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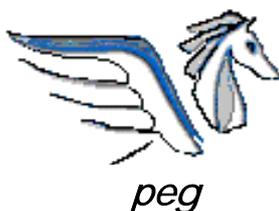
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Workshop Proceedings

THE ECONOMIC COST OF TERRORISM: Indonesia's Response—Moving Forward

**A Workshop Organized by:
Centre for Strategic and International Studies (CSIS)
Partnership for Economic Growth (PEG) Project¹
Economic Law and Improved Procurement Systems (ELIPS) Project¹
United States Agency for International Development (USAID)**

**Wednesday, May 8, 2002
Shangri-La Hotel, Jakarta**



Submitted to:
USAID/ECG, Jakarta, Indonesia

Submitted by:
Nathan/Checchi Joint Venture
Partnership for Economic Growth (PEG)
Project¹
Under USAID Contract #497-C-00-98-00045-00
(Project #497-0357)

May 8, 2002

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WORKSHOP PROCEEDINGS

“THE ECONOMIC COST OF TERRORISM: INDONESIA’S RESPONSE—MOVING FORWARD”

Organized by:

**Centre for Strategic and International Studies (CSIS)
Partnership for Economic Growth (PEG) Project¹
Economic Law and Improved Procurement Systems (ELIPS) Project¹
United States Agency for International Development (USAID)**

**Wednesday, May 8, 2002
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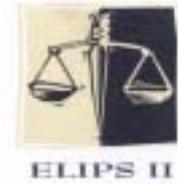
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AGENDA

Workshop on The Economic Cost of Terrorism: Indonesia's Responses

Shangri-La Hotel, Jakarta , Wednesday, 8 May 2002

Time	
08:30 – 09:00	Registration
09:00 – 12:30	<p>MOVING FORWARD</p> <p><i>Domestic Political Stability and Economic Development, 9/11 notwithstanding</i></p> <p style="text-align: center;">Bambang Widiyanto <i>Director, Directorate for Manpower National Development Planning Board</i></p> <p><i>Enhancing Indonesia's Capacity to Analyze Security and Terrorism Issues</i></p> <p style="text-align: center;">Rizal Sukma <i>Director of Studies, CSIS</i></p> <p style="text-align: center;">Neil J. McMullen <i>Partnership for Economic Growth</i></p> <p><i>Rethinking Development Cooperation in Response to Global Terrorism</i></p> <p style="text-align: center;">Robert Klitgaard <i>Dean, Rand Graduate School The Rand Corporation, Santa Monica, USA</i></p> <p>Comments by Panel</p> <p style="text-align: center;">Abdillah Toha <i>Deputy Chairman, National Mandate Party</i></p> <p style="text-align: center;">Raden Pardede <i>Senior Economist, PT Danareksa Sekuritas</i></p> <p style="text-align: center;">Anwar Nasution <i>Senior Deputy Governor, Bank Indonesia</i></p> <p>Chair Djisman Simanjuntak <i>Chair, Board of Trustees, CSIS</i></p> <p style="text-align: center;">12:30 Lunch</p>



WORKSHOP

on

THE ECONOMIC COST OF TERRORISM: INDONESIA'S RESPONSE—MOVING FORWARD

Wednesday, 8 May 2002

Shangri-La Hotel, Jakarta

Domestic Political Stability and Economic Development

Bambang Widianto

Organized by

CENTRE FOR STRATEGIC AND INTERNATIONAL STUDIES

with the support of

USAID

**Domestic Political Stability
and
Economic Development,**

by

Bambang Widianto
National Development Planning Agency

May 8, 2002

Introduction

One of the things that we have all learned in the last few years is the importance of political stability for economic stability and vice versa. There has been a lot of discussion in the literature on the direction of causality, and in this paper I would like to explore the nature of this relationship and the economic and political transformation we are undergoing in Indonesia.

First, let me briefly review the issue of causality including some recent literature on democracy and political stability. However, it is too late for issues of which should come first in Indonesia, we are clearly undergoing both simultaneously now. Finally, let me return to safer ground and explore the significance of our understandings in these areas for economic policy making.

Democracy, Economic Development and Political Stability

There is a great deal of literature on the impact of economic development on political development and specifically democracy. However, when I started looking at the opposite proposition and particular with respect to recent events in Asia, I found far less. For example, Haggard (2000), a political scientist, indicates that political explanations are practically non-existent in economic explanations of the financial crisis. He points out three crisis-related models by economists. First, that the crisis was the result of macroeconomic mismanagement, especially of the exchange rate; Second that it was the result of speculative behavior and herd instinct in newly globalized markets, or Third that it was related to inherently faulty economic institutions especially corporations and banks.² Only this last has a political component and even there it is implicit and second order. I don't want to dwell on the crisis and its causes. Rather I want to make the point that economists may have systematically underestimated the importance of political explanations in economic development, which include the causes and responses to events such as the recent crisis.

Most of the work on politics and economic development is designed to assess the relationship of democracy to economic growth, and vice versa. The stylized fact is that most well-off countries are democracies and most poor countries are authoritarian. Thus one school of thought holds that Democracy is income elastic - the taste for it grows with higher income. The other school holds that the property rights are better guaranteed under democracy and generate more rapid growth. The empirical evidence is still out on these propositions. For example Debraj

² Haggard, Stephen, *The Political Economy of the Asian Financial Crisis*, 2000, pg. 3-7.

Ray in his textbook on Economic Development states that:

“These results [that growth is related to the initial level of income, land inequality and human capital] are unaltered once we allow for structural differences across democratic and non-democratic political systems. ... It does appear that political systems play little role in the relationship.”³

However, there is support for the opposite view as well. The Human Development Report for Indonesia “Towards a new consensus” cites Bhalla (1994) on the positive effective of democracy on growth. Perhaps more important than the empirical result, is Bhalla’s argument “... democratic regimes are more likely to protect property and contract rights which are essential for a well-functioning market economy driven by the private sector.”⁴

However, there is also a slightly different question - the relationship of political stability to economic development.

Political stability and democracy are not the same thing. North Korea may have political stability (at least over a fairly long period) but not democracy. Conversely, many countries, especially in Latin America have, and have had, democracy without political stability. Streb (2001) explores this relationship in “Political Uncertainty and Economic Underdevelopment”.⁵

³ Ray, Debraj, (1998), Development Economics, Princeton, pg 221.

⁴ Bhalla, Surjit (1994), Freedom and Economic Growth: A virtuous Circle. Uppsala University, Sweden

⁵ Streb, Jorge M., 2001, Political Uncertainty and Economic Underdevelopment, Estudios de Economia, Vol.28—No I.

He suggests that there are two elements to political stability. The first relates to the durability of governments - or more accurately regimes - essentially their length of time in office (until there is a new regime), or a change to or from democracy. The second kind of stability relates to the durability of the institutions of government - here there can and are, almost by definition, changes in government. But the overall political situation remains stable.

Underlying this formulation of political stability is political certainty (not stability) and a lack of arbitrariness. With political institutions being defined as the “rules of the game” certainty involves clear rules, rules that persist when governments change. Arbitrariness is defined as the situation where the government operates within a framework of constraints, checks and balances, most particularly checks and balances that affect property rights.

This is an important point so let me quote at length.

“A government limited by the rule of law is not simply the difference between dictatorship and democracy. In a democracy, what is required is a constitutional setup that respects certain basic rights. In the Latin American tradition and elsewhere as well - this constitutional component has been emphasized far less than the popular component.”

The empirical implementation of the length of a regime is relatively straightforward (polity persistence), but a lack of arbitrariness requires a proxy; the “rule of law” a measure from the International Country Risk Guide (ICRG) is designed to capture lack of law

enforcement, non-effective solution of disputes, and disorderly political succession.

The results indicate that the level of income in a country is directly related to the strength of the “rule of law” and to the interaction of the “rule of law” with the durability of the government, that is the time since the last unstable regime change. However the length of regime per se has no independent effect (either positive or negative).⁶ Thus, according to the statistical evidence the level of development, is not in fact helped by regimes that have been around a long time, unless these regimes are associated with an effective rule of law, the second definition of political stability.

Why might this be so? “Over time, both the preferences and the actual workings of the political system become common knowledge. Thus to the extent that there is “the rule of law” and polity persistence, steady state income can be expected to be higher.

More concretely following Mancur Olson (2000) he points out that the difference between development and underdevelopment is the existence (and efficient functioning) of capital markets.⁷ Capital markets are based on trust and trust is difficult in the absence of political stability. Even more concretely, reduced political stability plays out in higher interest rates, since investors with choice must receive a higher return in the face of higher risk.

⁶ Econometrically he includes each term separately, and their interaction. The “rule of law” is significant as is the interaction, polity persistence on its own is not.

⁷ Olson, Mancur, Power and Prosperity, Outgrowing communist and Capitalist Dictatorships, Basic Books, New York, 2000.

A Simultaneous Transition in Indonesia

However, the question of causality in Indonesia may not be the most pressing one at the moment as we are undergoing both an economic and democratic transition simultaneously. There is another literature on this phenomenon, one that suggests just how difficult this can be. In their article Armijo, Biersteker and Lowenthal examine “The Problems of Simultaneous Transitions” (1994).⁸

They suggest that economic reform under emerging democracy (and not political stability) can be difficult for three reasons. First, the adjustment costs are felt immediately and the benefits are in the uncertain future. Second, these costs are unevenly distributed, and some of those hurt may have the ability to derail reforms. Third, potential beneficiaries often do not realize that their situation will improve and therefore do not support the reform as they should.

A problem often arises when a government attempts to maintain its legitimacy while executing economic reform. Often this goes to the budget situation and involves a) increasing spending, b) reallocating spending, or c) ignoring the demands. Obviously each of these has its own consequences either jeopardizing the reforms and economic stability or transferring economic reform pressure to the democratic process.

⁸ Armijo, Leslie Elliott, Biersteker, Thomas, and Lowenthal Abraham, The Problems of Simultaneous Transitions, *Journal of Democracy* Vol. 5, No. 4, 1994.

Lessons for Indonesian Economic Policy Making

The authors of the article on “Transitions” also suggest some lessons for economic policy making during transitions that have been learned over time. These include 1) “fine tuning” economic reforms, that is sequencing them in order to keep the gains as much in line with the costs as possible. 2) Strengthening the “state’s capacity” to execute reforms. It is perhaps paradoxical but stronger bureaucracies appear to be better able to carry out effective reform. 3) Perfecting democratic political institutions. This includes such issues as parliamentary versus presidential states and the design of checks and balances, reflecting an earlier theme. 4) The fourth and final suggestion is that economic policy makers or bureaucrats have to be “policy entrepreneurs”. By this they mean that they have to sell their programs generally and specifically to groups in business and elsewhere.

In sum it seems there will be political uncertainty in Indonesia (and therefore economic uncertainty) for as long as it takes to demonstrate a) that there is an improved rule of law or at least more certainty, and b) that there is polity persistence in the sense that elections are held and governments changed without severe disruption to implicit property rights.

As economists we must also take this lingering, although hopefully declining political instability into consideration as we make policy and the suggestions above are worth developing into more concrete measures. However, let me concentrate on the first and third suggestion as they are most closely related to economic policy makers areas of responsibility.

Indonesia is not beginning either an economic or political adjustment. We are in the middle of both. Thus we start from a position where a great deal of economic structural adjustment (or certainly pain) has already occurred.⁹ The political transition is less far along, but certainly equally in process.

It is clear that rapid and excessive changes in inflation, exchange rates and interest rates weaken investor and general confidence. However, the important question is why these variables are volatile or, as in the case of the exchange rate, reflect such fundamental weaknesses. The answer lies in implicit threats to fiscal sustainability. Why is this so? The inability or unwillingness, for political reasons, to bring revenues and expenditures into a balance sufficient to support growth without recourse to excessive domestic borrowing or money creation threatens the future value of the currency. This value can be either its domestic value, inflation, or its foreign value, the exchange rate, or both. This in turn causes people to avoid the currency resulting in depreciation and inflation. This is the process described above.

Given this importance the government has focused on providing a clear and clearly explained program to achieve fiscal sustainability. This has been perhaps our highest continuous economic priority. To implement this specific budget deficit targets were established, put into the Proenas, (the five year plan) where they were passed into law. These budget deficits have been consistently achieved or bettered. In addition despite being thrown off track due to exchange rate fluctuations, we are again rapidly reducing the debt to GDP ratio, the ultimate criteria for

⁹ Interestingly these transitions did not begin from either an economic or political transition, but have now resulted in both.

fiscal sustainability. [These and other targets for from Repeta FY 2003 are included as Annex Table I.]

This concentration on fiscal sustainability and macroeconomic stabilization has begun to work but it cannot endure unless we follow-up with improved policy, and policy implementation in the real sector.

The real sector areas that I am most familiar with are employment and poverty. Let me turn to employment first. Employment generation, is a, perhaps the, key to longer-term economic and political stability. The policy objective here has to be the goal of putting as many people to work as possible in the best jobs possible. Currently we face a problem generating sufficient jobs, much less good ones. Pre-crisis open unemployment at a consistent definition was close to 4-5%, whereas it is now 6-7%.¹⁰ More importantly from a political stability perspective this growing unemployment is concentrated almost entirely young males and females between 15 and 25.

Thus it is critical that we use scarce political and economic capital to make clear the consequences of the recent rapid increases in minimum wages that increase youth unemployment, and shift jobs from the formal to the informal sector at lower incomes. Other important issues here include policies that raise the cost of hiring semi and unskilled workers. Increased employment has to be the overall objective of policy now that we are moving out of the crisis.¹¹ [See Annex Table 2 for employment

¹⁰ The open unemployment definition used is the standard world definition. Indonesian estimates of unemployment that range much higher are based on those working less than 25 hours a week. Many of these, especially in rural areas choose to work less hours, so these higher unemployment rates are not consistent with unemployment rates in other countries. This is not to say that those working have “good jobs”, working in a warung for 60 hours a week is a job, but not a good job.

¹¹ A study by SMERU done for Bappenas indicates that the approximate 30% increase in minimum

related statistics.]

Let me close with a look at real sector policy affecting poverty another area critical for political stability. Again the crisis left a legacy of reduced real incomes and higher poverty. Further, and this may be more important for political stability, many more are near-poor with a high risk of falling into poverty if the economic recovery falters. Poverty or near poverty raises uncertainty and reduces aspirations for the future. This in turn reduces the payoffs to household investments in health and education which risks prolonging the crisis and lowering future growth. Appropriate policy tuning here needs to be oriented toward creating jobs and including the issues I touched above. However, a broader approach to eliminating poverty and improve political stability in the short and longer run is needed. Thus our objective is to develop an approach to mainstreaming poverty reduction. We hope to begin a process whereby budget programs are assessed with respect to their impact on poverty. But most of the gains will have to be made by the private sector, and we also need to review policies in agriculture, industry and trade to make sure that poverty reduction and employment creation are important, perhaps overriding objectives for policy makers. Making and documenting significant reductions in employment, gains in income and moving out of poverty is critical to maintaining political legitimacy and economic momentum. [See Annex Table 3 for poverty related statistics.]

wages in 2002 would have resulted in a loss of almost 600,000 formal sector jobs. SMERU, Wage and Employment Effects and Minimum Wage Policy in the Indonesian Urban Labor Market, October 2001

Conclusion

Let me return now to the theme of the overall conference - the impact of terrorism. Perhaps we cannot directly relate good economic or political policy and/or stability to terrorism. However, it is likely that people, especially vulnerable young people in urban areas with good jobs and political rights are less likely to be interested in joining groups advocating violence and terror. Further, with a real effort on the part of the government (and society) to deal with poverty, our young people employed or not will have less motivation to join these groups.

The key to economic policy at this point is to reinforce growing macro stability with effective and wide reaching real sector reforms. Every year Indonesia sees more than 2 million plus new entrants to the labor force, many of them less than adequately educated for the job market today much less tomorrow. To avoid them joining the ranks of the unemployed we have to examine policies and budgets in every area with an eye to employment generation and poverty reduction. It is undoubtedly true that there are costs to continuing economic reform, but the costs of not reforming are even higher.

Table 1
Key Macroeconomic Indicators
Repeta 2003

Indicator	Realization		Projection			
	2000	2001	2002	2003	2004	2005
Inflation, CPI	9.4	12.6	9-10	8-10	7-9	6-8
Nominal exchange rate (Rp./US\$)	8,438	10,255	9.000-10.000	9.000-10.000	8.750-9.750	8.500-9.500
Change in real exchange rate (%) ¹⁾						
Year	5.5	9.6	-14.1	-6.4	-8.0	-7.2
Over 1996/97	67.8	83.9	58.0	47.9	36.0	26.1
Economic Growth %	4.9	3.3	3,5-4,5	4,5-5,5	5,0-6,0	5,5-6,5
GDP per capita						
Nominal (US\$) ²⁾	756	704	863	979	1,142	1,331
Constant price 1998 (thsnd Rp.)	4,967	5,058	5,186	5,370	5,588	5,843
Open Unemployment (%) ³⁾	6.1	8.1	8.8	9.1	9.1	8.6
Balance of Payments						
Current account/GDP (%)	5.3	4.5	2.4	1.4	0.6	-0.1
Export growth Non oil & gas (%)	22.8	-10.8	5.9	7.1	8.3	9.4
Import growth Non oil & gas (%)	29.1	-14.5	7.8	10.4	11.3	12.1
Reserves (US\$ billions)	29.4	28.0	28.7	29.4	29.8	30.0
State Finances ⁴⁾						
Surplus/Deficit APBN/GDP (%) ⁵⁾	-3.2	-3.7	-2.5	-0.4	2.5	3.4
Estimate taxes/GDP (%) ⁵⁾	11.8	12.5	13	14.4	15.7	16.3
Government Debt Stock/GDP (%)	103.3	93.3	76.7	66.8	54.3	42.6
Foreign Debt	49.3	49.1	39.8	35.0	28.3	22.6
Domestic Debt	54.0	44.2	36.9	31.7	25.9	20.0
Economic Growth Production %						
Farming	1.7	0.6	0.9	1.8	2.1	2.3
Manufacturing	6.1	4.3	5.2	6.5	7.2	8.1
Non oil & gas	7.2	5.2	5.7	7.0	7.8	8.7
Others	5.3	3.6	4.3	5.2	5.6	5.9
Investment & source of funds (%)						
(Ratio to GNP)						
Total Investment (incl. chg in stock)	15.7	17.7	19.5	20.8	22.5	23.2
Government	4.6	3.9	4.6	4.8	5.0	4.9
Private	11.2	13.8	14.9	16.1	17.5	18.3
Total Savings	15.7	17.7	19.5	20.8	22.5	23.2
National Savings	19.4	22.5	21.9	22.2	23.1	23.1
Government	0.4	1.8	2.0	4.8	8.1	8.3
Private	19.0	20.7	19.8	17.5	15.0	14.8
Foreign Savings	-3.7	-4.8	-2.4	-1.4	-0.6	0.1

¹⁾ Positive numbers are depreciation and negative appreciation

²⁾ 2000 and 2001 based on BPS realization data calculate at an average exchange rate

³⁾ In 2001 BPS changed the definition of open unemployment

⁴⁾ 1999 is fiscal year 1999/2000 (April 1, 1999 to March 31, 2000), 2000 is April 1, 2000 to December 31, 2000. Subsequent fiscal years are the same as calendar years.

⁵⁾ For 2000 realization April 1st to December 31, 2000. Year 2001 is for APBN-revised – Year 2002 is the APBN for 2002

Table 2
Economic Growth and Unemployment

Period	Economic Growth (%)	Additional Jobs (Million)	New Employment (Million)	Unemployment	
				Million	(%)
1996	7.82	3.79	3.96	4.3	4.86
1999	0.85	1.14	2.11	6	6.26
2000	4.77	1.00	0.94	5.8	6.07
2001	3.32	0.97	3.16	8	8.10
2002	4.00	1.22	2.10	8.86	8.78
2003	5.00	1.56	2.10	9.38	9.11
2004	5.50	1.94	2.10	9.54	9.08
2005	6.00	2.37	2.10	9.27	8.65

Remarks: 1996, 1999 and 2000 used the number from SAKERNAS (BPS). 2000 excludes Maluku Province. 2001 uses the number of SAKERNAS by using the updated definition of unemployment, and this includes Maluku Province.

2002 – 2005 uses the BAPPENAS projection assumptions, and assumes the updated definition of unemployment and includes Maluku Province.

Table 3
Poverty
History and Projections

<i>Years</i>	<i>Number of Poor (million)</i>				
	<i>Urban</i>	<i>Rural</i>	<i>Urban + Rural</i>		
<i>1996</i> *)	7.2	15.3	22.5	(11,3%)	
	<i>11.5</i>	<i>26.5</i>	<i>38.0</i>	<i>(19,2%)</i>	
<i>Des. 1998</i> *)	12.3	21.9	34.2	(16,7%)	
	<i>17.6</i>	<i>31.9</i>	<i>49.5</i>	<i>(24,2%)</i>	
<i>Feb. 1999</i> *)	14.3	27.3	41.6	(20,3%)	
	<i>19.3</i>	<i>36.8</i>	<i>56.1</i>	<i>(27,4%)</i>	
<i>Agt. 1999</i> *)	7.5	15.8	23.3	(11,3%)	
	<i>13.1</i>	<i>24.9</i>	<i>38.0</i>	<i>(18,4%)</i>	
2000	12.5	20.8	33.3	(15,8%)	
2001	11.9	20.0	31.9	(15,0%)	
2002	11.9	19.8	31.7	(14,6%)	
2003	11.9	19.5	31.4	(14,3%)	
2004	12.3	18.7	31.0	(14,0%)	
2005	12.4	17.1	29.6	(13,1%)	

Note :

*) *Numbers without italics are published BPS numbers. Numbers with italics have been calculated subsequently and are consistent with the current definition.*

PANEL PRESENTATIONS & COMMENTS

WORKSHOP

“THE ECONOMIC COST OF TERRORISM: INDONESIA’S RESPONSES”

Organized by:

**Centre for Strategic and International Studies (CSIS)
Partnership for Economic Growth (PEG) Project
Economic Law and Improved Procurement Systems (ELIPS) Project
United States Agency for International Development (USAID)**

**Wednesday, May 8, 2002
Shangri-La Hotel, Jakarta**

MOVING FORWARD

CHAIR: Dr. Djisman Simanjuntak

At 09:00 AM, Dr. Simanjuntak commences the session by thanking all participants and especially speakers and commentators to this workshop. Furthermore, he outlines the background to this workshop, specifically on the issue being addressed today. First, the possible economic policy design that the government can adopt in its attempts to fight terrorism. Second, capacity building. In Indonesia, security was largely seen as an exclusive business of the military, and capacity building among civilian is another crucial issue. Third, as the 9/11 event has fundamentally changed the development policy-design everywhere. Thus, it is expected that discussion today will also touch upon this particular issue.

Speakers

- **DOMESTIC POLITICAL STABILITY AND ECONOMIC DEVELOPMENT, 9/11 NOTWITHSTANDING**
- *Bambang Widianto*

He thanks the organiser for inviting him to this workshop. He kicks off the presentation by sharing his strong conviction that democratisation and economic reform have to go along together and reinforcing each other. Yet, it must be acknowledged that these two issues have been seen differently by different people

with different background. He further describes in brief various perspectives on these two issues, namely the libertarian, and modernisation theorists.

For those who view those two issues as incompatible toward each other, they believe that the two can be mutually reinforced in developed country, but not in developing countries. He presents some of the arguments to support his view, with regards to people's freedom and guarantee from the system to competitive and capable players in the market.

Furthermore, he also mentions about the transitional incompatibility of these two concepts, as adjustment cost pinches immediately, benefits lags, adjustment costs tend to be unevenly distributed, and there is a potential or even probable beneficiary of reform that is unlikely to realise the benefits.

The question then, what to do? Indonesians tend to favour incremental solutions to the transitional incompatibility problems and recommendations as follows:

1. Fine tuning the economic design of the rest reforms. There are a lot of sectors need to be reformed better i.e. energy subsidy.
2. Strengthening the state capacity
3. Perfecting democratic political institutions
4. Spurring economic policy makers or bureaucrats to become policy entrepreneurs.

In that regard, he also describes the plan as put in the REPETA (it is a yearly development planning). From the table provided, he mentions that Indonesia's growth rate until the year 2005, can only reach to 5-6%. Thus, we would never come back to the pre-crisis level of growth. Another thing closely relates to political stability unemployment issues. Labour inception to the labour market is relatively small, but the trend is increasing. This implies a call that if government wants some stability, government should create jobs.

Another important issue raised in his presentation is poverty. Of course, he reminds there is problem in defining poverty as measurements of poverty itself are varied. However, regardless any basic definition of poverty and its measurements, he still believes that within the next ten years, Indonesia cannot return back to the pre-crisis poverty level. In fact, there are a lot of issues in labour that the government needs to address:

1. Growing Unemployment
2. Uncertainty in labour policies which creates industrial strife and affects investors perceptions. Among the core problems are: lack of experience of trade union, and a growing trend toward multiple unions. As a result, collective bargaining is not clear as yet, and also conflict resolution is hardly to be formulated, especially the policy that can resolve labour disputes. Yet, we also should remember that there is unlimited supply of labour where 65% of labour force working in informal sectors.

Finally, he reiterates that Indonesia should redesign better reforms in the future. Yet, some questions remain to be seen, indeed.

Dr. Djisman Simanjuntak: He reminds that we need to get back to high growth. The question then is how Indonesia can return to the market. As he further notes, materialising the growth requires strong efforts in building the capacity. Henceforth, the main problem is that we never dare to reform boldly. We tend to take an intermediate way between state and the market. His conviction is clear that the key to a return to high growth path is confidence, where confidence requires stability and firm security in its widest scope. To do so, recovery program is badly needed.

- **ENHANCING INDONESIA'S CAPACITY TO ANALYSE SECURITY AND TERRORISM ISSUES**

- **Rizal Sukma**

He tries to look at the broader term of security and capacity building. He believes that current capacity of Indonesian authority to deal with terrorism in particular is relatively weak. Many cases of terrorism remain concealed and unsolved. In particular, such a conviction is clearly reflected in the incapacity of the police to curb the accused perpetrators of terrorism. Consequently, Indonesia is not able to hinder criticism from international community.

Why is it happened then? He begins his analysis by mentioning Indonesia's complacency in dealing with (internal) security as a legacy since 1980s when Indonesia was under military might of the New Order. Yet, after the fall of Suharto, the military and police have been suffered from deteriorating image because of human rights problems and abuses in the past. Terrorism issue is not at the government's high agenda because the government is still overwhelmed by other more pressing domestic issues. Another reason is perhaps due to the ongoing reorganisation of security authority as to which institutions should be responsible in handling security issues. There is a lack of understanding on the nature of security. Finally, the sensitivity of the issue contributes to our inability or incapacity to deal with the issue of terrorism as has been demonstrated in the arrest of Laskar Jihad's leaders, Ja'far Umar Thalib.

Furthermore, he also notes that the complexity of problem itself had undermined the government and security credibility of Indonesian, including the international image of Indonesia. Yet, he acknowledges some improvements or things that need to be addressed immediately in order to improve our capacity in tackling the issue of terrorism and security in general.

First, in terms of actors involved in security issues. Civilian is now being involved actively in the issue. Military domination in the past had caused serious problems to the civilian capacity in understanding, analysing and contributing to the fighting terrorism. Second, is the institutional improvement, like governance. Third, the establishment of a counter terrorism office and incorporate it to the overall program of combating terrorism. Legal improvement is also another important aspect that needs to be remedied. At this point, in terms of intelligence, among the things that need to be improved are the improvements of HUMINT, and SIGINT. Training the officers would serve as the best way to that endeavour. Fourth, the role of the military should be maintained in a better way. Yet, we need to specify the role the military can play in anti-terrorist campaign. Yet, civilian control should not be overlooked. Fifth, there

should be a national planning and co-ordination in fighting terrorism. Sixth, research and development. Research on the issues of terrorism should be nurtured and promoted in order to improve capacity. Another related issue is establishing the data bank and link of terrorism, which can be used for improving the capacity. More training for officers is needed. International co-operation and support is important. Indonesia should have more access to information sharing, training, and so forth. But it requires seriousness, especially at the regional level.

- **Neil J. McMullen**

The first area he touches upon is Indonesia's capacity to fight terrorism. He outlines the background and changes posed by the new post-cold war international system. Implication of terrorism on the system is indeed widening complexity of security problem, and as a consequence, more sophisticated means to tackle security is needed.

Apart from the issue of implication, he raises a more or less important one, which is what the donor community might do in this current exercise? Moreover, what kind of specific issue that needs to be addressed in discussing the improvement of state to fight terrorism.

At this point, he believes that the pressing challenge is to look at related questions around terrorism, including its impacts on policy. Another fundamental dimension that needs to be looked at is on the institutional implications as to what kind of institutional setting is needed in order to combat terrorism.

First, donors would like to help the improvement human resources, including the capacity and capability of individuals and government in tackling the issues. It certainly implies a long-term interest and strategic need. In that regard, education is seen as one of the most important points that need to be promoted.

Second, donors are interested in strengthening the regular network and co-operation, and also in establishing security-based institutes in various universities.

Another related issue that also needs to be addressed is to what extent alleviating poverty can hinder the acts of violence? What are the roots of violence?

In addition to that, McMullen is convinced that civic institutions need to be continuously supported, including a more emphasis on the conflict resolution. Competition on the non-violence way should be clearly defined.

As to the use of legitimate violence, measures and transparency/accountability of authority is immediately needed, including the development of operation procedures, while bearing in mind the primacy of civilian supremacy and good civil military relations. Another important point is the proportion of budget to security, not only between the military services, but also between functions.

On the economic front, in terms of returning back to the high growth track, contract enforcement is crucial to restore the confidence and continued presence of investors. In that sense, rule of laws is the way to proceed with this agenda. Second area that

desperately needs attention is stabilising the financial sector. Moral hazard is the predominant issue that aggravates the overall financial stabilising attempts.

Dr. Simanjuntak: He reminds that Indonesia has been thrown away from middle income country to middle-low income country. The problem is that Indonesia fails to allocate adequate resource in building its human resources. In the years to come, Indonesia is facing serious fiscal problems that can only complicate the overall harsh period.

- **RETHINKING DEVELOPMENT COOPERATION IN RESPONSE TO GLOBAL TERRORISM**

- *Robert Klitgaard*

He thanks the organiser and participants, including the Asia Foundation for supporting his attendance to this workshop. He uses an interesting imagery description of the year 2007 as a basis to review the development in the year 2002. In his view, donors are now believed to be more concerned with the issue of failed states: on guarding the borders, issue of bad governance, and terrorism/nest for terrorism. Donors are now concerned with issue of good governance, but the issue itself is a difficult one. Foreign aid at this point becomes one important issue because it can be used as a good means or to do bad things. Many questions are now related with who should be the recipients, level of effectiveness. Foreign aid fails when the government is bad, but if it is good, they no longer need aid. This is the dilemma of aids that countries are facing in the year 2002.

Then, how could international action lead to a better condition? New focal points of aid need to be put on the table. New international mechanism to monitor performance should immediately be installed and widely introduced.

This implies some of the challenges to the centre and research institutes. We don't have yet a coalescence of indicators or measures to good governance. Is good governance different in different places? There are two possible questions: Why and should they be different?

Comparison on performance of good governance should not only be alluded to an inter-country/inter-temporal comparison but also a comparison within the ministries. Three ways to measures this conduct of good governance: from public opinion; peer-reviews from other colleagues within bureaucracy; and the level of achievement such as improvements in revenues etc.

In determining aid, we should not look at the threshold only, but on the changes that take place in a country, and the country's policy to improve its governance. Foreign aid challenges of post-9/11, is a good news for recipients, but whether or not—and how—donors can tie it up with a strong demand for good governance remain to be seen. Of course legal problems that aggravate the corrupt system is another key stone in winning the problem.

COMMENTS

- **Abdillah Toha**

Comments will be limited to challenges posed by terrorism in relation with foreign aid. In the future, foreign aid should directly be given to the society, and not the government. In his views, he sees that terrorism is definitely not a result from a single cause like poverty, but many others, both internally and externally. Yet if we assume that economic factor such as poverty is the primary cause, the perpetrators of terrorism are normally not poor and uneducated people. Nevertheless, at this point, he believes that globalisation does matter, which not only has made some people in few parts of the world getting richer, but also creates a wider gap between the poor and the rich within and across countries.

From the view of donor countries, it needs to be questioned whether or not rich donor countries have been giving enough? Data shows that it merely rhetoric, because rich countries fail to deliver its aid promise, but rather spending much of its GDP proportion to defence sector. Budget for defence is sometimes reach 37 times higher than budget for international aid. Even in many cases show that a large of aid proportion is allocated for security and military sectors. In fact, foreign aid should be allocated to alleviate the poor people, but it was and is not the case as many proposals for a new Marshall plan is bluntly rejected.

The aid budget over the last 15 years had fallen in terms of real value. Definitely, aid is not a charity but the self-interest of donor country. In the light of terrorism, there is a growing militarization of aid, and aid tends to be seen as part of security budget.

Does aid benefit donor countries? The answer is yes, but not fully. It is reported that 80% of USAID budget return back to US consultants, contractors, and US people. The laws in the US pertaining with foreign aid allow the US consultant to have higher benefits and tariffs.

In conclusion, if rich countries are willing to make their aid more effective, then more aid should be allocated proportional to their GDP. Aid should be channelled more to the society than to government. Donor countries should give guarantee to the investors in order to attract the return of investors to a country. Media is also another important component in relation with terrorism.

- **Raden Pardede**

Political stability does not necessary benefit the economic development. The last path of development clearly showed that without the presence of political stability, development could still be undertaken. Political dynamics, in that regard, can also receive benefits from economic development. He believes that in the case of transitional Indonesia, democracy guarantees property rights in a better way. In his sense, political stability and democracy are two different kinds of thing, and political

stability should not be only confined or juxtaposed with democracy. For him, from the economic point of view, job creation is the most and more important issue than growth itself. But, unfortunately, in Indonesia, job creation remains worrisome. The reason for this argument is income issue and without income, dignity is eroded, and may easily lead to unrest.

In his assessment, he believes that current stability is a result of good relations between president and military, or people are tired already with continuous instability, or perhaps because the government is more able to deal with conflict, and finally less attention or pressures given on human rights. Post-911 had changed the whole notion of human rights. He also shares that economic mood of the country, both seen from macro fundamentals or investors point of views, has started to bounce back.

The last legitimate question that remains to be seen is whether current stability can be maintained in the longer run, especially as Indonesian is entering the critical year of 2004. Indonesia is still not in a bright mood, as it still facing some precarious problems such as corporate reforms and political uncertainty. Last but not least, legal problems can still be serious challenges to the overall stability.

- **Anwar Nasution**

He agrees that improving governance is the only way for Indonesia to enter market, in terms of production, capital, and assistance. Analogously using the Ten Commandments, he believes that authority has a role in preventing people from “cheating and lying.” Furthermore, he is convinced that investment is the key to the return of high rate of growth of the past (25% of GDP). Production capacity should also be maintained and increased.

So far, he firmly informs that Indonesia is still fully compliant with the concerted efforts to fight terrorism, and its manifestation. Being a member of the UN, this has been at the fullest attention of government. As a result, due to know-your-customer rules of the thumb, Indonesia has been using the aid it receives to build and strengthen the institutional capacity of the country.

What does Indonesia need then? In his view, Indonesia first needs some assistance in harmonising several legal definitions of terrorism. Second, Indonesia also needs co-operation on the information exchange related with the suspicious transactions including the person, institution and way of operation. Third, Indonesia needs co-operation for the investigation, prosecution and extradition of those committed suspicious transactions. Lastly, the country also needs co-operation in international assistance for capacity building to implement international agreements, to socialise the laws, and to implement the laws itself, including training the persons in charge to this exercise. We need also sophisticated equipment to track the suspicious transactions.

QUESTIONS AND ANSWERS

QUESTIONS I

Q.1. Hadi Soesastro

The issue is governance and what people think about it. It is widely perceived that it is extremely difficult to improve the governance. Then, how to transmit a wake up call to the issue of governance by making government irrelevant?

Q. 2. Mrs. Sunarjati Hartono

It is impossible to ignore government. She believes that economic crisis is a result of our ignorance toward the government. She then alludes to the importance of several institutions, established by the government to channel the issue of governance, most notably the Ombudsman Commission.

Q. 3. Mr. Hasjim Djalal

He agrees on the importance of good governance. He agrees with Rizal that we need a mechanism to fight terrorism, especially on the division of labour among various security authorities. But the question is that when we establish a new body to deal with terrorism, and this should not be a co-ordinating body!

What are the implications of fighting terrorism on other pressing areas such as human rights, freedom of the press and so forth? Would it be acceptable to the people if fighting terrorism obstructing individual freedom? While US concerned about international terrorism, and Indonesia is busy combating domestic terrorism, how can we reconcile the two approaches?

ANSWERS I

Mr. Klitgaard

Boldness is difficult for government, but Indonesia has been proceeding with some bold measures such as decentralisation. In fact, Indonesian has to think in a visionary way in shaping what the Indonesian scene would look like in the future.

Mr. Sukma

We should not sacrifice democracy for the sake of terrorism. Yet, the problem is that we haven't been able to differentiate the concept of democracy and lawlessness. Sometimes, the issue of human rights is used to cover up the authority's inability in dealing with the use of violence by public —let alone terrorism. Another problem is the issue of selectivity and double standard in picking up which human right issues that need to be advocated. Furthermore, he believes that separatist movements should not always be conjugated with terrorist groups. It can be said so by looking at the target of action. If the non-belligerent/civilian becomes target, then, the accusation is valid.

Mr. Abdillah Toha

It is very difficult to make the government irrelevant based on tax concerns etc. He agrees that one way to avoid corruption is to minimise the role of government, thus, preventing them from intervening to the private sector too deeply.

Actually, he believes that Indonesia has enough legal foundation and instruments to enforce law for stabilising action by the authority, but the problems are lack of political will, and consistency.

Resorting to reducing civil liberties in regard with anti-terrorist campaigns, one of the concerns is actually the return of relations between military and the US for instance. Also assurance has been given that the US will not resume aid for military until reforms are finished, yet, reforms implies two ways, informal and formal. We have to be very careful in looking at this point.

Mr. Widianto

He describes that low wage of officials, and approvals to conduct moonlighting are among the driving forces in the issue of corruption within government bodies. He agrees that labour disputes should be resolved within the workers and employers forum. Yet, we must be careful as to whether or not the employers can act fairly. Inconsistency within leadership is also another element of concern for bureaucrats.

Mr. McMullen

To fight corruption should not be aimed at a total eradication of and zero corruption, but preventing predictable or at least keeping corruption within acceptable amount of operation. It is basically getting a system where corruption is not the main obstacle to development, and respect for contract. There are stationary and roving bandits. Suharto is stationary, because he wants the economy to be benefited while roving is a hit and run bandit or corrupters. The latter is more dangerous.

QUESTIONS II

Q. 4. Mr. Hartomo Reksodiputro

How to uphold the laws?

Q. 5. William James

Middle road is needed in order to avoid negative impacts of reducing government's involvement in dealing with inter-economies transaction, especially in the area of custom in the border, which may destabilise the border areas.

Q.6. Wisber Luis

What was the reason for the success of good governance?

ANSWERS II

Mr. Thoha

While agreeing with James, he believes that governance should be channelled through private actors. He still believes that Indonesia has enough good, talented and honest people who is unused by the government. He also thinks that if government's officials receive more salary it may reduce corruption but no guarantee to total eradication.

Mr. Klitgaard

Incentive does matter. People in government, like anyone else, also react to incentive. The real question would be how we can proceed with all anti-corruption programs, and not think on how to increase salary overnight. Honour is also another important factor aside from incentive, as some people within the governments are driven by honour in serving their countries. Thus, we should challenge their honour.

Mr. Pardede

The question of how to reinvigorate the government is more important than putting them aside. Yet, governance issue is not only within the government, but also NGOs. Ethics, at this point, remains unclear, as it is not in place yet.

CONCLUSION

Mr. Simandjuntak concludes that it is extremely difficult to couple with the issues. Another important point is that the role of government should be limited to a certain level. New ways of governance are needed. We need champion more than good planning and commitment. Yet, champions should be organised, and this is where political parties and NGOs can play a significant role. Nevertheless, life must continue, as we have to survive the wave of globalisation. At the end, he thanks participants and speakers, and adjourns the session at 12:30.