices, but rather in the re-distribution of the old monopolies to a new group of business interests.

A group of NGOs have submitted an alternative version of the anti-monopoly law to the House of Representatives. The group has requested that some of its suggestions be incorporated into the official bill. The suggestions include the establishment of an independent commission to oversee enforcement of the anti-monopoly law and strict sanctions against monopolistic practices.

The budget: The government budget for 1998/99 has been set at Rp. 263.9 trillion, roughly double the 1997/98 budget of Rp. 131.5 trillion and over three times the 1996 level of Rp. 95 trillion. This year's spending increase will be covered by a substantial rise in international donor aid, which is projected to total Rp. 127.8 trillion (US\$12 billion at a projected exchange rate of Rp10,600:\$1). The level of international aid is

more than triple last year's figure of Rp. 32.3 trillion (\$5.4 billion at an average exchange rate of Rp.6,000:\$1). (In the face of year-on-year inflation approaching 80%, the real budget increase is closer to a doubling of last year's level.)

Despite the higher budget, the government has encountered significant difficulties in delivering services amidst the crisis environment. The ongoing policy reform process, preparations for the upcoming elections, and sporadic social unrest have slowed official efforts to put in place crisis-related programs. The government initially projected a budget deficit in 1998/99 of 8.5% of GDP. The deficit was to be totally covered by the increased international aid. Because spending programs have been slow the start, however, the budget has remained in surplus.

To mitigate the worst consequences of the crisis on the poor, government plans to continue targeted subsidies on essential commodities. Most subsidies will, however be gradually reduced over the coming year in accordance with the IMF agreement. The government has scrapped all budgetary and non-budgetary support for controversial projects such as state aircraft maker, IPTN, as well as bringing some off-budget funds into the budget, which in the past had been a vehicle for spending on questionable practices. The funds of many government bodies, however, remain off-budget.

Economic laws: In return for international financial support, the Indonesia government has committed itself to the wholesale restructuring of its existing economic and commercial laws and policies. These laws have long been criticized as being outdated, unclearly written, or inadequate to the needs of modern, global business transactions.

As noted, modification to the existing Bankruptcy law was one of the first legal reforms to be completed. In addition to the pro-competition law, a secured transactions law and a contracts law are being debated. While the political commitment to passing these laws seems strong, fears have been voiced that the changes made by the new laws may not be comprehensive enough to achieve the sweeping change needed in the area of economic law. Other concerns include the worry that the government may lack the technical expertise to develop laws that are in keeping with the demands of a modern, global economy.

Privatization of state enterprises: The economic collapse has severely limited the scope for raising tax revenue. Partly to compensate for this shortfall, the government's agreement the IMF calls for additional funds to be raised by the partial privatization of state enterprises. The minister responsible for the state enterprises revealed on April 20 the privatization program involving increased divestment of state equity in the five firms already listed in the stock exchange and the partial sale on the government stock of seven other firms drawn up for 1999. These sales are expected to yield revenue of Rp 15 trn, which will be used to cover budget deficits and to restructure the troubled banking sector.

Progress on the privatization program has been slow and early work was mired by accusations of unfair competition. Existing regulations which give the government exclusive rights to manage key sectors such as resources and infrastructure, have been

hampering progress. Another barrier is the current bearish sentiment of the capital markets, which has caused several privatizations to be postponed. The Minister of Empowerment of State Enterprises has stated that the government will retain the national telephone company stock until the market improves. The government also needs time to restructure the firms and check for the presence of corrupt or collusive contracts made within any of the companies. The seven state enterprises planned to be privatized by March 1999 include : two port management companies, a steel company; a toll road company, a plantation firm, a mining firm, and a airport operator.

B. ECONOMIC NEEDS OR CHALLENGES

Macro Economic Challenges: Reestablishing macro economic stability will be the first step toward a sustained economic recovery. The most important challenges in this area are:

Stabilizing the rupiah by:

- Clearly demonstrating government commitment to political and economic reform and good governance;
- Minimizing social unrest through social safety net programs;
- Maintaining positive real interest rates on rupiah-based savings accounts, which increases the attractiveness of holding rupiah. This policy, however, must be balanced with the need to eventually reduce interest rates in order to make finance more easily available to the private sector.)

Controlling inflation by:

- Strengthening the rupiah beyond its current level (Rp. 8,000 – Rp. 9,000 to the dollar) and achieving currency stability:
- Reducing the real monetary stock by continuing the tight monetary policy begun in March 1998:
- Continuing targeted government subsidies of key commodities while beginning a gradual phase-out period;

Stimulating economic activity by:

- Achieving the projected government deficit of 8.5 percent of GDP. (As noted, the 1997/98 budget, despite calling for an 8.5 percent deficit, is currently in surplus due to delays in launching many government programs. Delayed programs should be launched as quickly as possible in order to help 'kick-start' the economy.)
- Continuing to lower interest rates to make finance more easily available. It is critical, however, that interest rates remain relatively high until the rupiah has stabilized. (There have been some market indications that interest rates are prepared to drop below the October 1998 level of 55 percent. Determining the rate at which interests rates will be lowered is one of the most challenging macroeconomic decisions facing the government of Indonesia)

Financial Sector Challenges: Indonesia's financial sector is largely paralyzed and, some argue, on the verge of collapse. Resuscitating this sector and reestablishing an effectively flow of finance will be critical to beginning the country's economic recovery. At the same time, structural reforms need to be put into place to ensure that the sector can perform effectively in the future and that past mistakes are not repeated.

The greatest challenges in reforming the financial sector are:

Ensuring more stringent enforcement of banking sector regulations. This goal can be achieved by:

- Expanding BI's power to adjudicate delinquent banks. (As noted, Indonesia is generally considered to have reasonably sound banking regulations. The major problem has been that the regulations were weakly and inconsistently enforced;
- Reducing corrupt and collusive practices in the banking sector by strengthening BI's oversight capacity;

- Enhancing the technical capacity of BI personnel to identify delinquent banking practices;

- Increasing the independence of BI from other government agencies;

- Increasing the accountability of Bank Indonesia to ensure that it polices the banking sector fairly and equitably;

- Adopting within Indonesia improved standards for accounting and risk analysis;

- Increasing BI's accountability and transparency in order to prevent corrupt and collusive practices

- Increasing the capacity of the Indonesia Bank Restructuring Agency to efficiently restructure the banking system. This goal can be achieved by:

- Enhancing the technical capabilities of personnel inside IBRA;

- Ensuring the Agency's independence from other government agencies. Such independence is critical. If the Agency is to restructure the banking sector effectively, it must operate on sound financial and economic principles, free from political influence

- Increasing the Agency's accountability and transparency in order to minimize opportunities for corruption;

- Developing oversight systems to ensure that new, competent management is introduced into restructured banks;

- Improving the capacity of the banking sector itself by:

- Increasing the ability of banking professionals to assess and manage risk;

- Developing more stringent standards for banking professionals.

- Improving access to trade finance for exporters. This can be achieved by:

- Reviewing the existing facility for government guarantees of L/Cs to identify the reasons it is being underutilized;

- Amending the program or developing an alternative facility.

Corporate Sector Challenges: The greatest challenge in the corporate sector is corporate debt overhang. Several efforts have been launched to help Indonesian corporates restructure their corporate debt, including the Frankfurt Agreements and the Jakarta Initiatives. In addition the finance sector must be reformed in order to sustainably restore the flow of credit which has now largely stopped in the corporate sector. Several further steps are also needed including:

Increasing the technical capacity for effectively restructuring corporate debts. This can be accomplished by:

- Utilizing the Jakarta Initiative to reach deals between debtor and creditor companies before restructuring packages are brought to INDRA;
- Enhancing the technical capabilities of personnel inside INDRA;
- Ensuring the Agency's independence from other government agencies, allowing it operate in a rational, disinterested way;
- Increasing the Agency's accountability and transparency in order to minimize opportunities for corruption.
- Stabilizing the real value of rupiah. This would help Indonesian companies to repay dollar denominated loans. (See 'Macroeconomic Challenges' subsection above.)

C. USAID AND OTHER DONOR RESPONSE

USAID is focusing on providing U.S. technical expertise to support achievement of the economic and financial reform agenda set under the IMF/GOI agreement and supported by all members of the Consultative Group for Indonesia. In the financial and corporate sectors, this allows Indonesia to benefit from U.S. experience related to such situations as resolution of the U.S. S&L crisis of the mid-80's and U.S. support to economic and financial restructuring in eastern Europe. Given the strength of the U.S. economic system, provision of U.S. expertise related to corporate governance, economic law and regulation, and macroeconomic policy, is also especially appropriate. The program is carefully coordinated with other involved U.S. institutions, such as the U.S. Treasury, as well as the IMF and the other multilaterals.

The international donor community has mounted a major rescue effort for Indonesia. Under the leadership of the International Monetary Fund (IMF), a \$40 billion economic reform and recovery package was formulated for Indonesia. This package, to be disbursed over three years, include: IMF stand-by credits of \$10.14 billion, \$3.5 billion from the Asian Development Bank (ADB), \$4.5 billion from the World Bank (WB), and pledges from bilateral donors as follows: Singapore, \$10 billion; Japan, \$5 billion; the U.S. , \$3 billion; and Australia, Hong Kong, Taiwan, and Malaysia, \$1 billion each. The goals of this program are: the stimulation of domestic demand by supporting a carefully managed program of government deficit spending; restarting the shattered financial sector; resolving corporate sector debt issues and assisting associated restructuring efforts; and strengthening economic governance.

The World Bank: A \$1 billion structural adjustment loan is in place which, among other topics, contains an agenda focused on financial sector restructuring. In support of this program, the Bank is providing \$20 million being used primarily to support accountancy work to establish the financial condition of many banks prior to restructuring. The Bank is also planning to provide \$30 million to support corporate restructuring efforts.

The Asian Development Bank: The ADB also has a structural adjustment loan focused on finance, which includes \$50 million in support for development of a secondary mortgage facility, and \$50 million in technical support for the banking sector. Most of this \$50 million is being used again for accounting services to determine the financial status of banking institutions. The ADB is also planning a \$3-400 million SAL oriented toward trade and industry and small business development. This loan has been closely coordinated with USAID and other donors.

Other Bilateral Donors: Japan is the major bilateral donor to Indonesia. It does provide some technical assistance, such as to the Planning Ministry (BAPPENAS). However, most of its financing is lending in support of the IMF/GOI package, infrastructure development, or trade credits. Australia is providing AU\$70 million in support of the strengthening of economic institutions, including support for the development of the new bankruptcy mechanism. The EC is supplying ECU15 million to ASEM Trust Fund of the World Bank to support technical assistance in economic and financial reform.

Trade Credits: In recognition of the major banking difficulties faced by the country, both the GOI and many international donors have established special facilities to support trade finance. The GOI has placed \$1 billion in foreign exchange with ten foreign banks as collateral to confirm letters of credit from Indonesian banks. A guarantee program for up to 80% of the value of Indonesian letters of credit up to \$1.5 million is also being planned by the GOI. Other such facilities include: Japan EXIM: \$1 billion (operational); U.S. EXIM: \$1 billion (under negotiation); Singapore \$5 billion (planned); Canada: \$30 million; Germany: \$250 million; and Netherlands: \$500 million (planned).

III. POLITICAL CONSEQUENCES, NEEDS AND RESPONSE

A. Political Consequences of the Crisis

New opportunities: Perhaps the most palpable consequence of the Indonesian crisis has been to open unprecedented opportunities for reforming the country's political process. During President Suharto's 32 years of rule, Indonesian society acquiesced to a corrupt, and authoritarian regime in exchange for the benefits of economic growth. The economy's sudden reversal beginning in mid-1997 brought increasingly vocal calls for political change, including explicit calls for Suharto to step down. These calls sounded not only from activists and student groups, but ultimately from elements of the bureaucratic elite, including the political party, Golkar, Suharto's long-time power base. This movement culminated in Suharto's resignation on May 21, 1998.

Suharto's successor, B.J. Habibie, appears on the surface to support the growing calls for political reform. In his inaugural speech, President Habibie explicitly accepted the agreement reached by his predecessor with the IMF, which calls for no less than 117 different measures of reform over the next 18 months. A flurry of reform-oriented legislation has been launched under Habibie's rule.

There is lingering concern, however, about the genuineness of Habibie's commitment to reform. As a protégé of Suharto, Habibie raises concerns that the authoritarianism and cronyism that defined the previous regime may live on.

Elections: The government has taken some significant steps toward reform. Shortly after taking office, Habibie called for elections to be held in 1999. Legislation was launched to establish new electoral regulations that would replace the existing system, which is widely considered corrupt and subject to official manipulation. Conducting open, equitable elections will be no small task. Under the current system, popular elections are held every five years to elect the national House of Representatives (DPR). In the same year as the House elections, the People's Consultative Assembly (MPR), formally the highest authority of government, convenes to sanction the guidelines of state policy and elect the president and vice president for the next five years. The Assembly is comprised of the 500 members of the House of Representatives and an additional 500 members appointed by the Executive. Traditionally, the President's power to appoint half of the Assembly seats virtually ensures his re-election. This privilege was one of the main tools Suharto used to perpetuate his seven consecutive terms in power.

Legislation is presently being debated to amend these serious shortcomings in the electoral system. Under the proposed legislation, the number of Executive appointees in the Assembly will be reduced to less than 30 percent of the body's total membership, thereby reducing the President's influence over the Assembly. Proposals have been made to reduce the number of appointees from the Armed Forces from 75 to 55, beginning the retreat of the military from the political realm. Critics have argued the presence of any appointees compromises the Assembly's accountability as an elected body, the proposed legislation does constitute a vital step towards more representative government.

Legislation is also in the works to move the electoral process for the House Of Representatives from a system of proportional representation to one more heavily weighted towards district-based constituencies. Under the former system, each province's seats in the DPR were held by members of the political party that district elected, but not necessarily by MPs who hailed from that district. The proposed district-based constituency system is expected to reduce the influence of political parties and strengthen the accountability of elected representatives to their constituents. Legislators will now for the first time be bound by a domicile rule stating they must live in the district they represent. Under the proposed system, 428 MPs will directly represent a district while only an additional 67 MPs will be elected on a proportional basis to represent the party.

Political Parties: For most of the Suharto period, party politics were tightly controlled. After 1972, only two political parties existed legally, the Muslim United Development Party (PPP), and the nationalist Indonesian Democratic Party (PDI). Both were overshadowed by the government-controlled Golkar, which held the status of a 'supra-party' dedicated to defending 'national prosperity'. As such, it was not subject to the same restriction on campaigning as the PDI and the PPP. Golkar's electoral successes (in the last general election it polled 74 percent of the vote) rested heavily on the mandatory support of the armed forces and the bureaucracy.

Shortly after assuming the presidency, Mr. Habibie announced that the party system would be opened. This announcement led to an explosion of new parties. Concerns surfaced that these parties were harbingers of either political fragmentation or political sectarianism, either of which could end in a return to authoritarianism. By June 1998, some 30 parties had emerged, included workers parties, religiously based parties, and at least two Chinese parties. The following month, a more reassuring political environment seemed to be emerging in which large parties, often in alliance with each other, would dominate the scene. Nonetheless, as of October 1998, some 90 parties had been officially registered.

Legislation is being debated to ensure fair competition among political parties. Under the proposed 'political parties law' many special privileges enjoyed by Golkar will end. Civil servants, for example, will no longer be obliged to vote for Golkar. The civil servants' association, Korps Pegawai Negeri (Korpri), will no longer form part of Golkar and its members will not be required to campaign for the party. In addition, all political parties will be recognized by the government provided they meet a list of conditions (See below).

While the proposed law does much to create a fair campaigning environment, concerns have been voiced about some of the law's proposed statutes. For example, to be officially recognized, all parties will be required to have 13 provincial branches as well as sub-branches in at least half of the regencies of any province. If a party fails to meet the above requirements, it must have at least one million signatures from its prospective constituents, complete with names, addresses and copies of their identification cards. Some observers argue that such stringent requirements would be too demanding for many emerging parties and would cement the position of a well-established Golkar.

Another concern surrounds the bill's proposal to limit campaign contributions to Rp 5 million (US\$ 600) on individual donations and Rp 50 million (US\$ 6000) on donations from corporations. Such a stipulation would clearly benefit the already well-financed Golkar and hinder the myriad of fledgling opposition parties.

The government is also proposing to maintain its 'floating mass' policy which the Suharto regime used to effectively bar political parties from establishing branches or campaigning at the sub-district or village level. Golkar is excluded from this restriction as it is not considered a political party but rather a 'functional group'.

A final point of concern relates to the government's stance on the 'schism' within the PDI. The Suharto government was widely accused of engineering a rift in this increasingly popular party headed by Megawati Sukarnoputri. Mrs. Megawati was removed from the official party leadership in June 1996 in what was considered a government-orchestrated campaign. By continuing to recognize Mrs. Megawati's rival as the official party leader, the Habibie government has cast some doubt on its commitment to pursuing a 'hands-off' approach to party politics.

It must be recalled that all of the above legislation is still under deliberation with the final shape of the laws yet to be determined. Significantly, the legislation will ultimately be decided by MPs brought into office under the old, corrupt electoral process, many of whom stand to lose their office under a more open system. The steps the final legislation takes toward a clean, transparent electoral system will send a strong signal regarding the government's commitment to real reform.

The timing of elections also remains unclear. President Habibie has announced the possibility of a delay in the previous timetable, which called for House elections in May 1999 and an Assembly session the following December to elect the president and vice president. It is not clear whether the proposed delay is due to the purely technical reasons of running an open election for the first time.

The power of the Executive: The economic crisis has also brought about calls for improved institutions of governance and increased accountability and transparency of government institutions. Probably the loudest calls have been for limitations on the power of the Executive. Indonesia's constitution does call for a strong President. Indeed, the constitution gives the President the power to issue Presidential Decrees (INPRES and KEPPRES) which have the same legal force as laws enacted by the House and which do not require House approval.

Despite this substantial constitutional power, Suharto in his three decades of rule incrementally expanded the power of the Presidency until it effectively overshadowed all other parts of the government. For example, while Indonesia's constitution empowers the House to reject legislation proposed by the Executive, the House of Representatives under Suharto never blocked an Executive-sponsored bill and proposed no original legislation of its own. Most observers agree that there is a strong need for the Presidency to be limited to its original powers granted in the constitution.

The House: With the resignation of President Suharto, there have been several signs that the House of Representatives is prepared to assume a more active role in governance. In June, the House proposed original legislation for the first time in 32 years. It has also actively contested several bills proposed by the Executive. In addition, all major factions of the House of Representatives recently recommended that the president and vice president be limited to two five-year terms in office. This proposal is expected to pass during the working sessions of the Assembly in November. Under this proposal, the President would also be required to address the Assembly every year instead of every five years.

The political rules of the game: It is still difficult to assess the political forces that will influence the future of the policy process under the new Habibie government. For over thirty years, policy was directed almost exclusively by a single man: President Suharto. Even influential ministers were reluctant to take political action without first seeking Presidential approval. The political process, while unrepresentative, was clear and predictable.

The sitting President holds a much narrower power base than his predecessor. Consequently, the number of influential political players, and the ability of these players to sway policy, has grown markedly. Table One provides an overview of the major power centers in the Habibie government. Many forces outside the government – NGOs, political parties, religious organization, cooperatives – have also assumed a more active role in influencing policy decisions. The future of Indonesia politics will be strongly influenced by how the various political actors fill the power vacuum created by Suharto's departure.

Corruption: One of the loudest calls for reform this year has been for a reduction of corruption, collusion and nepotism. Indonesia ranked 80th out of 84 countries on the Transparency International's 1998 Corruption Perception Index. Under the previous administration, abuses by government officials and well-connected individuals, notably Suharto's own family, were widely known and generally went unpunished. Demands to reduce corruption were hushed amidst the climate of political repression. Since Suharto's resignation, the expanded media freedom has turned the spotlight on corruption. In addition, there is growing recognition among Indonesian society that the economic distortions created by corruption practices were partly responsible for the country's economic collapse.

Some observers have suggested that President Habibie is unlikely to move quickly to reduce corruption. Throughout the Suharto years, most of the earnings of the Timsco Group (Habibie's family business) came from government supply contracts, particularly from state-owned entities within Habibie's ministerial portfolio in research and strategic industries.

The Armed Forces seem equally unlikely to take action against corruption. General Wiranto's public promise on May 21st to protect the Suharto family was widely understood to include its wealth. The replacement in late June of attorney-general

Sudjono Atmonegoro by Major-General Ghalib, an active army officer, suggested to many observers that Mr. Habibie had been pressured to slow the investigation into the Suharto family wealth.

The investigation into Suharto's wealth has assumed as high profile among Indonesian society, as it is symbolic of the previous regime's corrupt practices. Failure to reclaim at least some of Suharto's reported billions of dollars, will send a negative message to Indonesian society regarding the current administration's commitment to reform, a message that could add to the already growing social tensions.

Decentralization: The economic crisis has also increased calls for more local self-governance. Under the current political system, mayors and regents are selected in an election process that is heavily influenced by the Ministry of Home Affairs. As a consequence, 75 percent of current mayors and regents are active or retired military member, most with strong allegiances to the central government. Despite substantial progress in fiscal decentralization, approximately 70 percent of the funding for the local government expenditures still originates from central government grants and transfers.

The current political environment presents a potential watershed for political decentralization in Indonesia which can be translated into accelerated technical decentralization. Political will is emerging for legislation that could result in substantial authorities being delegated away from the central level.

Several outlying provinces have gone beyond calls for decentralization, demanding greater levels of political autonomy or even outright independence. East Timor, for example, has put forward a proposal to hold a referendum on self-determination. Little evidence has emerged, however, of a fundamental shift in the government's position on Timor. Ali Alatas, Indonesia's Foreign Minister, outlined a partial autonomy plan that would give an East Timorese government control over all political matters except foreign affairs, defense and monetary and fiscal policy. This would go beyond the very limited "special status" already granted to a few areas of Indonesia such as Yogyakarta and Jakarta. Initial reactions suggest that East Timorese regard the proposal as inadequate.

It is important to recall the potentially fractious nature of Indonesian Republic. The archipelago comprises hundreds of different ethnic and linguistic groups, many of which feel minimal allegiance to the nation. There is resentment in many regions toward the island of Java and the capital city Jakarta, which have developed much faster than the other islands and are believed to have received disproportionately high levels of development aid. Resentment is particularly strong in resource-rich areas, which have regularly seen profits from resource-based industries returned to Jakarta, where most mining, forestry, and petroleum companies are based.

Civil Freedoms

Freedom of expression: One of the most visible effects of the Indonesian crisis has been an explosion of public expression not seen for decades. In the waning months of Suharto's rule, Indonesian society became much more aggressive and open in its calls for change. After an initial crackdown, the Military seemed reluctant to attack the growing number of demonstrators. It is unclear if this stance signals growing support among the armed forces for increased freedom, or, if the military is simply trying to improve its public image in the wake of the unrest in May 1998.

The position of the government is less clear. On October 22 the House of Representatives passed a new freedom of expression law that expanded rights to demonstrate in public places. Under the new law, protests cannot be staged within a certain radius of strategic locations, such as the presidential palace and military installations, and organizers are required to notify the police at least three days before a planned protest. The police are obliged to protect demonstrators as long as they have met all the legal requirements.

While the bill is considered an improvement on previous freedom of expression laws, critics argue that the registration requirements leave too much room for the government to prevent demonstrations from occurring. It is also significant to note that prior to the current bill's passage, President Habibie had proposed what was considered a much more repressive law on public gatherings.

The government has also taken steps to protect freedom of association. The bill on public protests passed through the House in just 20 days at a time when members were behind schedule on their debate of the new electoral laws. The swift passage of this law suggests that the government afforded it a high priority. During debate on the final draft of the bill, members of the House managed to convince the Executive to drop the condition that protesters must be granted a police permit before holding a protest of more than 50 people. Regular protests against the bill by students and NGOs at the House may have also influenced the government's decision to drop this controversial clause.

The media: In early June 1997, the new Information Minister rescinded the controversial 1984 Press Law which allowed him to unilaterally revoke press licenses from publications. The process to obtain a publishing license has also been cut from 16 conditions and three permits to just three conditions. Publishing companies no longer need government approval to appoint or change their editorial boards.

The government has also stated that the Indonesian Journalists Association (PWI) will no longer be the only organization allowed to represent journalists. Private radio stations are now allowed to produce and manage their own news and are only required to relay four news broadcast a day from the state-run Radio Republic Indonesia, down from the previously required 14 broadcasts.

Critics worry that these changes are insufficient. The Information Minister, for example, still retains the right to revoke licenses for an unspecified period of time.

Many consider this a dangerous power, as license revocation was one of the main tools used by Suharto to control the media. President Habibie has also proposed the possibility of requiring journalists to be accredited and licensed, a requirement which could be closely controlled by the government.

Despite increased openness, it is important to recall that publishers and broadcasters, like many businesses in crisis-stricken Indonesia, will be struggling to survive in the face of falling revenues and rising costs. Almost all publications have had to reduce the number of pages they print or otherwise downsize operations. The price of newsprint rose almost 600 percent in rupiah terms from July 1997 to July 1998 (*figure 2.1*). In addition, advertising revenues have fallen substantially as the market for many products has sharply contracted. (see figure 2.1)

Labor unions: Within days of becoming President, Habibie signed the International Labor Organization (ILO) convention No. 87, which guarantees workers the right to organize. One month later, the Minister of Labor issued a decree formally granting freedom to workers to form unions as long as they register with the government. The new decree also allows unions to form federations and confederations in order to strengthen their bargaining power. The Ministry of Manpower is currently drafting a new law on labor unions which is says will strengthen further the legal basis for labor organizations in the future.

These moves are a significant departure from the government's previous labor policy. Under the Suharto regime, workers could only form unions at the company level and these unions had to be affiliated with the government-sanctioned All-Indonesia Workers Union (FSPSI). In a highly publicized case, one union, the Indonesia Prosperous Labor Union (SBSI), founded in 1992 by lawyer Muchtar Pakpahan, was outlawed and several of its leaders, including Pakpahan, were jailed. SBSI has since been given official recognition and Pakpahan has been released from jail. Some 12 other independent unions have been established in the wake of the government's more liberal stance.

Several other key ILO Conventions, notably No. 105 on migrant workers, No. 111 on discrimination in employment and No. 138 on minimum wages, have yet to be signed by Indonesia. Officials at the Ministry of Manpower have said the government is studying these conventions before reaching a decision.

A concern has arisen that labor activities are growing at exactly the time when Indonesian companies are least able to provide improved terms and benefits for workers. In July 1998 a group of factory workers in Bandung, West Java held a demonstration demanding a 75 percent wage increase. When company management proposed an increase of 35 percent, claiming the firm could bear no greater hike, the demonstrators flew into a rage, destroying factory facilities and equipment

NGOs and civil society: The recent change of administrations has also allowed NGOs and institutions of civil society to expand their activities. Under Suharto, the

government attempted to control or marginalize most civil society institutions and forced activist NGOs to operate at the fringes of the policy and political arena. In the new atmosphere of political openness, these institutions are enjoying new liberties.

Many civil society organizations and NGOs have played a significant role in responding to the ongoing crisis in Indonesia. When political activists disappeared earlier this year, the Indonesian Legal Aid Foundation (YLBHI) was instrumental in identifying and tracking the phenomenon, as well as providing advice and legal assistance to the families. They and other NGOs publicized the disappearances and kept the issue alive. A number of organizations have continued to publicize the issue of the sexual assaults in Jakarta during the May riots and a few have been included in the official investigation into the riots.

Other organizations are working with the press to support the free and open flow of information in an effort to maintain the momentum for reform. In October, a South Sumatran regional court found two logging concession holders guilty of starting forest fires. The companies had previously blamed the fires and the subsequent pollution last year on local slash and burn farmers. Using satellite photos as evidence, the Indonesian Forum on the Environment (Walhi) and the local Legal Aid Foundation were able to successfully identify the source.

The role of the military: The role of the Indonesian military has also come under close examination. The May riots in Jakarta are widely suspected to have been sparked by a military shooting of four student protestors at a local University. Since then, widespread criticisms have been sounded about the military's lack of professionalism and disregard for human rights.

Increased scrutiny of ABRI has also drawn into question the military's role in politics. At present, the military has a legally sanctioned political role, formalized in the doctrine of *dwifungsi* or "double function". This policy guarantees the military a set number of seats in both the House of Representatives and the Assembly. Many observers claim that under Suharto, *dwifungsi* came to mean not just military participation in House and the civilian bureaucracy but also the covert manipulation and suppression of political activity in general. The covert role usually involved a range of activities from gathering political intelligence, to orchestrating the elections of recognized political parties, to use of terror against political dissidents.

In the wake of Suharto's resignation there have been powerful voices within ABRI itself hinting about the need to reduce the political role of the military. While such calls are generally viewed as a favorable development, they do run the risk of exacerbating rifts in the already fractious military.

Calls have also been sounded for the military to abandon its extensive business activities. ABRI currently operates 64 major companies in Indonesia. This business role is considered necessary in order to complement the military's rather limited government funding. (Capital spending on defense averages only 2-4 percent of the total yearly government budget.) Because ABRI's business revenues are off-budget, however, they open substantial opportunities for abuse. Complaints have also been

heard for years that the military uses intimidation and threats, and sometimes outright violence, to strong-arm its suppliers and competitors.

LEGAL PROCESS AND RULE OF LAW

New laws proposed: With the opening of the doors to political reform, unprecedented opportunities have emerged for reforming Indonesia's legal system. Analysts have for years insisted that a thorough overhaul of the country's legal system would be necessary for Indonesia to fully integrate into the global economy. Most of the legal code and legal institutions in place in Indonesia today originated from the time of the Dutch East Indies and have changed little since the middle of the 19th century. Significantly, many of the laws drafted since independence, including those issued during the Suharto era, continue the colonial legal policies of emphasizing national stability at the expense of individual liberties.

There has been a flurry of new bills drafted since President Habibie took office in May and it seems that the current Minister of Justice, Muladi, is indeed committed to pursuing legal reform in a proactive manner. The most high profile are the laws addressing freedom of expression, the elections, and political parties (see pages 2-3). Economic and commercial laws have also assumed high priority (see Section II).

Legal Institutions: Calls for new and better laws have been accompanied by growing public outcry for more independent legal institutions. Most frequently cited is the need for an independent and impartial judiciary. Under the present political system, the judiciary, as part of the Ministry of Justice, is strongly influenced by the Executive branch. Critics argue that because judges are appointed and can be fired directly by the Justice Minister, their impartiality is compromised. Adi Andoyo, a former Supreme Court Judge who was sacked by Suharto after exposing acts of corruption within the Supreme Court has stated that money and power often prevail over justice.

To date, the government has taken no clear steps to reform this important area. Establishing the judiciary as an independent 'branch' of government, outside the Executive, would require a constitutional amendment. It is unclear if the current administration is prepared to go to these lengths.

The police: One of the results of the growing public demand for accountability from the Armed Forces is a new role for the 177,000-strong national police force. There has been increasing public criticism of the police for failing to impartially enforce the law and for violating human rights. Amidst this storm of criticism, Minister of Defense and Armed Forces Commander Wiranto announced in October that the National Police Force will be separated from the Armed Forces starting in April 1999.

Supervision of the police force will initially be transferred to the Ministry of Defense. After a six month interim, this responsibility will be handed over to the Ministry of Home Affairs or to the President, or possibly kept within the Ministry of Defense. The Defense Minister explained that the shift was intended to change in the police force's philosophy from one of being military-oriented officers to public-oriented civil servants.

HUMAN RIGHTS

Human Rights issues: One of the effects of the crisis was to turn the world spotlight on Indonesia, especially during the international broadcast of the May riots in Jakarta. Increased press coverage has raised international concern over the issues of human rights violations in Indonesia. Indonesian citizens and NGOs have also begun to speak out more actively on these issues amidst the liberalized atmosphere of expression.

The government has responded by making several significant human rights gestures. In June, President Habibie officially launched a five-year National Action Plan on Human Rights. The President set the ratification of human rights conventions, the dissemination of information and education on human rights principles as targets to be met by 2003.

Indonesia has only ratified four of the 24 UN conventions on human rights. The government has yet to ratify the prime convention, the International Bill of Human Rights, as well as two main covenants: the International Covenant on Civil and Political Rights and International Covenant on Economic, Social and Cultural Rights. At least 50 political prisoners have been released in a blaze of publicity at various times since Habibie took power, although an estimated 120 anti-government activists still remain in jail.

The government-affiliated National Commission on Human Rights has pledged to increase its independence and authority. The rights body, which was established in 1993 based on a presidential decree, has traditionally been permitted only to make recommendations from the results of its findings in the field. It holds no authority to carry out investigations on its own or to compel authorities to take action against human rights abuses.

Vice Chairman Marzuki Darusman has stated that negotiations are on-going with the government and the House of Representatives to draft a law expanding the commission's authority in defending human rights. This stronger legal base would give the rights body the authority to investigate human rights violations on their own initiative and to promote legal action against violators.

The Jakarta riots in May resulted in a considerable loss of human life, caused heavy damage to property and businesses, and eroded confidence in the country. The National Human Rights Commission estimated that 1,188 people died, many in fires set by rioters at shopping centers while looters and others were trapped inside. Property damages have been officially estimated at almost \$400m. The commission also concluded that an "organized group" was involved.

The Commission's report indicated that 168 women, most of whom were Chinese Indonesian, were sexually assaulted during the May riots in Jakarta, and that 20 died during or after the assaults. More difficult to count is the intangible losses such as the forfeiture of international confidence and the exodus of ethnic-Chinese Indonesians, who play a pivotal role in the country's commercial life.

The military conducted its own investigation and was unable to locate any rape victims or evidence of an organized group behind the May riots. The military has also issued stern warnings to activists publicizing the assaults. Victims and NGO activists have reported numerous instances of military harassment and intimidation. In mid-October, an 18-year old girl who had been counseling the rape victims was found murdered in her home under mysterious circumstances. Other volunteers saw this as a threat one week before their planned trip to the United States to testify before the U.S. Congress.

On July 23rd the government set up a Joint Fact-Finding Team (TGPF) to look into the shooting of four students at Trisakti University, the Jakarta riots, and the reported rape of ethnic Chinese women. On the team were several independent figures, including representatives of respected NGOs, officials from the human rights commission and army officers.

Presenting its results on November 3rd the TGPF team confirmed that the riots were engineered for political reasons with "preparations behind this having started at the highest decision-making level." Team Chairman Marzuki Darusman stated that the whole process had clear political dimensions aimed at securing extraordinary powers based on an existing decree which would have given President Suharto extra-constitutional powers to overcome any temporary emergency situation. The report mentions Suharto son-in-law Lt. Gen. Prabowo and then-Jakarta military commander Maj. Gen. Sjafrie Sjamsoeddin, as the probable organizers. The team also found physical evidence of 66 rapes during the riots, the majority of which were gang rapes while the majority of the victims were ethnic Chinese women.

Since September, a series of mysterious killings has occurred in East Java has left more than 150 dead under unexplained circumstances. Abdurrahman Wahid, the head of the country's largest Muslim social organization Nahdlatul Ulama (NU) has suggested that the someone in the cabinet is behind the killings in an effort to split a growing alliance between NU and Megawati of the PDI, both of which have power bases in East Java. The head of the Armed Forces General Wiranto also admitted the deaths were politically motivated. In the weeks since these statements, little progress has been made in uncovering the truth or stopping the killings. Minister of Co-ops Adi Sasono has denied reports that he and extreme Islamic groups are behind the killings.

Although the fall of Suharto has led to calls to open past cases of abuses by the government and ABRI, the new Habibie government has not been eager to investigate. The possible complicity of higher-ups, including Suharto, and the prospect of growing clamor for investigation into the long list of other abuses-in East Timor, Aceh, Irian Jaya, and against Muslims-allegedly committed by the military may also explain it. Many of the implicated organizers of these abuses still remain in power within the Habibie government.

The change of government has opened up the debate on East Timor. After its invasion and annexation in 1975-76 East Timor became a permanent impediment to Suharto's hopes for international respectability. The incorporation of East Timor as

Indonesia's "27th province" was never recognized by the UN, which regards Portugal as administering power. Low-level armed guerrilla activity has continued. Since the late 1980s the main resistance to central authority has come from the urban youth. The Roman Catholic Church has played the difficult role of mediator and protector.

There have been separatist stirrings in Irian Jaya. One focus of the protests in Irian Jaya has been human rights abuses by the military. A church-sponsored report released in May describes an indiscriminate rampage by troops in the highlands last year, following the release of European and Indonesian hostages taken by Organisasi Papua Merdeka (Free Papua Organization).

Similar revelations have been coming-out about Aceh, the North Sumatran province where Muslim tinged-separatism has regularly flared-up over many years. At the end of July, a House fact-finding team was reported to have found mass graves, containing thousands of skeletons, suggesting that the scale the abuses was far larger than previously thought. The National Commission on Human Rights exhumed several mass graves and confirmed that 781 people were killed during the nine-year military operation. The Aceh NGOs forum recently estimated the number of casualties in several mass graves to range from 1,165 to 1,800. Again witnesses implicated Kopassus.

B. POLITICAL NEEDS AND CHALLENGES

Challenges of free and fair elections

Specific challenges in holding free, fair elections include:

Developing new laws that support open, transparent elections that are freely contested by all political parties. As noted, new laws on elections and political parties are currently being debated. Sound regulations in these areas will be crucial to free, fair elections. In timing the completion of these laws, the government must strike a delicate balance. It must avoid rushing the electoral legislation, which could compromise the effectiveness of the final laws. At the same time, it should avoid further postponements of the elections, as such delays have raised suspicions regarding the official commitment to electoral reform.

Developing the capacity of political parties. The over 90 political parties that have sprung up in the past six months are in general poorly organized, inexperienced at campaigning, and devoid of clear, lucid platforms. These parties need support in clarifying their agendas and planing organized, professionally managed campaigns. Support is also needed to ensure that women participate substantively in party activities.

Strengthening the capability civil society institutions to serve as vehicles for political participation and expression. It must be recalled that the vast majority of voters in any democracy do not actively participate in political parties; political expression is more common through civil society institutions. Under the Suharto regime, civil society institutions were strongly discouraged from playing any

political role. To begin to play an active political role, civil society institutions need legal recognition of their political activities. They will also need to develop their institutional capacity in order to allow them to operate effectively after years of political hibernation. Special attention should be given to ensure that women are included in the structure and activities of civil society institutions.

Encouraging public understanding and debate of political issues. Even with effective laws in place, there is a pressing need to encourage social dialogue on political issues in order to develop an informed electorate. Public discussion and debate, a practice discouraged under the Suharto regime, needs to be fostered among all segments of society.

Monitoring the election. One of the greatest challenges ahead is ensuring that the election is conducted in an equitable, transparent manner. This is no mean task in a nation of 210 million spread across some 13,000 islands. Well-planned, nationwide monitoring will be crucial to ensuring that the voting is fairly conducted. (Monitoring activities should be designed to ensure that both women and men are able to participate freely in the election.) Equally important, the fairness of the election (assuming that is the outcome) needs to be publicized to all segments of Indonesian society. After decades of tainted elections, Indonesians are ill inclined to acknowledge any election as clean. For the elected government to gain legitimacy in the eyes of its constituency, the fairness of the election needs to be documented and broadcast by respected sources.

Challenges of Good Governance: While fair elections are Indonesia's most pressing need, good governance is a more long-term, arguably more important challenge. International confidence in Indonesia will not return until a clear agenda is established for developing an open, accountable system of governance. Without the return of international confidence, and the attendant return of investment, Indonesia will be unable to bring a sustained economic recovery.

In addition to the shoring up international confidence, good governance is required to effectively guide Indonesia's future development. The system of patronage and corruption under Suharto caused enormous economic distortions and created a high-cost, high-risk economy. In boom times, with annual growth rates exceeding six percent, such economic problems could be largely overlooked. In the lean years ahead, however, Indonesia must establish sound systems of governance if it is to develop a healthy, growing economy. Finally, without taking concrete steps toward better systems of governance, Indonesian may run the risk of losing the stream of international aid that now forms the basis of the country's social safety net programs.

Specific challenges in the process of improving governance include:

Expanding the independence, capacity, and accountability of the House. As noted previously, the House of Representatives recently proposed legislation for the first time in 32 years. The House of Representatives needs to continue assuming a more active role in the policy process. At the same time, it needs to develop technical capacity to develop, analyze, and debate legislation. (Many current

members of the House hold only high school degrees, with no formal training in the fields they must address. MP offices are also notoriously understaffed and lacking in resources.) The House of Representatives also needs to enhance its communications and constituency relations capacity in order to make it more accountable to voters.

Expanding the independence, capability, and accountability of the judiciary. A more autonomous court system dedicated to impartially enforcing the law will be crucial to supporting good governance in Indonesia. The judiciary needs to be granted greater autonomy from the Executive branch, possible by being separated from the Ministry of Justice. The capabilities and accountability of judges also need to be expanded to ensure laws are applied effectively and impartially.

Increasing the accountability and transparency of government bodies. As discussed previously, few systems exist within the Indonesian government for monitoring and adjudicating delinquent political bodies. Monitoring systems – both government and non-governmental -- will need to be developed to ensure official bodies operate in a clean, open way. Special attention should be given to increasing the accountability of the Executive, owing to this office's disproportionate influence on policy (see page four).

Reduction of corrupt practices within the government. This endeavor will clearly constitute a long-term process, as the system of corruption and patronage developed by Suharto is entrenched in most branches of the government. A concerted, well-planned, and transparent program for exposing and eliminating corrupt practices will be needed if progress is to be made in this area.

Decentralizing power from central government to regional and local government. Indonesia needs to achieve a better balance between the power afforded to central government and that of regional and local governments. Decentralization of power will give a greater voice in government decisions to citizens. It can also increase the government's efficiency in delivering services by ensuring that local voices influence policy and decision-making. An unprecedented opportunity for decentralization has opened, as the current administration seems to recognize the limitations of central government to deliver services throughout the archipelago. Steps should be taken to capitalize on this opportunity and make progress toward increasing to power and responsibilities of regional and local governments.

Challenges of freedom of expression, association and information: Freedom of expression and free access to information are essential to any democratic government. While Indonesia has taken some steps towards liberalizing these areas over the past months, further measures are needed. Specific challenges include:

Developing stronger, more comprehensive laws to protect freedom of expression and freedom of association. While recent laws in these areas clearly improve on past regulations, most observers agree that the new laws are still incomplete and leave

opportunities for government restrictions on freedoms. The government will need to give high priority to drafting more comprehensive laws as soon as its legislative agenda permits.

Increasing the freedom and capability of the media. Indonesia also needs to nurture its newly independent media, which can serve as a watchdog on government and can also stimulate public debate on political issues. Most important in this area is the drafting of clearer laws to protect media freedom. There is also a need for the media to enhance its professional capacity so that it can more effectively inform the public.

Increasing the ability of labor organization to promote workers' rights. Labor is another vitally important area. The leadership of most of the newly formed unions has little or no experience in lobbying government and championing labor rights. The unions clearly need to develop their capacity for lobbying, communications, and organization if they are to effectively advocate the rights of their members. Clearer, more comprehensive labor laws are also needed to ensure that the current environment of openness toward organizing labor is not curtailed or reversed in the future. Special attention should be given to ensure that women actively participate in labor unions.

Providing improved protection of human rights. Indonesia needs to take additional steps to improve its tarnished human right record. Better protection of human right can send a strong message, to Indonesian society and to the world, that the government is serious about reform. It will also be vital to maintaining the international and domestic support necessary to leading the country to recovery. The government needs to developing clearer policies and regulations to protect human rights, as well as better monitoring systems to report human right violations. Efforts to improve human rights protection should be designed to ensure that they provide equal protection to both women and men.

C. USAID AND DONOR RESPONSE

USAID has been and will continue to be one of the largest and most active donors in civic and community participation (democracy and governance sectors). The USAID Program, more than any single donor program, has been instrumental in laying the groundwork for political reform and will continue to support and facilitate the active engagement of donor groups in strengthening democratic reforms. The assistance requirements within the DG sector are enormous and no one donor will have sufficient resources to address the wide number of democracy and governance issues. Furthermore because of sovereignty and impartiality concerns, broad and active support from international donors is highly important and useful.

During the past ten years, USAID has actively supported the development of civil society groups in advocating for reforms. This support, joined with other donor programs has been instrumental in limiting powerful status quo groups which have acted with impunity and without regard for the rights and interests of the broader population. Our approach has been to strengthen a solid institutional base and

encourage support and assistance from other donors to extend coverage and programs to civil society and reform groups. In highly sensitive areas of support we have established working groups among other donors and to identify gaps and areas of collaboration and coordination. Both of these approaches have extended the coverage and effectiveness of programs and flagged the resolve of the international community to support the political reform. During the next six months, our focus will be centered particularly on the work required to support free and fair elections.

Elections Support: The UNDP has agreed, at the request of the Government of Indonesia, to provide overall coordination and facilitation of support for the elections planned in May 1999. We have worked closely with the UNDP to assist their coordination and share information and analyses of the USAID supported election assistance work already underway. Our support at this critical time has been to provide feasibility and assessment analyses in such areas as election management assessments, media, voter and civic education needs, and the status of public information and to encourage other donors to identify programs in these areas.

Regrettably, most of the donor elections programs are at the identification and feasibility stages and we should expect a period of consolidation and review before more defined activities and programs are developed. However, a few activities have been initiated and some level of program interest has been identified. We will work closely with the UNDP to encourage additional support.

Other Donors

Australia Provided training to elections officials and has indicated an interest in supporting election management.

Japan The Japanese Government has indicated that they are willing to provide election commodities such as ballot boxes and perhaps indelible voter identification ink.

Germany The German Government and the UNDP are providing assistance on electoral reform and assistance to NGOs.

Many other donors have indicated an interest in supporting the election and we have met with the Swedish Aid (SIDA), British Aid, Danish AID (DANIDA) and other donor groups to support their programs.

Other Democracy and Governance Programs

In other democracy sectors, USAID has also been the most active and largest donor. There are encouraging signs that other donors will expand their assistance.

- CIDA and AUSAID are providing assistance to the National Human Rights Commission, and they are providing assistance for human rights training, community

advocacy, election assistance, and are contemplating funding some programs with the national parliament. AUSAID is also reviewing a parliamentary support program and assistance to the Supreme Court.

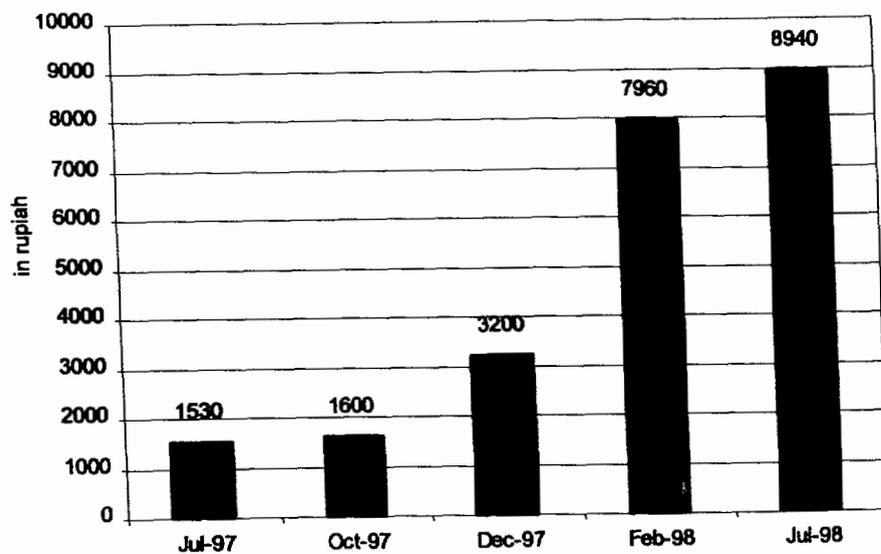
- The WB has announced a comprehensive program of good governance and the elimination of corruption and support for legal reforms. They are actively seeking the support of civil society groups.

- The Canadian and German Foundations are providing media assistance especially print media.

- DANIDA, is extending some support to NGOs. They have indicated that they will fund seminars on electoral reforms and competition. The DANIDA has also informally indicated that they may be interested in supporting the political transition in East Timor.

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FIGURE 2.1
Newsprint Price
(Rp per kg)



Source: Kompas 1998

FIGURE 3.3
Percentage of Poor Villages
by Island Region
(Bappenas, 1998)

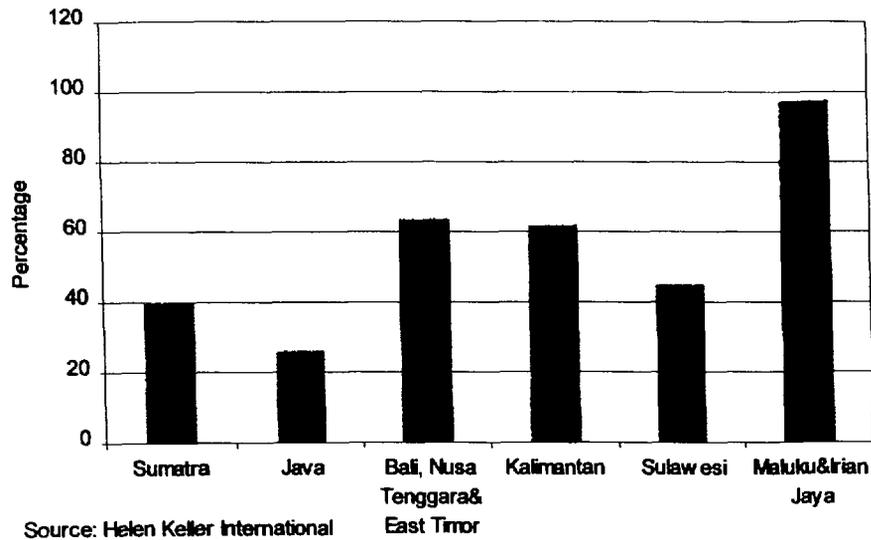


FIGURE 3.4
Actual Numbers of People
Living in Poor Villages
(BPS 1996, Bappenas 1998)

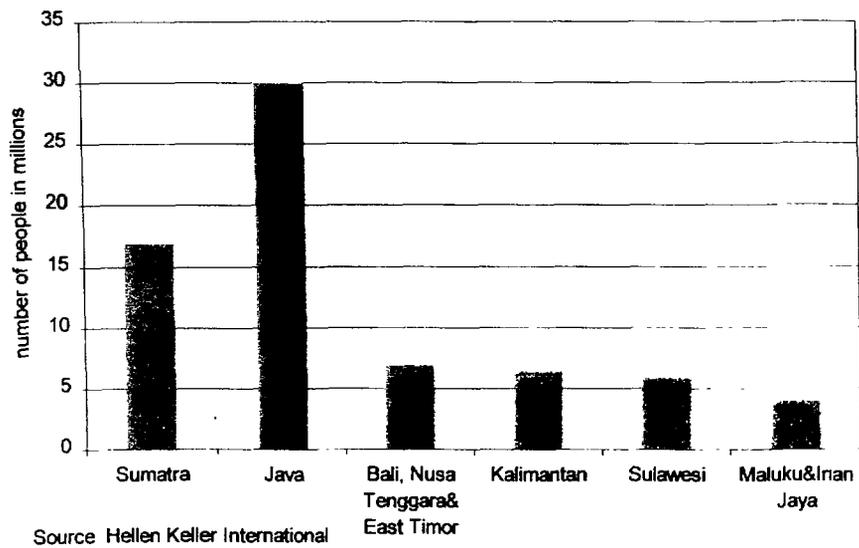
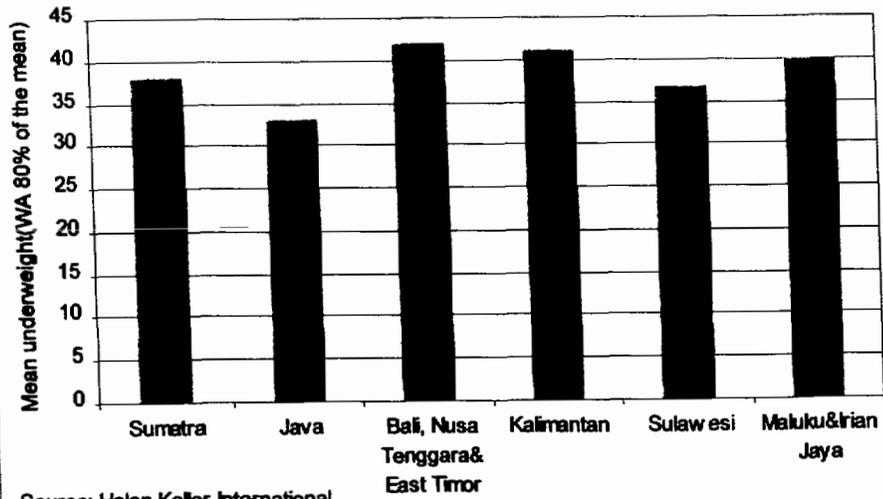
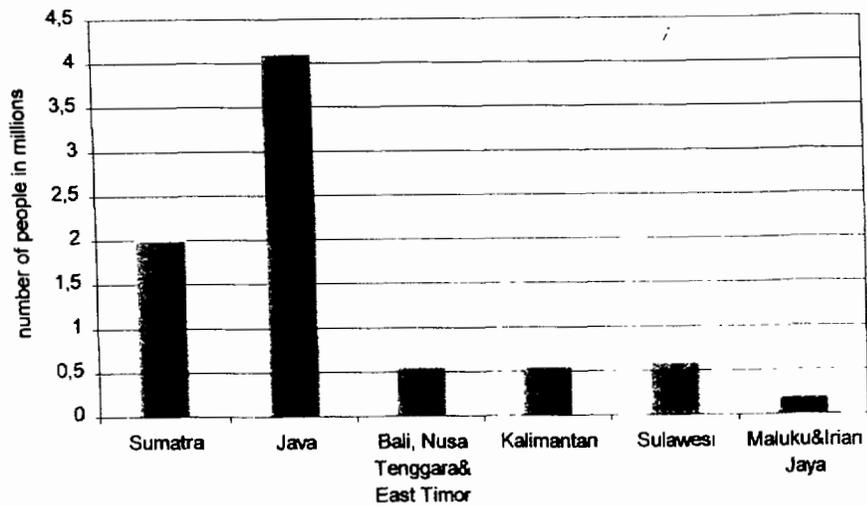


FIGURE 3.7
Prevalance of Malnutrition among
0-4 Children by the Islands (BPS 1996)



Source: Helen Keller International

FIGURE 3.8
Actual Number of Malnourished Children
aged 0-4 years by the Island Region (BPS 1996)



Source: Helen Keller International

FIGURE 3.11
The Prevalence of Childhood Blindness
Before and After Crisis
in three ecological zones of Central Java

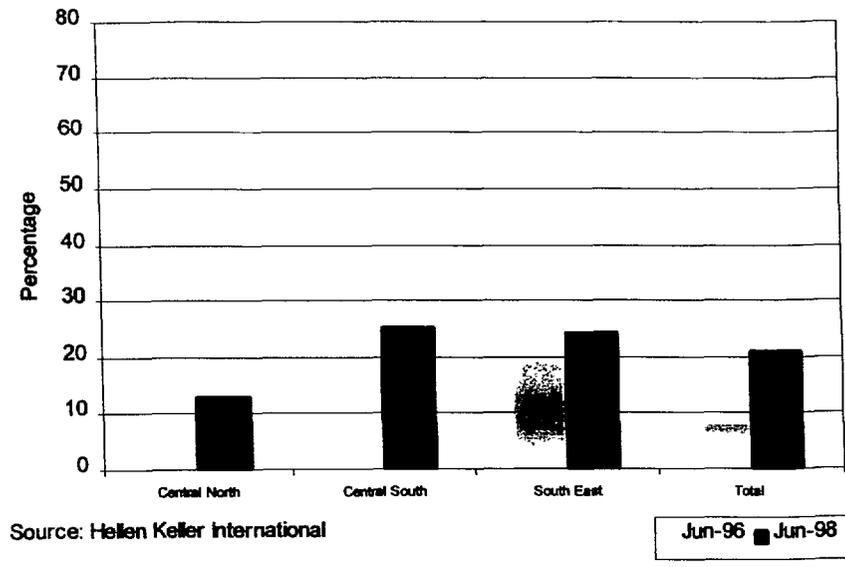


FIGURE 3.12
The Prevalence of Childhood Anemia
Before and After Crisis
in three ecological zones of Central Java

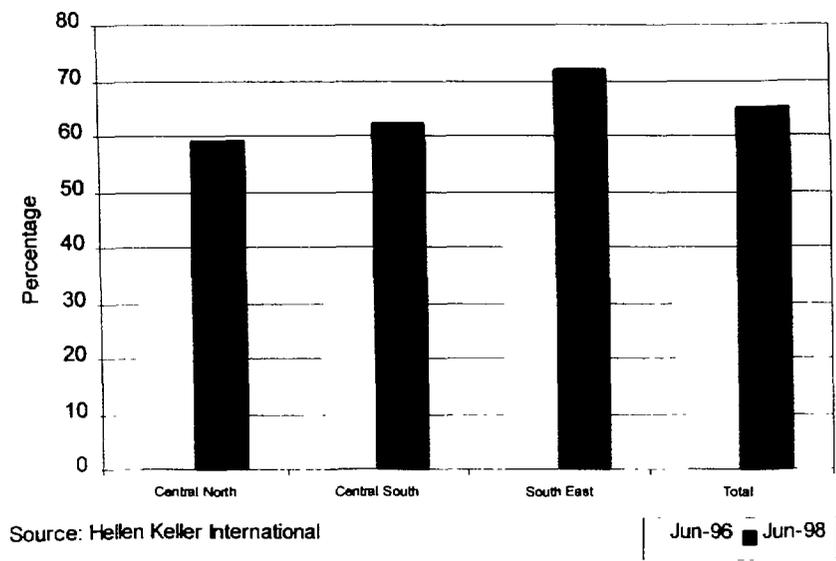


FIGURE 4.1
Indonesian Growth

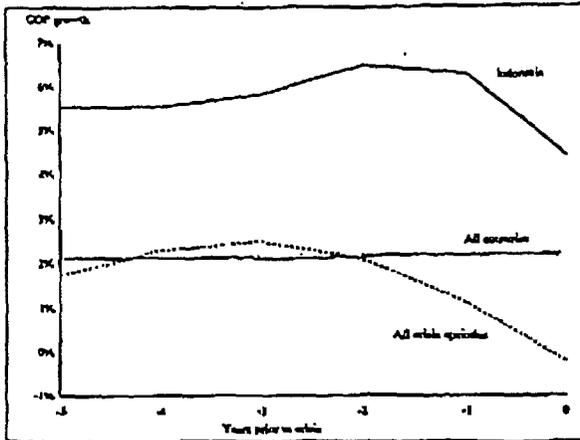


FIGURE 4.2
Foreign Exchange Reserves

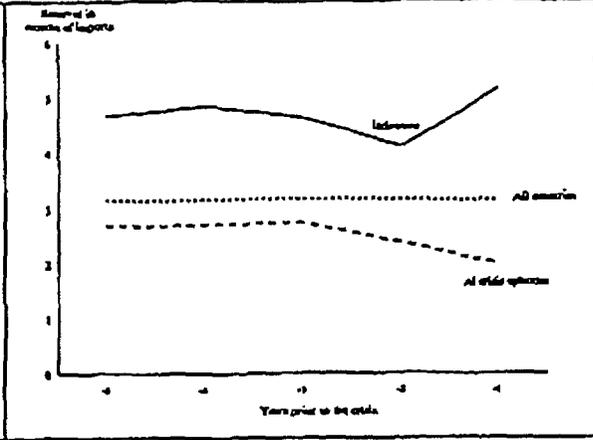


FIGURE 4.3
Inflation

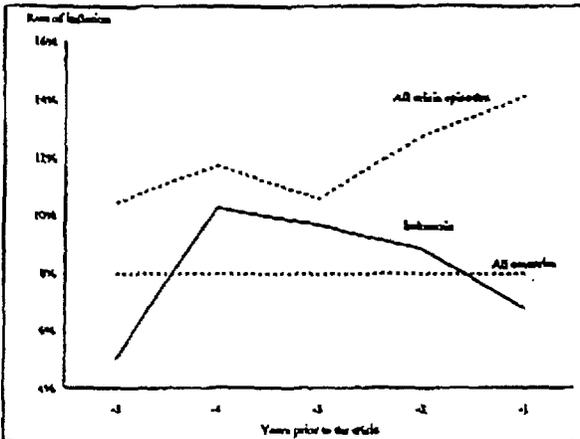


FIGURE 4.4
Current Account Deficit

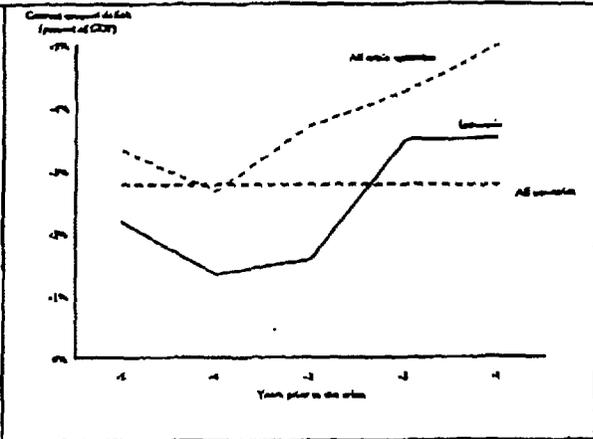


FIGURE 4.5
Real Effective Exchange Rate

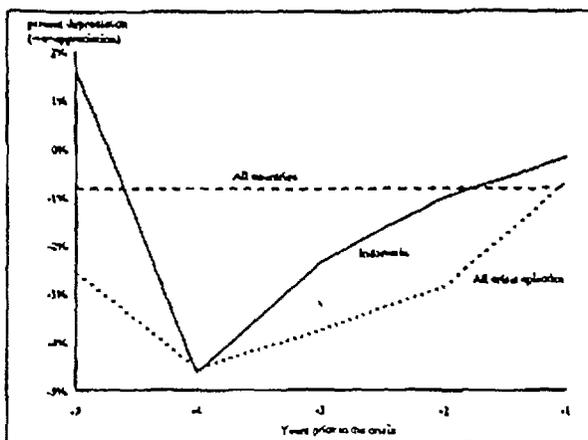
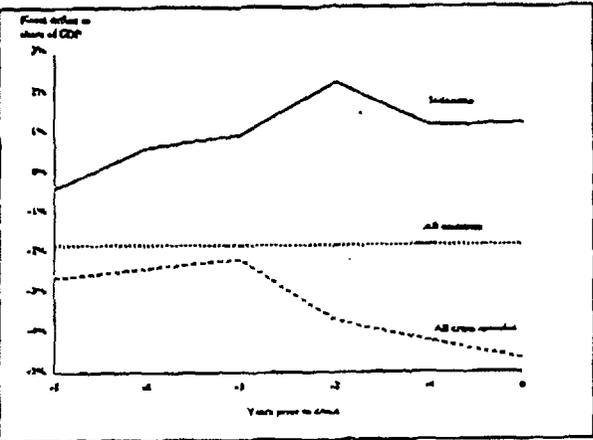


FIGURE 4.6
Fiscal Deficit



Source: World Bank

62

FIGURE 4.7
Indonesian Rupiah In Comparison to Other Currencies
(Index of nominal exchange rates for selected Asian Countries, 07/01/97-06/13/98)

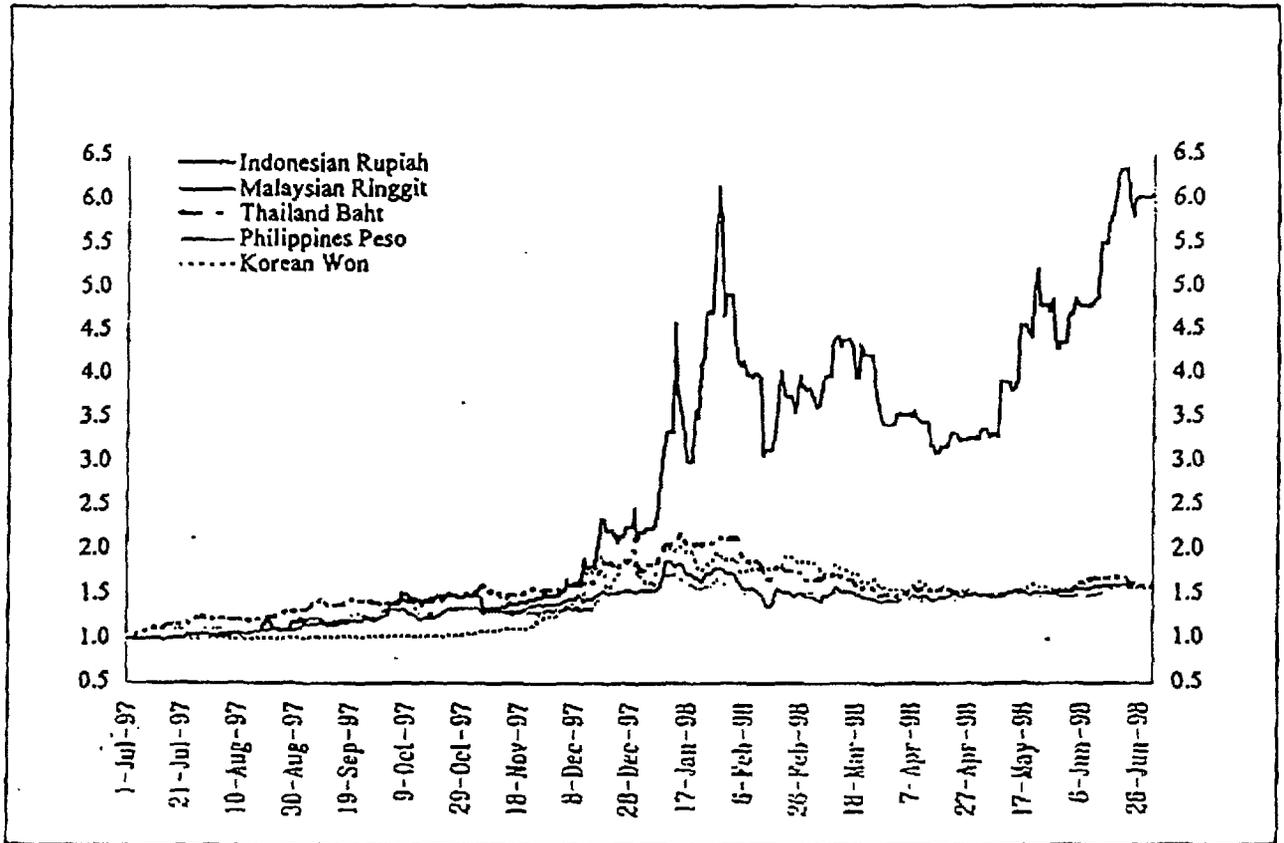


FIGURE 4.8
Increase in Price&CPI
(12 month % Changes in CPI)

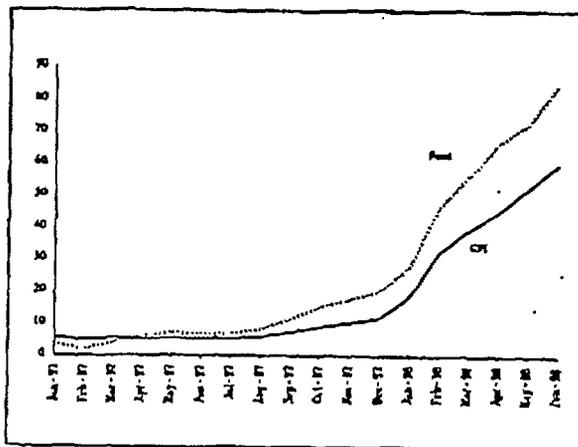
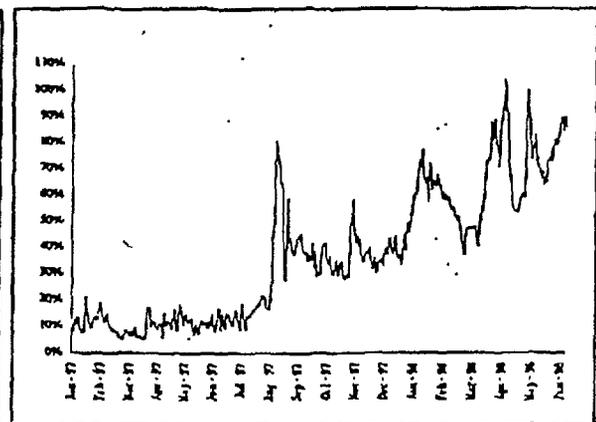
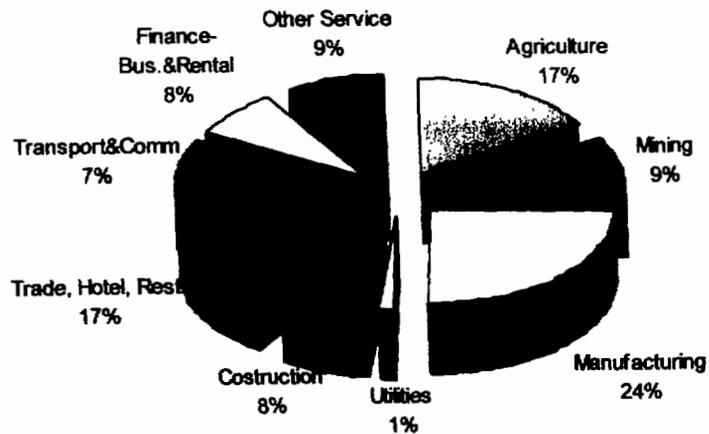


FIGURE 4.9
Interest Rate Hikes
(Overnight Interbank Call rate)



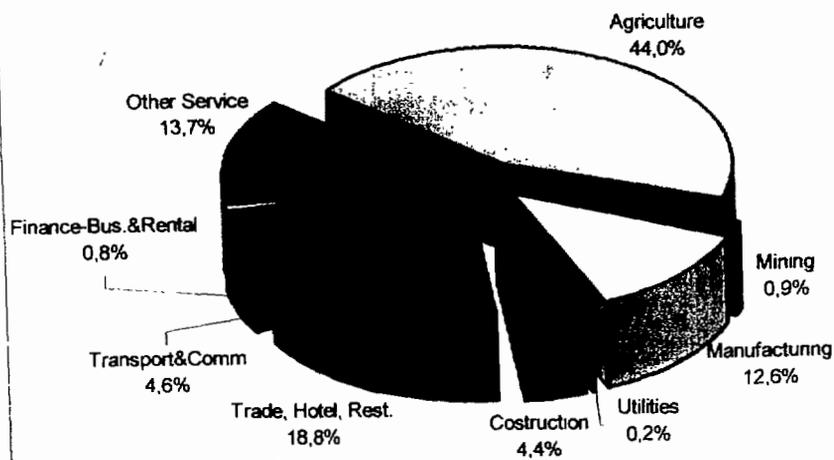
Source: World Bank

FIGURE 4.10
1996 GDP Breakdown for 9 Major Sectors
(Overall GDP for 1996=Rp624.3 Trillions*)



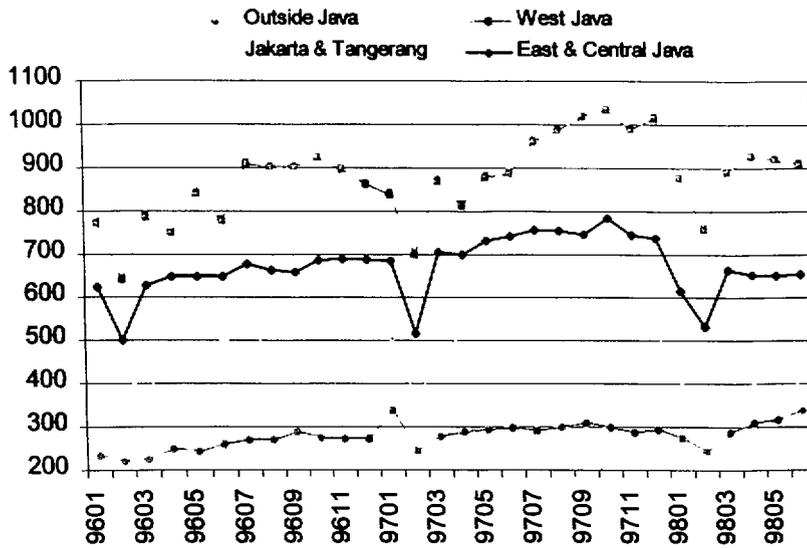
Data from BPS
 *)in current market price

FIGURE 4.11
1996 Sectoral Composition
of Employment



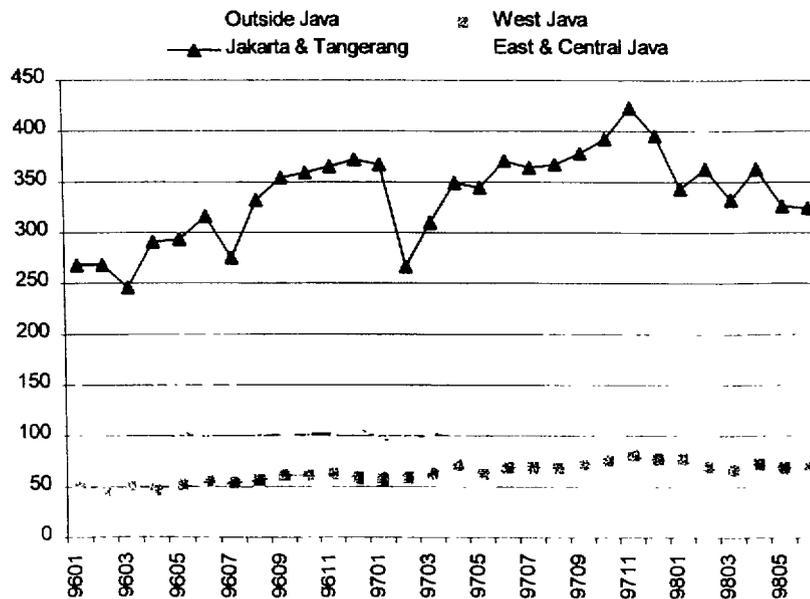
Data from BPS
 Statistical Yearbook 1996

FIGURE 4.13
PLN sales to Industry,
1996-98



Source: USAID

FIGURE 4.14
Commercial Sales of PLN
1996-1998



Source USAID

FIGURE 4.15
Loss of Depositors Confidence over
The Private Banking Sector
 (ratio of deposits in private banks compare
 to in all commercial banks)



FIGURE 4.16
Liquidity Injection
 to Save Banks by GOI
 (in Rp. Trillion)

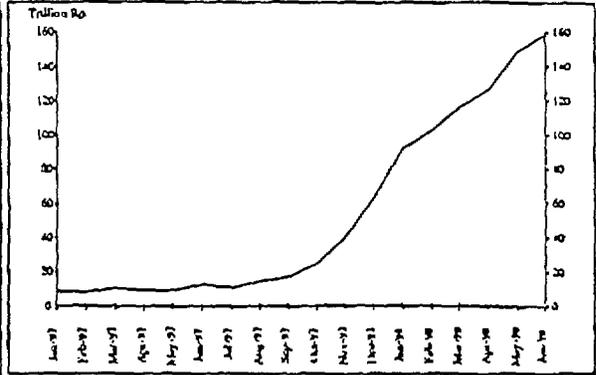
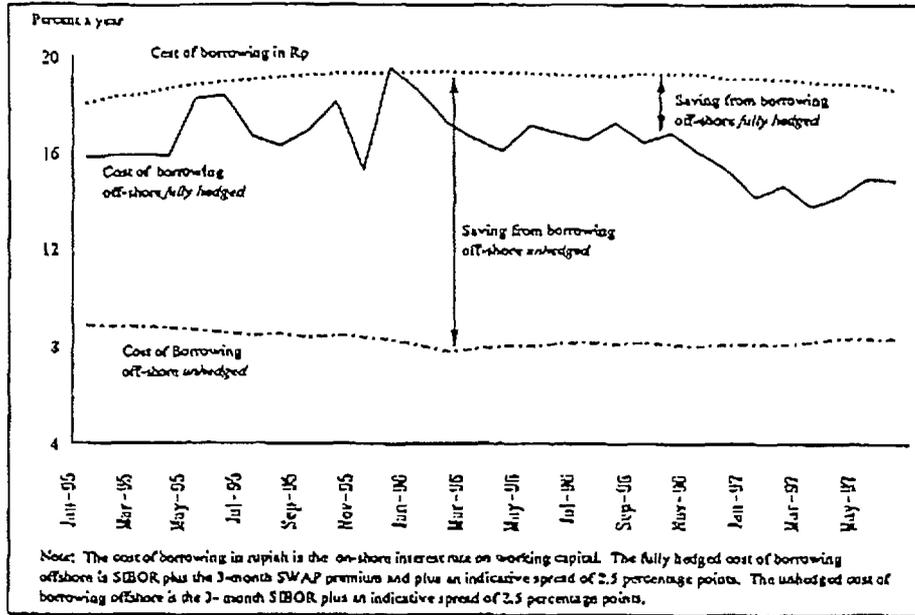
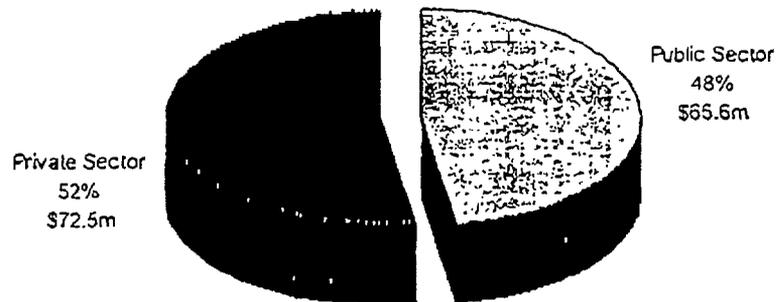


FIGURE 4.18
Spread of Borrowing Abroad Without Hedging with Domestic Borrowing



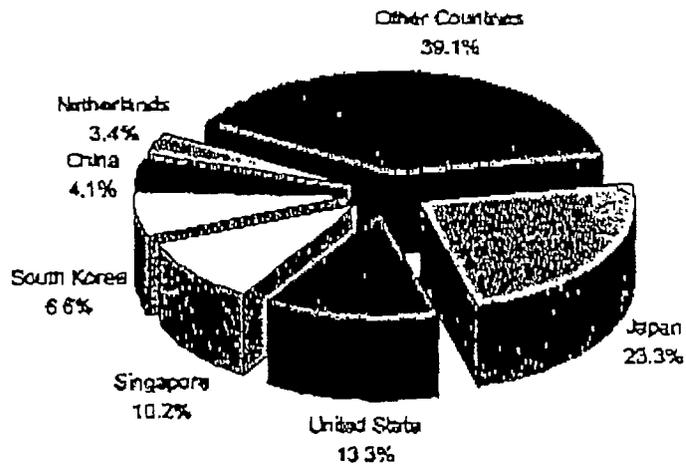
Source: World Bank & Bank Indonesia

FIGURE 4.19
Indonesian External Debt
per March 1998



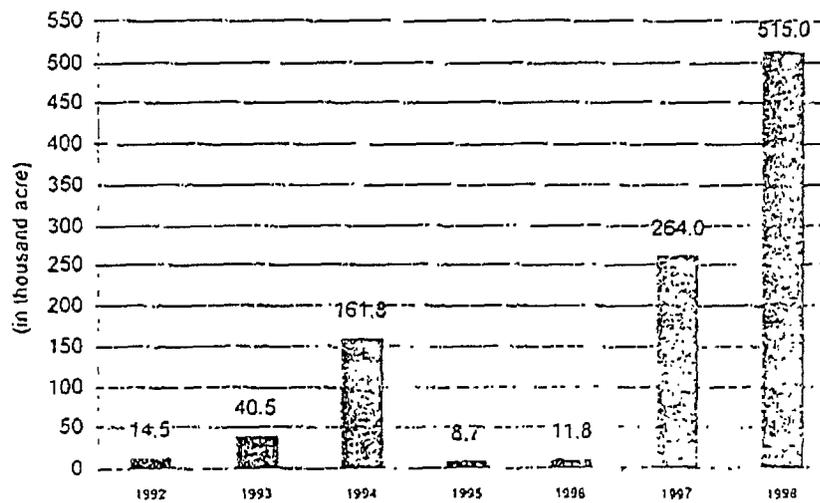
Source: World Bank & Bank Indonesia

FIGURE 4.20
1997 Indonesian Exports Destinations



Source: EIU 3Q98

FIGURE 4.21
Indonesian Forest Fire
1992-1998 (up to Sept)



Source: Forestry Dept.

MPR (Majelis Permusyawaratan Rakyat) – the People’s Consultative Assembly which meets every 5 years to elect a President and Vice-President.

Nahdlatul Ulama (NU) – the largest Muslim organization in Indonesia; counts almost 30 million members who follow a tolerant form of Javanese-oriented Islam

Prabowo, General – son-in-law of former President Suharto and head of the Army Strategic Command Unit (KOSTRAD) until being demoted following the May riots in Jakarta.

PDI (Partai Demokrasi Indonesia) – the Indonesian Democratic Party is one of two officially-sanctioned parties during the Suharto era; now led by Megawati Soekarnoputri

PPP (Partai Persatuan Pembangunan) – the United Development Party is the second officially-sanctioned party during the Suharto era.

Salim Group - the largest business conglomerate in Indonesia owned by Suharto friend Liem Sioe Leong; highly-diversified in all sectors of the economy.

SBSI (Serikat Buruh Seluruh Indonesia) – the All Indonesia Laborers Union led by Mucktar Pahkpanan; an illegal union under Suharto

Soeharto – served as Indonesia’s second President from 1967 until 1998; was the brainchild of the New Order government and the Chairman of Golkar

Walhi (Wahana Lingkungan Hidup) – the largest Environmental NGO in Indonesia.

Wiranto, General – Minister of Defense and head of the Armed Forces.

YLBHI (Yayasan Lembaga Bantuan Hukum Indonesia) – the Indonesian Legal Aid Institute.

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