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INDONESIA: CONFRONTING THE POLITICAL AND ECONOMIC CRISES

Wednesday, February 16, 2000

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON ASIA AND THE PACIFIC,
COMMITTEE ON INTERNATIONAL RELATIONS,
Washington, D.C.

The Subcommittee met, pursuant to notice, at 10 a.m., in room 2200, Rayburn House Office Building, Hon. Doug Bereuter (Chairman of the Subcommittee) presiding.

Chairman BEREUTER. [presiding] The Subcommittee will come to order. We will proceed, at least initially, without Mr. Lantos, our Ranking Member, with the approval of the staff.

The Subcommittee on Asia and the Pacific meets today in open session to receive testimony on the ongoing transition to democracy in Indonesia, and the prospects for achieving political and economic stability and maintaining national unity in that country.

When the Subcommittee last held hearings on Indonesia, on September 9, 1999, we were faced with a crisis situation in East Timor as military-sponsored militia were systematically killing, looting, burning, and destroying the country. Attention was naturally focused on that crisis situation. At the same time, Indonesia was preparing for historic democratic elections which, against considerable odds, were conducted in a free and fair manner. They then had to select a new president and vice president, which resulted in the establishment of the first democratically-elected government in that country in many decades.

Last week, the Subcommittee held a hearing on East Timor which they discussed the situation and prospects for that newly emerging country. Today, I emphasize for Members of the Subcommittee, and I will emphasize it again if necessary, it is my intent that we focus our attention on the serious political and economic crisis facing Indonesia as it struggles to institutionalize a new democratic and decentralized system of government. Members had their chance to speak on East Timor last week. We want to focus this time on Indonesia.

Undoubtedly, this is a critical juncture in history for Indonesia, and the stakes are high for it and for the entire region. Indonesia is both the fourth most populous nation in the world and the country with the largest population of followers of the Muslim faith. It is a country of stunning geographic and ethnic diversity, occupying an archipelago stretching over an area wider than the continental United States. In fact, I think it is the most complicated country on Earth.

Moreover, Indonesia is key to the entire Southeast Asia region. It was the original founder of ASEAN, the Association of Southeast Asian Nations, and has emerged as a natural leader in that organization's emergence as an important contributor to stability and economic progress in that part of the world.

Finally, Indonesia has been a good friend and important trading partner of the United States. I believe that most surely it is in America's national security interest to help Indonesia achieve the economic and political reforms necessary to ensure future stability and prosperity.

However, the situation in Indonesia remains troubling. The consequences of further economic and political collapse would be extremely serious and would adversely impact regional stability and U.S. national security. Necessary and painful economic reforms Indonesia must undertake would be daunting even for a well-established democracy. Indonesia must boldly undertake this action while at the same time, with the most minimal experience, undertake massive political reform.

To date, I believe that President Wahid has made a promising beginning in guiding Indonesia during this difficult transition and in dealing with the myriad problems facing the country. He has taken appropriate steps to help end the violence in Timor and exceeded to the majority will of the people of East Timor to become independent. He has given priority to resolving regional conflicts and opened the dialogue with disaffected groups in such regions as Aceh and Irian Jaya. He has moved to reestablish the rule of law, undertaken judicial reform, established a commission to investigate serious human rights violations, and indicated that those found responsible will be held accountable.

In this context, former armed forces chief General Wiranto has removed from his position in the cabinet as Coordinating Minister for Politics and Security on February 14, 2000, after being found importantly culpable for the mayhem in East Timor by the Indonesian commission which investigated that catastrophe.

This assertion of civilian control over the military, I believe, is a welcome and historic step. President Wahid has also begun to take important steps to stabilize the fragile economy and has thereby won international financial support from the IMF, the World Bank, the Asian Development Bank (ADB), the International Consultative Group on Indonesia, and other multilateral and bilateral sources. He has begun the daunting task of re-capitalizing the banking and corporate sectors through the Indonesian Bank Reconstruction Agency (IBRA) and dealing with the enormous problems of corruption and cronyism.

While these reforms have been welcome, they are tenuous and face determined opposition from determined, entrenched interests. The newly-appointed ministers, though intelligent and well-meaning, have little experience in managing the deeply suspicious bureaucracy.

In my judgment, the U.S. is correctly providing financial, technical, and political support for Indonesia in an effort to bolster their positive efforts. Yet the separatist unrest and religious and ethnic strife in Acheh and elsewhere, and the resistance of some military and political leaders to the winds of change underscore

how fragile and volatile the situation is in Indonesia. Given the many serious problems facing the country, it appears probable that the armed forces will continue to be a key stabilizing force to ensure the security of the region, the secular integrity of Indonesia.

I believe that previous well-intentioned congressional actions—which were reactions to the violence and focused on East Timor, such as the suppression or suspension of the International Military Education and Training Program (IMET), and the denial to Indonesia of EIMET Program, which was specifically aimed at human rights training—have largely been counter-productive and have resulted in America losing access and leverage in Indonesia, particularly with the military. That was made apparent by our limited ability to influence and temper the military's actions in East Timor.

The need for response for U.S.-Indonesia military-to-military engagement is even more important today because the Indonesian military is already undergoing significant changes and because President Wahid has transferred reform-minded generals and admirals into new positions of authority. For the first time since the 1950's, Indonesia has a civilian defense minister. That is a move we should applaud and should do what we can to reinforce. Responsible U.S. assistance and engagement could help promote and shape these positive developments.

I am pleased today that we will have the opportunity to hear from the Administration and a distinguished panel of private witnesses. Testifying for the Administration will be Undersecretary for International Affairs at the U.S. Department of the Treasury, the Honorable Timothy F. Geithner, and the Assistant Secretary of State for East Asia and Pacific Affairs, the Honorable Stanley Roth, who was with us last week.

We welcome both these distinguished gentlemen, and look forward to hearing their testimony.

We will begin with Undersecretary Geithner, and then hear from Assistant Secretary Roth, who was, as I said, here to testify on East Timor last week.

We are also honored to have an excellent second panel of distinguished witnesses Dr. Theodore Friend is President Emeritus and Trustee of the Eisenhower Fellowships, and is Senior Fellow at the Foreign Policy Research Institute. He has tremendous expertise on Indonesia. He served as President at Swarthmore College. He has recently visited Indonesia, he speaks the language fluently, and he is the author of several important recent articles on the country.

We are also pleased to have as a witness Mr. Eric Bjornlund, Senior Associate and Director of Asian Programs of the National Democratic Institute (NDI) for International Affairs. Indonesia is currently NDI's largesT*ogr.ss Mrc BjornluHe ha(recentle re-)TjT*0.246 Twturione(froaly visal Wd look for-
ward tyy out testimony.

delegation to Indonesia, which met with senior business and political leaders.

Secretary Geithner, as we have two panels today, I would ask you and Secretary Roth, if you can, to limit your comments to about 10 minutes each. Your entire statements will be made a part of the record. You may proceed as you wish.

Secretary Geithner.

Mr. GEITHNER. If it is OK with you, Mr. Chairman, I was going to defer to the State Department, as we always do and invite Stanley to go first. It is good to start—when you are talking about economics, it is good to start with politics, anyway. I understand he can do that better than anybody.

Chairman BEREUTER. It is a courteous and good move. Ordinarily with equal rank, we would have recognized the State Department first. Since you are the Undersecretary, however, we have given you the opportunity to be courteous and pass the buck to Mr. Roth.

Secretary Roth, you may proceed.

STATEMENT OF STANLEY ROTH, ASSISTANT SECRETARY FOR EAST ASIAN AND PACIFIC AFFAIRS, UNITED STATES DEPARTMENT OF STATE

Mr. ROTH. Thank you very much, Mr. Chairman. I hope you do note, for the record, this extreme example of cooperation of two departments of the Executive Branch.

Chairman BEREUTER. By the way, I want to reassure my colleagues, when Mr. Lantos arrives, we will hear from the Democratic side of the aisle.

Please proceed as you wish.

Mr. ROTH. It is normally my practice not to go through my written testimony at great length. But I learned, somewhat to my surprise this morning, that the statement didn't go up last night. So you haven't had much chance to look at it. Would you like me to go through it in greater detail or would you still prefer that I give you the shrunken version?

Chairman BEREUTER. I think, unless I hear objection by colleagues, we would prefer the maximum time for questions. Some of us had seen it as we were in the other session.

Mr. ROTH. My apologies for the delay.

You will notice a considerable degree of overlap, which has come to be a regular feature, rather than a surprising feature between your opening statement and my prepared testimony.

Chairman BEREUTER. I have learned.

Mr. ROTH. But many of the same points are in there, so I will try not to be duplicative and just add the supplemental ones.

I think where I would like to begin with a statement that I made before this Subcommittee several times last year, which was that having a free and fair electoral process in Indonesia, which resulted in the selection of a legitimate government, was a necessary but not sufficient condition for Indonesia beginning to be in a position to address all its problems.

I go back to that statement, because I think there has been something of a tendency, more in Indonesia than in the United States but even in the United States, to hold Indonesia to an incredible standard, to look at the first 100 days and say, "What is

going on? They haven't fixed this. They haven't fixed that." When in fact, I think it is no surprise to anyone who has followed Indonesia, they have a rather daunting array of problems. We certainly didn't have any expectation that these were going to be solved in as short a period as 100 days. Indeed, I would be thrilled if they could solve them in a 1,000 days.

But what has taken place, and what you have referred to and is well known, is that they did have this legitimate process resulting in the first time we had an election where we didn't know the results before the election was cast. That was the first time in Indonesia since the 1950's that that happened, an election that has been accepted on the street, in terms of the people who voted for change and got change. So you certainly have a legitimate government which is now facing the task—a multitude of daunting tasks.

But I think it is worthwhile just briefly highlighting the fact, before we get to the problems, that there has been a whole lot of good news as well, and you mentioned some of those in your opening testimony. In addition to the election itself, I think the encouraging trend in terms of civilian supremacy over the military, President Wahid has moved very skillfully and carefully to put in his own people in key positions. You flagged the fact, for example, that you had an admiral as commander of the armed forces for the first time. You have a civilian, for the first time in many years, as defense minister. He has put in several people in other key ministries and officers in the military including intelligence. You have just seen the outcome of the struggle with General Wiranto, who has been suspended from his cabinet position at the request of the president. This of course relating to the naming of the general, and many others, in the investigation of the abuses in East Timor that we discussed last week.

But the important point is major progress toward civilian supremacy. We never saw any evidence—I want to stress this point. Congressman Faleomavaega asked me about it last week. We never saw any evidence that the Indonesian military was planning for a coup. There were many public statements by key generals that there would not be a coup. In fact, while we spoke out quite strongly about what the consequences would be if it occurred, for purposes of deterrence, it is very important to indicate that we shouldn't be blaming the Indonesian military for something it didn't do under these circumstances. So, I think important strides have been made on the principle of civilian supremacy.

On the economic side, I won't go into great detail given Undersecretary Geithner's presence here. But I think what I want to emphasize is, first of all, some refreshing differences from the past. For example, the rather quick decision to release the Bank Bali report, which had held up IMF negotiations previously under the Habibie regime, as an indicator of a different pattern of behavior. I think the clarification during President Wahid's trip to the United States that he was firmly interested in foreign investment and saw that as a model for economic development. There had been some concern about what his economic policies and his cabinet's policies might be, but I think he laid a lot of those concerns to rest during his trip to the United States, early in his presidency.

As a result, there has been some dramatic progress, and I think Tim will talk in detail about the IMF agreement and World Bank disbursements in general policy. But the stage has been set for economic progress.

In terms of democracy, you now have a parliament that, in the terms of one Indonesian cabinet minister, has come alive. This is a bona fide parliament, not a rubber stamp. The same is true at the provincial levels. You now have 27 provincial assemblies that are not parking places for retired military people and Suharto cronies, but legitimate instruments of local government. So you have a lot of democracy taking place in Indonesia.

We have seen the freeing of the remaining—almost all of the remaining political prisoners. To be fair, this was a process that certainly began under President Habibie, and has been expedited by President Wahid. You mentioned in your own statement that progress was being made in Aceh—and I will come back to Aceh in more detail since it is one of the more serious challenges—but at least efforts have been made to get a negotiating process under way.

This is the context in which I would like to start then considering some of the problems but making it very clear that the discussion of problems doesn't—shouldn't set the tone of suggesting that we are facing a crisis. It is rather more the long-term haul. We are in a long-term situation that Indonesia is going to have to deal with.

I started my written testimony with the economy, because I believe it is very important that we acknowledge that, ultimately, getting the economy revived and coming out of the impact of the Asian financial crisis where Indonesia has certainly been the slowest of the Asian countries to emerge, it is ultimately going to be critical to stability. Over the last year, year and a half, we necessarily focused either on East Timor with all the drama going on there or on the electoral process and much less on the economy. But the government no longer gets a bye, and so what they do in the economy will be critical.

Next, I turn to the issue of civilian supremacy. I have made the key points in my opening remarks about, one, the fact that civilian supremacy prevailed. The United States position was always clear, as Ambassador Holbrooke spoke very forcefully, and I think productively, warning against the consequences of a coup. But also that we see no evidence that one took place.

On Aceh, I go into considerable detail in my testimony, and I would like to take just a little bit of time now, because I think that is one of the greatest challenges. It is one of those cases where I think one has to recognize what has changed and what hasn't changed. What has changed is that for the first time that I can recall, you have a serious negotiating process. You have the government engaging with Acehnese leaders in Aceh, in exile, in Jakarta, and trying to come up with a process where they can actually get down to the negotiating table and try to work out a political resolution.

This has not been an easy process, and it has not gone on a straight line. In fact, there was a great deal of consternation about early remarks by President Wahid that he would support a ref-

erendum, creating the impression that the government would support a vote on independence, which could have been very destabilizing in terms of the territorial integrity of Indonesia. As you know, in the face of considerable criticism from virtually every quarter in Indonesia, President Wahid has changed course and now made it clear there will not be a referendum on independence, that he is prepared to see a referendum on the application of Islamic law, but not on political status.

After that shaky start, though, I think things have improved considerably. We have seen the government—primarily through the minister for human rights, Hasballah Saad, himself an Acehnese—working very closely with a wide range of Acehnese leaders to try to put together something called an All Aceh congress, the purpose of which is to come up with a group of people who can represent the Acehnese. You have student groups, business groups, revolutionary groups. There are so many different parities in Acehnese, that President Wahid has said to me, "What is the address? Who am I supposed to talk to negotiate?" So this is a very important effort by his government to see if they can help facilitate, with the Acehnese, the emergence of leadership.

There is also a very dramatic progress with the help of an NGO in Switzerland, which has been meeting, actually, with several—held broker meetings between the Indonesian government and two of the factions of the GAM, the Free Aceh Movement, to see if there could be an agreement on a cease-fire and humanitarian assistance. This took place just before Gus Dur's visit to Davoz a few weeks back, and there is another round scheduled for later in this month. There is no agreement yet, but there is an agreement to meet again, and obviously, if there could be a cease-fire, that would be a very positive development.

In the meantime, though, just to be accurate, there is still a very disturbing level of violence going on in Aceh itself, many fatalities each week on every side, meaning police, military Acehnese civilians, guerrillas. So, this is not yet a situation one could say is stable, but at least there is a diplomatic process which might achieve results, and that is a major change for which the government deserves credit. We will have to see if it all works.

I wish I had a good answer for what I know is of interest to you, Mr. Chairman, on the sectarian violence, particularly what we have seen take place in the Malukus and elsewhere. What I tried to point out in my testimony is, first, the obvious: What are the downsides of this violence in terms of decreasing confidence in the government's competence, leading to extremist Islamic elements trying to piggy-back on these developments to get more support, and of course, affecting the investment climate by making it appear that Indonesia is not safe?

The more difficult question, and one in which I have not yet seen the magic answer is, what is the fix? There is no simple solution that I am aware of. The government faces a real dilemma, which is, on the one hand, it has an obligation to protect its citizens and not allow this kind of violence to continue and escalate. At the same time, the government is fully aware of the previous track record of the military and police going into situations like this and committing numerous human rights abuses and making the prob-

lems worse. So merely the sending of troops is not in and of itself a comprehensive fix.

So this is going to be a long-term process involving improving the caliber of the police and the military, of getting people more quickly, not allowing it to escalate, of trying to rebuild where there has been violence so you don't have permanent separation of communities. But I can't give you what I myself would consider a satisfactory answer.

Finally, I review in the statement just the key points I made last week on East Timor, but in the interest of time, I will leave that for the record.

[The prepared statement of Mr. Roth appears in the appendix.]

Chairman BEREUTER. Thank you very much.

We have a vote on an amendment, possibly followed by final passage. Undersecretary Geithner, I think we may be able to hear a complete testimony before I turn the Chair over to Mr. Faleomavaega.

Undersecretary Geithner, would you please proceed as you wish?

STATEMENT OF TIMOTHY F. GEITHNER, UNDERSECRETARY FOR INTERNATIONAL AFFAIRS, UNITED STATES DEPARTMENT OF TREASURY

Mr. GEITHNER. Absolutely. Thanks for having me up here today.

This is an important issue for us, for this country, and we welcome the attention you are giving it.

I will focus my oral remarks on just two things: what we see as the major economic challenges facing Indonesia, and the things we think on the economic front the international community can be most effective in supporting.

Indonesia experienced, in 1997 and 1998 what you might call a perfect storm. They experienced a powerful combination of three forces: external contagion from Thailand in the north, a compelling set of domestic economic and financial vulnerabilities, and a serious political crisis, a succession crisis which led to a break-down of the basic institutions that are necessary to make any economy function.

These factors made the economic contraction much deeper and much more protracted in Indonesia than was the case in other countries hit by the crisis. Over the course of 1998 and 1999, the government—the previous government and this government—have taken some important steps to lay the foundation for recovery. As a result of these steps, the macroeconomic environment has stabilized a bit, and growth has started to resume. The government expects the economy to grow between 3 and 4 percent this year. Inflation is down to zero. Interest rates have fallen substantially. The rupiah has recovered significantly, although it is still about 25 percent below its pre-crisis level in real trade terms.

The new government has laid out a new framework for economic policy, which we think holds considerable promise. The main challenges they face are in four areas: macroeconomic policy, the financial corporate sector restructuring agenda, installing the rule of law, and promoting a functioning legal system, and, finally, bolstering the social front, investing in human capital.

Let me just review these briefly. On the macroeconomic front, I would just emphasize two points. The immediate challenge is to find the right balance between the need to support the economy, to fund adequate investment in basic health care, education, and social safety nets, and to finance an adequate re-capitalization in the banking system without making an already unsustainable fiscal situation worse.

In the program laid out with the IMF, the government has targeted a fiscal deficit of about 5 percent this year, which is about the same level as last year. They want to avoid a substantial expansion in the short term, which we think is appropriate.

Their hope is that, with an ambitious program of privatization, the sale of the assets the government now holds, they will begin to make some progress in reducing the public debt burden. Over time, of course, as the economy recovers, they are going to have to put in place a more forceful, credible program of fiscal consolidation. That is going to be a difficult task for them to manage, particularly in light of their plans to decentralize a substantial part of economic responsibility to the sub-national level.

It is very important, as they go forward, that the government commit to preserve the independence of the central bank, whose policies have been really critically important in Indonesia's return to stability.

The second challenge is on the financial and corporate sector restructuring front. There is no way economic growth is going to recover with any strength in Indonesia without a recovery in private sector activity. I think it is unlikely you are going to see any recovery in private investment on a meaningful scale until we see more progress toward repairing the financial sector and restructuring the corporate sector.

The government's efforts in this area have been painfully slow and inadequate, and the cost to the economy and to the budget itself has been substantial as a result. The program they have agreed to with the IMF has a variety of important and promising commitments in both areas, and I will just summarize them. In the financial sector, they are focusing appropriately on how to privatize the state-owned banks, how to improve supervision and governance in the financial sector generally, and how to develop deepen a debt and equity markets, to allow them to reduce their reliance on what is going to be a very weak banking sector for some time to come.

On the corporate debt front, the IMF Program is trying to make sure that the Indonesia Bank Restructuring Agency has stronger powers, is able to move ahead without political interference, and can send non-cooperative debtors to the bankruptcy court. They are focused on trying to make sure the bankruptcy regime actually works, and they are trying to make sure there is a creditable effort to combat corruption in the judiciary for obvious reasons.

This brings me to the third challenge, which is the challenge of creating a legal system that works, restoring some basis of fairness and predictability before the law. Again, I think it is very unlikely you are going to see any recovery in private enterprise and investment until you see greater confidence in the legal system. That is why the work of the newly appointed attorney general is going to be so important to the success of the economic program. That is

why the U.S. and other countries working with the World Bank made judicial reform a centerpiece of the recent consultative group meeting of donors.

In the social area, I think our view is that unless the government is able to deliver a broader, more substantial improvement in the general welfare of the people, they are unlikely to be able to continue to enjoy the support they need to carry out a program of economic reform. Given how difficult the government's fiscal position is now, it is very important that they move to concentrate their investments in the social sector, in areas where people need it most and where it can be used most effectively.

Chairman BEREUTER. Excuse me, Mr. Geithner, I am going to have to excuse myself. Please continue. I am going to turn the Chair over to Mr. Faleomavaega.

Mr. GEITHNER. I am going to move quickly to the end.

In my written statement, I laid out a number of steps which we think would be useful and important for the government to take in the short term to begin to restore some credibility with their citizens in the economic area and with foreign investors, generally. They have started to move in some of those areas. Some of those steps are encouraging, but we have a long way to go.

Indonesia's future is critical to the stability and prosperity of Southeast Asia and to the region as a whole. We of course have a major stake in the success of the political transition now underway and seeing the foundation laid for a strong and durable recovery. In our view, we need to be prepared to help this new government with this ambitious reform agenda, and we think we can be most effective by supporting the following things, and let me just mention four.

First, we can be helpful in supporting an adequate scale of official finance to this government in this period of transition. In this context, the new IMF Program will make available roughly $5 billion of assistance over the next 3 years. The pipeline of assistance from in the World Bank, and the Asian Development Bank totals about $7.8 billion now. I think we can be reasonably confident that will satisfy Indonesia's medium-term financial challenges externally; that is very important. Of course, all that money is conditioned on Indonesia delivering on the commitments they have made. But if they are prepared to deliver, I think they can count on having adequate supply of external financial assistance.

It is also very important that we continue to focus the IMF the World Bank, and the Asian Development Bank on the main challenges facing this new government to make sure that the reform conditions and the program they support are the right kind of conditions. As I said, all these reforms need to be focused on creating an environment conducive to private enterprise and new investment, on financing an adequate social safety net with investments in health care and education, and of course, growth-oriented macroeconomic policies.

It is also important that we do what we can to support giving this new government an appropriate breathing space on its external debt obligations to the official sector. We are going to work with other Paris Club creditors to give them another 2 years of

breathing space on the external debt front, which I think will free up another $4 to $5 billion in external payments.

Finally, we are working to develop and expand a program of technical assistance, working closely with the State Department and other agencies. I think we at the Treasury will try and focus on what we know something about, and we will try to target our assistance on public debt management, and fiscal decentralization, on financial and corporate debt restructuring, and in the law enforcement area.

In many ways, Indonesia's economic challenges are now fundamentally political. They are fundamentally political in the sense that progress depends critically on this new government's demonstrating it has the capacity to act, and to act forcefully and quickly. They have outlined a credible program for political change and economic reform, and we think that this program is strong enough to create the promise of a significant improvement in economic activity over the next few years.

Thank you very much.

[The prepared statement of Mr. Geithner appears in the appendix.]

Mr. FALEOMAVAEGA. [presiding] Thank you, Mr. Secretary.

I have been given the honorable task of continuing the dialogue while we wait for some of my Republican friends on the other side of the aisle to return to conduct the hearing. Nevertheless, the Chairman has asked me to raise my own set of questions that I have prepared, and hopefully, both of you gentlemen will be able to help me with.

It is always a pleasure for me, to welcome my good friend, the former Staff Director of this Subcommittee, Secretary Roth. Secretary Geithner, I also offer you my personal welcome.

I think in terms of numbers, we know that Indonesia is the most populous Muslim nation in the world, with well over 200 million people. It is also the fourth most populous country of the world. Perhaps we need to add another additional, unique number given the fact that after 30 years of military dictatorship in Indonesia we finally have a duly elected a civilian administration and governing body. To that effect, we have come a long way.

At the height of the Cold War, it seems to me that our basic foreign policy was we didn't care whether Indonesia's dictators were the worst abusers of human rights as long as they were anti-Communist. As long as they were pro-Western, the U.S. pretty much turned the other way when it came to a check on the activities of some of these dictators. The two dictators that come to mind as we talk about Indonesia today, of course, first Sukarno and then Suharto. As both of you gentlemen know, there are no simple solutions to the problems with Indonesia.

There are some historical things that I would like to bring to your attention and hopefully that you will share with me for the record. Although it is probably getting to be somewhat tedious for my good friend, Secretary Roth, always hearing me raise this issue, as we discussed early last week at the East Timor hearing, I want to review with you the problems with West Papua New Guinea.

Some people have asked me why am I so concerned about the situation in West Papua New Guinea? It just irks the hell out me—

if you will excuse the expression that I learned here in America—the fact that 10 years previous to the military take-over of East Timor in 1974, 1975, there was the same type of activity conducted by the Indonesian military in 1963, where well over 100,000 West Papua New Guineans were tortured, murdered, or simply disappeared. These atrocities were committed against these people for the simple reason that Indonesia decided that West Papua New Guinea was going to be part of their country, both of which were formerly Dutch colonies.

Gentlemen, I hope you will bear with me, but I do have some questions that I want to share with you and my concerns for West Papua New Guinea. The reason why I am committed to remain serious about West Papua New Guinea is because some of my relatives have served as missionaries in Papua New Guinea. Moreover, the Pacific Island relationship that we have with those people, gives me the sense of concern and a sense of kinship with the people living in West Papua.

In 1969, a vote entitled the Act of Free Choice which many Papuans call the Act of No Choice—was held to determine whether West Papua would be an independent country or part of Indonesia. This was a fraudulent process characterized by devastating Indonesian military repression and shameful neglect on the part of the United Nations. It is well documented that the United Nations' personnel overseeing the progress at that time revealed the extent to which the United Nations knew of the illegitimacy of the voting results. Only 1,000 West Papua New Guineans hand selected by the military junta under Suharto who allowed the vote. With a barrel of a gun to their hands, they say you will vote in favor of Indonesian rule on behalf of 800,000 West Papua New Guineans who had no voice.

In light of the continuing gross human rights violations committed by the Indonesian military in West Papua, the still strong indigenous movement for independence there and the role the U.S. played in the creation of the 1962 New York agreement, I would like to ask what is now being done both by the United States, as well as the United Nations, to revisit the process of a genuine act of self-determination for the people of West Papua New Guinea?

Mr. ROTH. I am afraid I am going to have to disappoint you, Congressman, because I think we disagree rather sharply on this issue, that I believe that the starting point for U.S. policy is the preservation of the territorial integrity of Indonesia. That is the position that President Clinton has articulated to President Wahid on his visit here, as well as many other occasions at many other levels. I think we will rue the day if we start going down the path of reexamining whether or not all the pieces of Indonesia should be allowed to stay there or not. I think the point we are beginning with is we support the country as it is. East Timor was suigeneros by virtue of the different legal status and the fact that its incorporation was never accepted by anyone, including not by the United Nations. It was also not considered part of Indonesia by most Indonesians. Basically, it is a totally different status.

But that should not be used as a precedent for West Papua. So we are simply not looking at re-opening this issue, and we are certainly not looking at taking this up in the United Nations. I don't

think we should leave the impression with the independence advocates that there is in any way U.S. support for this, because from the point of view of the Administration—and I can only speak for the Administration—there isn't.

Having said all that, I don't want to appear to be in way justifying the horrific abuses which did occur in what used to be called Irian Jaya and now which President Wahid has agreed to call Papua. Those are well known, and those are things which I believe need to be investigated by the current regime. I think there is a need for accountability as much in Papua as there is in Aceh, as there is in Timor. That is something that the government of Indonesia has to address, that many of the same military units that brought us the violence, or figures that brought us the violence in Timor and Aceh, were also active in Papua. I think that that has to be brought to justice.

I also think, and the government of Indonesia has indicated that it is willing to engage in a dialogue in terms of a different degree of autonomy, a different deal, different sharing of the resources, different levels of political control. The government, I think, has demonstrated its good faith simply by the very symbolic act of changing the name, which is something that of course you know had been resisted by the dictatorships that you referred to.

So, I think one can be sympathetic to the people, one can be sympathetic to their needs and their cause of justice, but I think one also has to look at the over-arching national interest of whether we want to be a party to the disintegration of Indonesia, which I think would have devastating consequences for stability in all of Southeast Asia. The answer to that is, in our judgment, is no.

Mr. FALEOMAVAEGA. So your response is the Administration says it is OK to grant the plebiscite and the right of self-determination for the people of East Timor, but not for the people of West Papua New Guinea? Is that basically the Administration's position?

Mr. ROTH. The position I expressed was that there is a different legal status for the two entities, and that that was driving our policy, that East Timor's incorporation had never been accepted by the United Nations or by the United States, or for that matter by any country in the world with, I think, the sole exception of Australia. It was a completely different legal status.

Mr. FALEOMAVAEGA. I happen to differ with you on that as a matter of history. So, you are saying that this Administration accepts as proper the fact that 1,000 West Papua New Guineans voted with a gun to their heads, on behalf of 800,000 West Papuans? That this sham vote made it legitimate for West Papua to become a part of Indonesia, even though it was done under military dictatorship?

Mr. ROTH. What I said is that we accept the process, the U.N. process that led to the incorporation of Papua New Guinea into—sorry, Irian Jaya into Indonesia, and we are not prepared to support the re-opening of that decision because of the consequences it would have for Indonesia and for stability in the region.

Mr. FALEOMAVAEGA. What happens if there are historical records in the United Nations documenting those shameful acts the United Nations committed against the West Papuans. The United Nations literally just turned its back when this issue was raised, including

Ezra Bunker, our Ambassador to the United Nations, who simply just turned the other way and refused to recognize the fact that these people were never given the right of self-determination?

Mr. ROTH. Yes, I don't have anything more to add to what I said, Congressman. This is not an issue that the Administration is prepared to re-open and revisit.

Mr. FALEOMAVAEGA. I am going to have to differ very, very critically with the Administration's position on this. It is proper to give East Timor its right of independence and self-determination, but the same is not true for West Papua, whose people, culture, ethnicity, and background, history have no relationship whatsoever to Indonesia. I consider this very shameful on the part of the Administration to hold that policy, to tell you quite frankly.

Indonesia's House of Representatives recently asked their government to review its contract with Freeport, Indonesia. Eighty-one point three percent of Freeport, Indonesia is owned by a U.S. mining company, Freeport McMoran Copper and Gold. In addition to claims that the contract violates investment regulations as well as the 1945 state constitution, the two House commissions which visited the Freeport mines in December found, and I quote, "The mining operations had also resulted in social economic injustice, rampant human rights abuse, and political tensions". Needless to say, the mining has also caused gross environmental destruction and environmental injustice. The Freeport Mining operation in West Papua New Guinea is the largest gold mining operation in the world.

I would like for the Administration to respond to that. What is being done about Freeport's activities in West Papua New Guinea?

Mr. ROTH. I am not sure that I accept the premise of the question that is there is something to be done about Freeport. I mean, I think you are acting on the basis of allegations rather than on the basis of how they behave now. This is not an area of great expertise on my part, but it is my impression—and I will get you a much more detailed answer for the record—that there has been considerable change and improvement in the activities of Freeport with respect, for example, to the environment.

I also make the point that there has been no request from the government of Indonesia to in any way abrogate change with the contract with Freeport Moran. You cited some activity by the House Committee, but in terms of the government of Indonesia, they have not asked us to do anything, have not issued any complaints. So, I think one has to be careful in the allegations one makes. But beyond that, I will be happy to get you a more detailed answer for the record.

Mr. FALEOMAVAEGA. Please, I would like more information on that.

[The information referred to appears in the appendix.]

Mr. FALEOMAVAEGA. Regarding the relationship between President Wahid and General Wiranto is Wiranto now no longer the minister of security or does he still have an important position within the security chain of command?

Mr. ROTH. No, he has been suspended from the position he—and a successor has been sworn in. So, he is out of the cabinet for now.

He has already resigned his military commission previously. So, he is neither in the military nor in the cabinet.

Mr. FALEOMAVAEGA. There was a recent report in the media that the Dutch government has taken a definite interest in revisiting the question of West Papua New Guinea. What is the Administration's position on this?

Mr. ROTH. I think I have already stated it, no desire to revisit the status.

Mr. FALEOMAVAEGA. So it is the Administration's position, as it also seems to be the position of the Australian government, the fear that you don't want to Balkanize Indonesia. Am I correct on this?

Mr. ROTH. Absolutely. We have said, unequivocally, that we support the territorial integrity of Indonesia. We said that East Timor was suigeneros based on a different legal status, and we are working in support of Indonesian's government policy to preserve territorial integrity. We certainly support efforts to engage in political dialogue with provinces with very legitimate grievances. Certainly, Aceh is in that category, certainly Irian Jaya and now Papua is in that category. But that is far short of saying supporting independence.

Mr. FALEOMAVAEGA. Secretary Geithner, you mentioned a couple points about trying to give assistance to Indonesia. Is this the format the Administration takes in giving assistance to countries like Indonesia? You mentioned financing and covering external debts. Indonesia's external debts now number well over $3 to $4 billion.

Mr. GEITHNER. Indonesia has got substantially more external debt outstanding to the governments of the world, as a whole. I think it owes the United States, now, roughly $3 billion.

Mr. FALEOMAVAEGA. What is the total U.S. investment right now in Indonesia?

Mr. GEITHNER. I don't know the answer to that, but I would be happy to get you the number. I suspect it is probably somewhere north of $3 billion.

Mr. FALEOMAVAEGA. I see.

Mr. ROTH. May I commend a bit on aid? I was neglectful in my statement in my rush to meet the bell, seeing the chairman looked at his watch, that I skipped the section on U.S. policy.

But, clearly, in our desire to support the new democratic government, we have taken a number of steps, some of have been on the diplomacy side—inviting President Wahid to the Oval Office, sending two cabinet members, Richard Holbrooke and Larry Summers, out early in the new Administration. But some of it has been on the aid side as well, and we are looking to increase traditional development assistance and economic support for money for Indonesia. The numbers are a little bit tricky, but if you—basically, from a base of $75 million last year, to $125 million this year—the reason I am using that funny formulation of a base is there is one-time-only money on top of last year's aid for the elections. But if you factor that out, it is roughly a 50 percent increase, and we will be seeking a slightly larger increase for 2001. We have also sent out an assessment team, an inter-agency assessment team to Indonesia, to try to look at some of their aid needs. Secretary Albright has a particular interest in institution building.

As you know, and you mentioned in your statement, under the two previous dictatorships there wasn't a hell of a lot of institution building in Indonesia. So when you look at all kinds of institutions, whether it is courts, police, journalists, NGO civil society, it is very poorly developed in Indonesia. So we would like to concentrate our resources, which admittedly are quite modest if you compare it to Japanese aid, or to aid from the IMF, the World Bank, and the ADB, and see if we could use that more effectively to help support some of these institutions which are key to democracy.

So, Tim has the big bucks. In terms of the multilateral development banks, the IMF, we are talking about billions. In terms of our bilateral aid, we are talking about fairly modest sums, but we are trying to use that as effectively as we can to help Indonesia support democracy.

Mr. FALEOMAVAEGA. If I remember correctly, if this is the same assessment team when we met with Secretary Albright, that the assessment has been requested in the amount of $500 million for assistance. Is this in the realm of what is being discussed in the Administration?

Mr. ROTH. The preliminary recommendation of the group, which has not issued it is report, is suggesting that over 3 years it should be about a $500 million level of assistance. I feel a little awkward, not having read the report yet, to pass judgment about whether that is right or not. But the key point is what we are trying to do is to increase our aid within the budget constraints that we have to give as much support as we can for shoring up democratic institutions in Indonesia.

Mr. FALEOMAVAEGA. Mr. Chairman, I appreciate you giving me the time to determine exactly where the Administration stands on West Papua New Guinea. It seems that my good friend, Secretary Roth, and I differ extremely on this. I am definitely going to be pursuing this, as I will promise both gentlemen, in the coming weeks and months on this issue of West Papua New Guinea.

Thank you, Mr. Chairman.

Chairman BEREUTER. [presiding] Thank you, Mr. Faleomavaega. I would be disappointed and surprised if you didn't.

I an sorry to have missed the last part of your testimony.

Mr. ROTH. You didn't miss anything, Mr. Chairman.

Chairman BEREUTER. We will have a rebuttal on that. But, the good news is that is the last recorded vote of the day, so we will be able, hopefully, to continue uninterrupted.

Secretary Geithner, I would like to ask you your ideas about the commitment and ability of the Indonesian government to take the steps necessary for privatization and for meeting some of the fairly ambitious conditions that have been provided to them by the IMF and also some from the ADB. What is different? There have been a lot of promises that have not been kept, to be fair to them, because of extraordinary circumstances that they faced.

Mr. GEITHNER. I think we will only know as we see how they act over the next few weeks and months. It is hard to make a judgment at this point. I think what is reassuring, in what we have seen so far is the following: We have a new government with a president who is committed to the kind of broader reforms that are really essential to making sure economic policy can work. There is

a new economic team with a general orientation which is quite positive and quite reassuring, quite pro-market, quite realistic. They say all the right things in terms of recognizing how dark it is, how big the challenges are, and having an appreciation for what has to happen. So, I think one can be reasonably hopeful. But, as in any case, you have to look at what they do, not just at what they say. They have taken a few important steps over the last several weeks to begin to unload some of the assets they now hold, and that is encouraging.

Chairman BEREUTER. You mentioned the desirability and their intention to go ahead in creating an equity market, which of course is important. What kind of steps would you expect them to take if they were to be able to successfully begin such a construction of an equity market?

Mr. GEITHNER. They have an equity market that is relatively small now, but functions. I think that, as is true in much of the rest of the economy, in some ways what you really need to do is to make sure you have a legal system that works. You have a set of requirements for transparency that are imposed on people that issue debt and raise equity, so that investors feel confident that they know what they are buying, and so they will be able to enforce their rights in court if things go bad. That is why I try to say that all these things—in the investment climate, in the financial sector, in the corporate sector—all these things rely really fundamentally on whether they can take steps that try to give people redress against corruption, make the court system work, give investors the sense there is going to be a basic fairness before the law. Without that, I think, it is going to be very difficult for them.

Chairman BEREUTER. Do we have any good idea of what the monthly capital flight is, and whether or not in fact it is begun to be reduced?

Mr. GEITHNER. I think it is very hard to tell from the overall numbers to get a real sense of that. So really what we have is anecdotal and I think what the anecdotal evidence suggests is that there is very little return of flight capital and relatively little new investment coming in from overseas. I think that is, in part, because people are still waiting to see, they are still willing to take the measure of the new government and to see how credible they are going to be in their actions. It is in part because, as Stanley said, the broader image presented by sectarian violence on a broad scale and the broader concerns about political stability have encouraged people to wait and see.

But it is a government that has tried to send a lot of positive signals, in particular to the Chinese community, which is so important to the economy of Indonesia. So I think if they can continue on this path, you would see that they will begin to gradually put together the confidence they are going to need to be able to attract some of that money back.

Chairman BEREUTER. As you point out, the Chinese ethnic-Indonesian is a very important part of the retail and business sector generally in Indonesia. Do you see any indication that the Chinese-Indonesian capital is returning, that they have some confidence in this government and in President Wahid?

Mr. GEITHNER. I don't think the total information gives you much confidence that it is coming back on any significant scale yet, but the government has made a real investment in trying to reach out to them. They've brought prominent Indonesian-Chinese businessmen into an advisory capacity on the economic team, which is a useful symbol. As I said, they're trying to make sure that they give confidence to all citizens in Indonesia that they're going to have equality before the law, and that helps. But I still think it is too early to tell, too early to see much positive response.

Chairman BEREUTER. Secretary Roth, with respect to refugee flows, do you see evidence that a significant part of the Chinese ethnic-Indonesian population has left? With respect to the potential flows of refugees from Aceh, as well as perhaps a few other parts of the country, what is the thinking, the attitude, and the concern in Malaysia or Singapore today?

Mr. ROTH. Several different issues: One, there was never a large Chinese refugee flow out of Indonesia. What there was a large amount of capital flight out of Indonesia, and some of the wealthiest of the Chinese who either propped themselves or in many cases their families, and you had people commuting back and forth while the families were propped in safer schools or elsewhere in Singapore. But that was always the very tip of the community, and the vast majority of the Chinese of course are not—Chinese-Indonesians are not multimillionaires and can't afford to live at the Regent Hotel in Singapore, and so they never did leave. So, that is not the issue.

We also have considerable evidence that most people came back, including many of the businessmen. Again, that doesn't address the real question which is have they brought their money back, which Undersecretary Geithner has addressed.

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On Aceh, I think there is no desire in either Singapore or Malaysia to see Aceh spill beyond its borders anymore than it has. There are already large and local refugee communities, Acehnese, in both Singapore and Malaysia. They would not like to see these increase; they would rather see a political settlement. During the recent ASEAN meeting in Manila, they made it very clear that they too supported the territorial integrity of Indonesia and wanted to see Aceh stay in the family, as it were.

Chairman BEREUTER. We will have a representative from the U.S.-Indonesian Business Council here in the second panel, but I was struck in the past by how relatively small American business investment was in Indonesia. In certain energy sectors, it is significant but, given the size of the country and its importance in the region, we have had a relatively small economic presence there.

Since Secretary Albright mentioned Indonesia as one of her four focal points for assistance and scrutiny and also seemed to give some support to the recommendations for perhaps $500 million in targeted, very specific aid recommended over the next 3 years by the study group, what can this government do to encourage American business investment in Indonesia. What signs, particularly, Secretary Geithner, will American business community look for? What will be the benchmarks they consider to see if the economic reforms and the political reforms are sufficient that they'll feel confident in returning or investing?

Mr. ROTH. Let me start with the political dimension of it, and then let Tim get to the more hard core economic dimension of it.

I mean, the thing about the market, it is obvious you can't force it to go in if you have the free market, and if you don't have an Indonesia that is perceived as stable, if you have horrific pictures of the Malukas on TV night after night and you see violence in Lombok and trouble up in Tem Island and islands in Aceh that create an impression that Indonesia's not safe, that obviously is going to make it much more difficult to attract foreign investment regardless of what economic policies the government adopts. So, stability in and of itself is one of the key issues.

Similarly, if people think that democracy is at risk, if they think that the government might be overthrown by a coup and they know that the consequences of that would be dire in terms of not just U.S. Government support but multilateral support, that is a deterrent.

So, part of the U.S. response has been to work for the cause of stability within Indonesia itself. As you know, and I have highlighted, we were very clear in our position about civilian supremacy and what the consequences of a coup would be, just to make sure no one misunderstood, and we emphasized that point repeatedly, and I think this outcome has helped right the fact that General Wiranto has been suspended from the cabinet, the fact that there has not been any maneuverance for a coup has I think reinforced the notion that civilian supremacy is setting in Indonesia.

On the ethnic violence, I think the government has to still demonstrate that it has more effective policies for bringing this under control. There has been some reduction in recent days in Ambon, I am sorry to say not the case in Aceh, but this is an area where

I think more work is needed if they're going to create the impression that Indonesia is a safe place in terms of economic policy.

Chairman BEREUTER. What will the American business community look for?

Mr. GEITHNER. I think they'll look for political stability on a broad scale. I think they're going to look to see whether the economic team is competent, able to act without political interference. I think they're going to look to see whether the government is open to selling the substantial assets they hold to foreigners. I think they are going to look to see whether the system which is frozen now starts to thaw in terms of actual movement on the financial sector. I think they are going to see whether the types of corruption that were so pervasive in Indonesia in the past still seep into most economic activity. They will see if that changes, and I think a couple of examples of a core system that works would be quite reassuring and quite helpful.

But I think there is a lot of interest in Indonesia now. If you read what the analysts in the financial community write about Indonesia, there is much more hope in it than there was before, and so I think people are taking a fresh look. The trip that Mike Gadbaw led I think demonstrates that level of interest and promise.

Chairman BEREUTER. The overseas Chinese community has been an important source of investment in Indonesia of course, but Japan has been the largest. They of course have their economic difficulties including their 7th or 8th year in economic doldrums. To what extent will their situation slow the economic recovery in Indonesia?

Second, With respect to the IMF LOI, will that resolve the OPIC claims that are filed against Indonesia?

Mr. GEITHNER. I think everybody believes, and I think the Japanese would acknowledge, that the best thing they could do for the region and the best thing they could do for Indonesia is to get their economy on a stronger footing. Growth would lend to increase imports from the region, including from Indonesia.

That would be quite powerful in trying to contribute to a stronger economic environment for the region as a whole. Japan has provided a really quite substantial scale of financial assistance to Indonesia over the last several years, and they are likely to continue to do so on a meaningful scale.

Chairman BEREUTER. You are talking about the Japanese government.

Mr. GEITHNER. Yes. I think that the dynamics that have traditionally governed private Japanese investment in Indonesia are probably likely to persist in the future. They are largely driven by two forces: One is the need for resources, where Indonesia is rich and Japan is poor, and the other is an interest in investing and building manufacturing capacity in the markets that are important to Japan.

I think those forces are likely to be a significant pull for Japanese interests going forward. I don't have a really good sense of whether Japanese financial institutions are going to be prepared to lend on a meaningful scale going forward. I suspect they are likely to be quite tentative and cautious going forward. But if the busi-

ness community sees the basis for stability and for a bit of protection from corruption, et cetera, before the law, they are likely to be in there too.

Chairman BEREUTER. Thank you.

Mr. GEITHNER. Now, you asked about the LOI. The Indonesian government, with a fair amount of encouragement from us and from the State Department and our Ambassador, has taken a number of quite important steps to help facilitate a resolution of the full range of problems they face in the power sector, including resolution of OPIC's claim. They have replaced the head of the state owned power company, the PLN. The government committed, and this commitment is reflected in the LOI, to engage in a process of negotiation with the full range of independent power producers.

They terminated a court case that had been filed as a means of frustrating the arbitration proceeding against Cal Energy and OPIC. I think this has left most people feeling a little more comfortable that there is at least a process underway that could lead to a favorable resolution. They are talking to OPIC and I think OPIC itself feels a little more comfortable. But as is true in almost everything we have discussed, we are going to have to see how it proceeds.

Chairman BEREUTER. That is generally favorable at this point. OPIC took a huge hit, as you know, relative to its history.

My final question would be directed to you, Secretary Roth. You have heard my comments about military-to-military contact and my attitude that we have reduced it at the wrong times. The Australians have played a very important military role in recent years, but now they have difficulties because of East Timor.

What has the State Department or what would you recommend that the State Department advise the Defense Department with respect to resumption or enhanced military-to-military contact and under what conditions, if any?

Mr. ROTH. First, obviously we agree with you that it is an unnatural state that we have a suspended military-to-military relationship with Indonesia. That was a result of the events you flagged in East Timor, and the situation has changed dramatically, and we actually have an interagency process near conclusion to make some recommendations to my bosses about how to restore aspects of a military-to-military relationship.

It goes without saying, testifying before this Subcommittee, that we need to obey the law and that there is congressional legislation that places very clear conditions on certain aspects of the military-to-military relationship. The Leahy amendment has six specific conditions that relate to and in fact basically preclude IMET or military sales until they are met, and at this point, I could not say that they have been met. So, that is a statutory bar for at least this current fiscal year.

Chairman BEREUTER. It is an appropriation measure that applies only to this year, isn't that correct?

Mr. ROTH. That is correct. It was hoped not to see it in future years. It also does not refer to the totality of the military relationship since the scope of that legislation is IMET FMF and not many of the other things that have been suspended. So, that is currently actively under review. I chaired an interagency meeting on it yes-

terday, and I hope that we will have some decisions in the next couple of weeks.

But at the same time, I think you rightly asked under what conditions, and I think the clear obvious one is twofold: One, the military's commitment to accountability. As you know, the Indonesian process, their own Commission of Inquiry on East Timor has named 33 individuals being referred to the attorney general for further investigation. It is expected, and the attorney general announced yesterday, that he expected to have his first indictment within 2 or 3 weeks. He didn't say whom out of that 33 or whether it was even 1 of those 33. But clearly how the military reacts to this accountability process, not just on Timor but elsewhere in Indonesia, is going to very important.

Second, the principle of civilian supremacy. We have seen one test of wills already with respect to General Wiranto which has been satisfactorily resolved.

Another is the firing of the military spokesman who had repeatedly contradicted the president of Indonesia about Aceh policy in his calls for martial law, and the president had indicated there would not be martial law or state of emergency there. But there will be future positions coming down the pike, and as we see how this principle of civilian supremacy is obeyed, that will influence our willingness to go ahead. So, it is basically the accountability and human rights plus the principle of civilian supremacy and of course our obligations under the law.

Chairman BEREUTER. Thank you very much. I think some advice from the State Department at the appropriate time certainly early in the appropriations season as to what would be appropriate or inappropriate from the Congress might be helpful to some of us who would like to see mistakes avoided.

I would like to turn to the gentleman from American Samoa to see if he has any last questions for either of our panelists.

Mr. FALEOMAVAEGA. I think I have completed my share of questions.

Mr. GEITHNER. I have an answer for you, though. You asked what the scale of U.S. foreign investment was in the country. The Commerce Department numbers say at the end of 1998 it was about $6.9 billion. That is in book terms, meaning its real value, market value is probably substantially higher than that.

Mr. FALEOMAVAEGA. I have another question.

Chairman BEREUTER. Go ahead.

Mr. FALEOMAVAEGA. What is the total amount of the value of the gold that Freeport Company has taken out of West Papua New Guinea?

Mr. GEITHNER. I have no idea nor do I know where we could find that out, but I am sure we could ask.

Mr. FALEOMAVAEGA. Could you?

Mr. GEITHNER. Sure.

Chairman BEREUTER. Gentlemen, thank you very much for helping us with information today and clarifying the Administration's views and some information about the international financial institutions. This has been very helpful to the Subcommittee, and we will try to relay this information to Full Committee.

Thank you again.

Mr. GEITHNER. Thank you very much.

Chairman BEREUTER. All Members' written statements that they may have will be made a part of the record.

I would like now to call up to the table the distinguished second panel in today's hearing.

Gentlemen, thank you very much for your attendance today to help the Subcommittee with your information and answering our questions. I have already, perhaps you have heard, given more formal introductions of you in terms of your biographical background.

I think we will call upon you in the order listed. So, first, we will hear from Mr. Michael Gadbaw, Chairman of the U.S.-Indonesia Business Committee of the U.S.-ASEAN Business Council and a an officer in General Electric.

Please proceed as you wish. Your entire statements will be made a part of the record, and you may proceed as you wish. Summarize or read portions—whatever suits you.

STATEMENT OF MICHAEL GADBAW, CHAIRMAN, UNITED STATES-INDONESIA BUSINESS COMMITTEE, UNITED STATES-ASEAN BUSINESS COUNCIL

Mr. GADBAW. Thank you, Mr. Chairman. I will do a summary of my testimony and agree to have the full text put in the record.

Mr. Chairman and your colleagues, I am pleased to be here on behalf of the U.S.-Indonesia Business Committee of the U.S.-ASEAN Business Council on its behalf. Chairman Bereuter, I want to thank you for your outstanding leadership and long-term commitment to Southeast Asia. The hearing today is an excellent opportunity to take stock of our current situation in Indonesia following what has been a breathtaking case of events. The sweep of positive changes in Indonesia must be seen to be truly believed.

Most recently, I was able to survey developments in Indonesia as the leader of a business delegation of 30 leading U.S. corporations who visited Indonesia from January 18 to the 20th. Our delegation was comprised of 48 senior U.S. corporate executives. The January mission called on President Wahid, speaker of the MPR, Amien Rais, speaker of the DPR, Akbar Tandjung, the attorney general, Marzuki Darusman, six key ministers and many others, including the new head of IBRA, Mr. Cacuk.

Our delegation concluded that the government of Indonesia, under President Abdurrahman Wahid, is committed to implementing changes necessary for full economic recovery. It is a challenging task. As the January 14th edition of Asiaweek suggested, President Wahid has probably the "toughest job on the planet." However, we believe that President Wahid has made an important start in naming key individuals to posts that will be critical to his success.

Among our mission's major findings and themes were the following: The Wahid government has prioritized resolving regional conflicts, re-establishing rule of law, civilian accountability over the military, judicial reform, and recapitalization of the banking and corporate sectors. While there is a consensus among the government and business leaders that foreign investment in Indonesia is a fundamental element of the economic recovery, it is clear that there is a wide range of definitions of acceptable levels.

Regionalism will be a continuing trend, and power will devolve from the central government to the province and district level. The legislative branch will demand more focus by the council and its Members, both in terms of policy work and business development strategy.

Sale of IBRA assets is likely to proceed more aggressively than in the past in the first part of this year, but it remains to be seen what type of financial structure will be allowed. Most agree that the optimum chance for 100 percent foreign owned deals will come earlier as opposed to later in this process.

Corporate restructuring looks unlikely to move quickly, as vested interests seem to have placed themselves strategically in key advisory roles and are likely to lobby hard for protection in legislative branch.

Bank recapitalization will take enormous political will by the Wahid government, and is not likely to get completed quickly, but they have begun the process, and we expect that that will eventually succeed.

Our business mission was in Indonesia at an auspicious moment, indeed, and extremely eventful week. The same week that our 48-member business delegation was there, the Wahid government and the IMF signed a new letter of intent that cleared the way for an additional $5 billion in IMF support, as you have just heard. The government also reached agreement on a new government budget, which I think, as you well know is no small task, particularly in a coalition government.

When presented to parliament on January 20th, the budget was cast as a blueprint to reduce the size of the deficit and Indonesia's reliance on external financing. Significantly, the budget seeks to defuse regional tensions by addressing the need for fiscal decentralization. Two weeks later, in response to this good news, Indonesia's international donors, under the umbrella of the Consultative Group on Indonesia, approved an additional $4.7 billion in new assistance to Indonesia.

In addition to our delegation, Secretary of the Treasury Summers was in town the week of January 17th expressing support for Indonesia. This is evidence of a concerted U.S. Government effort to engage Indonesia at this critical time in its economic and political transition. We also applaud the initiative by Senator Kit Bond in bringing a delegation to Indonesia, and we encourage other such congressional visits.

In another critical development that week, the government announced that it would drop its lawsuit against energy company P.T. Paiton. In return, the power plant sponsors agreed to withdraw their international arbitration, and both sides agreed to begin earnest negotiations under the leadership of the new PLN President Kuntoro. This is a 2-year dispute over contract terms negotiated with a previous Indonesian government. Many in the private sector of the United States view resolution of this dispute as a barometer of the new Indonesian government's commitment to contract sanctity. The commencement of negotiations is therefore an encouraging turn of events for stakeholders in Indonesia's economy.

Despite this incredible effort on the part of the new government to address its most basic economic problems, the international

media that week focused almost entirely on social disturbances. In no way would I want to minimize the human cost of the disturbances. They are, indeed, very serious. In the particular case of Aceh, the underlying political issues pose a threat to the nation's unity. However, I am suggesting that focusing almost exclusively on these conflicts has created an incomplete and indeed distorted image of what is going on in Indonesia.

On our mission to Indonesia, we raised many core business issues, both with the Indonesian government and with our counterparts in the private sector. We discussed with them a detailed set of policy issues from power deregulation to telecommunications reform to agricultural reform that are critical to U.S. business interested in stimulating additional trade and investment, and they are captured in a paper re-entitled "U.S.-Indonesia Business Committee, Dashboard, Key Goals," which I would be happy to submit to the Committee if you would like that level of detail. We also discussed the importance to American business of on-going U.S. Government programs, including Ex-Im Bank, TDA, and USAID. We found the Indonesian government very much open to suggestion and quite engaging on our most pressing concerns.

Prior to the crisis, Indonesia's economy averaged 7 percent growth per year for 25 years. It had created a middle-class conservatively estimated at 20 million—a larger population than all of Australia. To be certain, some of this remarkable growth was unsound. But a great deal of it is attributable to Indonesia's integration into the global economy, conscious diversification, the strengths of the Indonesian people and Indonesia's other natural resources. Structural economic reform carried out to its designated end and political stability will once again permit Indonesia to make the most of its national assets. Speaking on behalf of the U.S.- Indonesia Business Committee of the ASEAN Business Council, I am confident of this. I am also confident that President Wahid and his government is up to the task.

Let me close by thanking you once again, Mr. Chairman, for the opportunity to testify. We have been very fortunate to have been given the opportunity to publicly report the findings of our missions to Congress following each of our visits to Indonesia, in either your Subcommittee, or that of your colleague on the Senate side, Senator Thomas. It provides the U.S. private sector a regular channel through which to provide fresh policy input to Congress. It is a tradition that we hope to continue.

Thank you.

[The prepared statement of Mr. Gadbaw appears in the appendix.]

Chairman BEREUTER. Mr. Gadbaw, thank you very much for your testimony. We are glad to receive information from you and other business interests that have an American perspective.

I would, at this point, ask unanimous consent that a statement from the U.S.-Indonesian AmCham also be entered into our record. Hearing no objection, that will be the order.

Our next witness is Dr. Theodore Friend. He is Senior Fellow at the Foreign Policy Research Institute and President Emeritus and Trustee of the Eisenhower Fellowships.

Dr. Friend, we know of your expertise on Indonesia and other foreign policy issues so we look forward to your testimony. You may proceed as you wish.

STATEMENT OF THEODORE FRIEND, SENIOR FELLOW, FOREIGN POLICY RESEARCH CENTER

Dr. FRIEND. Thank you very much, Mr. Chairman.

Given the expert initial statement by yourself and the witnesses that have preceded me, I will skip over a lot of what is in my written statement, trusting that will appear in history somewhere.

Chairman BEREUTER. It will be part of the record.

Dr. FRIEND. Thank you. Focus on three things, reading from my statement only at the very end on American policy salients.

I think everybody in this room feels an enormous hope or even personal affinity to Abdurrahman Wahid, known as Gus Dur. I am going to use that name for him, because I feel I am among his 10,000 most intimate friends. He invites friendship everywhere, and he is a tremendously accessible person.

But with all that can be said for him, I think we have to face into some of the immediate problems. It needs to be said that no president of Indonesia until him made evident his beliefs in gender equality, racial equality, and religious equality. He is a universalist Muslim. That is a tremendously valuable thing for Indonesia and I believe for our international relations.

Second, of course, no Indonesian president made evident his belief in democracy, rules of law, and transparent business transactions. So, we have got six enormously important qualities residing in this one man. Mr. Gadbaw has referred to some of the last three. I just want to emphasize them from the point of view of an independent historian.

Gas Dar faces, as I detail in my papers, three kinds of major problems: six separatisms, a couple of ethno-cultural tensions, and distorted institutions left over from the Suharto regime. The most distorted, I am sorry to say, is the army upon which he must rely to get the country back together.

Now, because my predecessor to my right has said the newspapers have over accentuated some of the negatives, I will try not to do that, but leave in the record what I have tried to detail usefully to this Committee.

Indonesia, I believe, can prevail over the several things tearing it apart. Even if all six separatisms succeeded, it would amount, if the Far East Economic Review is correct, to only 17 percent of the GNP. So, you can say, if you want to take a relaxed point of view, five-sixths of Indonesia would survive in economic terms. But I think our interests there are not numerical in that way. I think our interests are two: They are ideal in the sense that we want to see this democracy work; and they have to deal with the Straits of Malacca and the passage of oil to our allies in Korea and Japan. So, it is this geo-strategic interest combined with an ideal interest—conceptual and concrete, both.

They unite in the fact that Indonesia used to be the center of gravity of ASEAN, and now that is pulled apart. So, we want to see Indonesia reassemble itself, hold together. I expect that Mr. Faleomavaega, may not totally agree on that, but we want to see

Indonesia hold together. We want to see it to be a counter weigh to negative things in that region.

A stabilized democracy is the best guarantee of security throughout the region and our own international security interest. To be questioned the sooner, let me make a couple of summarizing remarks.

As the only, perhaps, think-tank historian here, let me talk about long-term prospects, very long-term, while respecting the excellent expert advice in the earlier panel. My view of Indonesian recovery is in multiyear terms. Reattracting capital and regenerating first-rate business momentum in a fresh transparent environment could take—to get back to old levels and go beyond them—could take as much as 5 years in my view, and that is the fastest recovery. Business, I believe, and I respect it, actually seems to modernize practices faster than other institutions. Reforming and professionalizing the army could be achieved in 5 or 10 years. Recovering lost ground in education and achieving new plateaus of learning and skill could be done in 10 or 15 to a level that amounts to something. Rescuing the court system from corruption, alluded to twice by Undersecretary Geithner, or maybe thrice, and nourishing rule of law, could reach significant effectiveness in 15 years, or at best 10. All of this obviously intuition thinking.

If Indonesia with leadership, luck and patience can achieve substantial progress by sustained effort in these tasks, its fifth democratic election successively in 2019 could see it standing proud among the world's democracies. It stands modestly there now, and also in jeopardy. With synergy among all the enterprises mentioned, the goal could be achieved in the fourth or maybe the third such election. So, I hope this Committee and other leaders of our government will stay the long course with this major fragile nation.

How can we help? Let me explicitly state six ways:

Explicitly support the values that the reform government represents. Nourish Gus Dur as the elected leader with moral support, without over personalizing the relationship as we may have done in some other countries in past times. We can love the man, but we have got to deal with a country that is highly volatile, friable—and plenty of other adjectives, too.

Two, endorse what I understand and which I heard, from Secretary Roth specify, so I will allow myself to use the numbers, to be a proposed expansion of the USAID budget from $75 to $125 million. I think that is an excellent step.

Support IMF and World Bank projects and ADB and other multilaterals. It is very invaluable for Indonesia recovery. My sense of IMF and World Bank is that they have responded to criticism since the Asian crisis on timing and discipline, and they are going to do their best.

Fourth may be more controversial—reinstitute (I believe not controversial with the Chairman here) reinstitute IMET and JCET Programs for advanced education of Indonesian military in the United States. Punishing a past Administration does not help the present one. Breaking such ties does nothing to advance the reform movement within the military, let alone develop future relations with a future reformed military. So, I think we have got to start now. Others know the obstacles much more than I. I just encour-

age, if I may, getting over the obstacles. The current free press—let me offer one example—in Indonesia was launched by a retired general as minister of information, who learned his Jeffersonian principles at Fort Benning, and he proudly attests to that fact.

Fifth, encourage public and private foundations to form consortia, as was done in Eastern Central Europe after the Berlin Wall fell. Now that all the Suharto walls have fallen, we should do the same. Here, I am really talking to colleagues in private and public foundations, so I will not take more of the Committee's time. But every field that the Committee has mentioned has been iterated here—educational, health, free press, and law, plus others.

Last, a strategic point: stand fast in the whole Southwest Pacific. Pull away no military assets. I think we should remain what Lee Kuan Yew asked us to be a long time ago, "the sheriff of the Pacific." Recognize there are difficulties. Islamists in South Malaysia are getting together with separatists in Aceh and supporting them with arms and money.

Tactical moves and occasional statements by China suggest they would like to be a posse leader, but I believe that they are going to have to be preoccupied with the Taiwan Strait for a long time before they dare into the Strait of Malacca. Still, we must recognize the whole region may be becoming a little more like our own "Wild West" than it was 20 years ago. This is a much more volatile time in that region, so we must be prepared for restrained action.

To summarize: our two major interests are a conceptual support of democratic values and concrete protection of free passage of oil through the Malacca Straits. I believe support of Indonesian democracy will help stabilize the government and ensure the realization of both center of gravity in ASEAN, and a center of democracy in the Muslim world and the world entire.

Thank you, Mr. Chairman.

[The prepared statement of Dr. Friend appears in the appendix.]

Chairman BEREUTER. Thank you very much, Dr. Friend, particularly for your concluding six areas of recommendations which you have summarized.

Next we will call upon Mr. Eric Bjornlund. He is Director of the Asia Programs of the National Democratic Institute (NDI), and, as I think I said in introduction, and I hope I am right, this is probably your largest overseas activity. You in fact have been personally involved in it so we are looking forward to your testimony. You may proceed as you wish.

STATEMENT OF ERIC C. BJORNLUND, DIRECTOR OF ASIA PROGRAMS, NATIONAL DEMOCRATIC INSTITUTE

Mr.BJORNLUND. Thank you, Mr. Chairman, for this opportunity.

I will not speak from my statement or really even summarize it. I just want to draw out a few points.

In fact, I have lived in Indonesia for more than the last year, and I must say today I am encouraged by the discussion that seems to reflect increasing recognition of the profound changes that have happened in Indonesia. It does not always seem that way to those of us in the international community in Jakarta. It sometimes seems like the policy debate in the rest of the world was more about how to deal with a semi-authoritarian country, whether and

to what extent to engage. I think that some of those premises have been mistaken, and I am glad that it is clear from this discussion that everyone testifying here and the Members of Congress have today understand how profound the changes have been in Indonesia.

I think the intrinsic importance of the country I don't need to remind you of, and Dr. Friend has pointed out a number of important factors. What I think is important to remind everyone of you the record is that this is a very important time in Indonesia's history. Not only is Indonesia an important country, but this is a very historic opportunity for Indonesia to consolidate a democracy. It has changed dramatically in the last 2 years.

Indonesia is a profoundly different country, not only because of the fact that there have been democratic elections that were essentially accepted by all political forces, not only because there is a new democratically elected government and legislature, but also because there is been broader political liberalization. There is a free press; there is freedom to organize political parties, and there is a different set of expectations by the public and by the political elites and expectations for the future.

I think all of us recognize, as well—everyone in this room recognizes—that democracy in Indonesia is still very vulnerable. We should be talking about how the international community can help a democratic country, a real democratic country, but one that is still very fragile, a democracy, a transition that still faces many challenges. The new president and his multiparty national unity government recognize that fragility and are trying to deal with those challenges. The important thing that I want to underline is that they are worthy of our support, that the transition in Indonesia, the country of Indonesia is worthy of support for the process of institutional reform.

I mentioned in my prepared statement eight specific challenges that confront the institutionalization, the consolidation of democracy in Indonesia. I will list them, but I want to talk a little bit about three of them in particular. To a significant extent, these are short-term challenges. Dr. Friend talked about the long-term process, but there are many aspects of these challenges that must be confronted in the short-term.

The list that we have come up with is, one, civil military relations, ending the military's extensive involvement in politics—this has been much discussed today; second, the problem of separatists and communal violence; third, the process of constitutional restructuring; fourth, the need for election reform.

I won't talk about that verbally today, but I would like to make it clear that although the elections were successful last year, they carried the seeds of many problems in the future. There are fundamental questions that need to be addressed about how elections are organized in the future, such as whether future elections should be organized with a very complicated system of proportional representation, how the president is elected, and who should administer the elections, whether the authorities who run the elections are credible.

Five, is the problem of decentralization and devolution; six is the empowerment of the legislature; seven is rule of law. This includes

not only strengthening the judiciary, but also attacking corruption and addressing human rights abuses. Eight is the role of civil society.

Most of these, seven of these eight, are what we in the business of promoting democracy will call supply side questions. They are questions of whether institutions can deliver a democracy, whether the supply of democracy will be there; in other words, whether existing institutions can be appropriately reformed or new institutions can be established that will make democracy real in Indonesia. The last is about the extent to which the political parties and civil society organizations as intermediaries for the public can maintain pressure for democracy and can maintain the demand for democratic institutions.

If I can I would like to just take a few minutes to mention three of these issues in a little bit more detail with some idea of what some of the appropriate responses in the short-term might be.

The first I wanted to mention is constitutional restructuring. The Indonesian constitution is a vague document that was written in a very few days in 1945, and it has been used to legitimize authoritarian rule for much of the last 50 or more years. Nevertheless, there is broad agreement in Indonesia that it shouldn't be scrapped and that it should be merely amended.

The MPR is the larger legislative body whose most important responsibility is to elect the president and vice president, but that also has the power to amend the constitution. In its meeting last October, the MDR adopted a first amendment making some amendments to the constitution. They consciously decided to follow the U.S. style in not rewriting sections of the constitution but rather making amendments.

One item of consensus also has been to not change the preamble to the constitution, which means Indonesia will not have to have a fractious debate over what kind of state it is—what the role of Islam in the state is, for example—but rather can focus on institutions of government.

The first of the most important challenges, the most important issues, in the constitutional debate is what the process is by which the president is elected. I think there is an emerging consensus that there will be a direct election of the president in the future. As you know, President Abdurrahman Wahid was elected by this 700-member body, the MPR, that was about two-thirds directly elected and one-third elected by regional legislatures and appointed, and there is an expectation that that will change in the future.

A second important question is whether the country will adopt a bicameral legislature as part of its response to the problem of separatism and sentiment for independence around the country. It would change this MPR body, this larger legislative body, into something along the lines of the U.S. Senate.

The third question is whether Indonesia will become a Federal state or how regional interests will be protected in the constitution.

The fourth is the extent of separation of powers and checks and balances.

We believe that it is important for the international community to provide comparative international experiences to the MPR, the

body that is amending the constitution, and to civil society and to parties on what is possible in this constitutional reform process, and we encourage civil society organizations to continue to monitor and advocate changes and to develop a process that is inclusive, that involves the public in the constitutional debate. Indonesian political elites seem very open to international advice, if it is provided in an appropriate way. They are interested in the American experience, as I have alluded to, among others, and they want to try to use this opportunity to develop a constitution that will institutionalize their democracy.

The reason that this is an important issue in the short-term, in part, is because the MPR has decided to amend the constitution at its meeting in August of this year, so it has 6 months to try to make some very fundamental decisions. The opportunities for the international community to try to help with that process are very much in the short-term.

The second issue I wanted to mention in a little more depth is the process of strengthening the legislature, working with the DPR—that is, the national legislature. The new national legislature has 21 political parties represented in it. They are elected in a system that doesn't develop strong ties to constituencies. They need to determine how to support the interests of their constituents. Eighty percent of the Members, roughly, are new, have not served in the past legislatures, and much of what they do now will set precedents for the future.

Once again, we think there are opportunities for the international community to offer advice to explain how legislatures work in other countries; to create exchange opportunities for these members of the legislature, many of whom, as I said, have not served in the national legislature before; to help with their rules and procedures, their system of ethics disclosure, their process of developing professional staff and the like. These opportunities, again, are very important in the short-run, because much of what they do now will set precedents for the future, and in the absence of other information, they look to the precedents of past legislatures that were much less real.

Finally, I wanted to mention the importance of supporting civil society organizations and political parties. These organizations must perform well in order to maintain the pressure for democracy in Indonesia, in order to ensure that the public does not become dissatisfied with the performance of the government and the parties and the legislatures. There are enormous opportunities for the international community to provide advocacy training and organizational development advice, to share experiences from around the world on how parties can be successful, on how advocacy organizations can influence public policy, and how they can operate within a democracy.

As I mentioned in my statement, we believe that the United States has performed well in its support for the election process in Indonesia, and we believe it is important that there be continued efforts to support the consolidation of democracy and to continue to work with the new government, not only at the national level but also at the provincial and district levels; with the legislatures, with the DPR and the MPR, the two parts of the national legislature,

with parties and civil society organizations; with the judiciary; with trade unions; with media. There are enormous opportunities, and many of these opportunities are particularly important in the short-run.

The question about the levels of foreign assistance and the extent of diplomatic support seems to be coming clearer. Not long ago, it seemed that foreign assistance actually might be going down, so it is encouraging to hear what we have heard today.

In the short-term, there will be fundamental decisions made about institutions, as I have said. There will be precedents established that will have influence far into the future, and there are these challenges that we have talked about and that you are aware of that threaten serious crisis to the new government and to the new democracy. But I—in the longer-term, I share the optimism of the others who have spoken today about the prospects for Indonesia.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Bjornlund appears in the appendix.]

Chairman BEREUTER. Thank you very much, Mr. Bjornlund, for your excellent statement, too. It is organized in the eight major challenges with your focus on three of them in particular, and the appendix is attached to give us more detail on the NDI Programs.

I would just say that those favorable comments we heard from Secretary Roth and also from Secretary Albright this morning about funding for Indonesia in the next year and 3 years sound good, but, with the pressure for Wye River Accords appropriations and with the restiveness on the part of the Black Caucus and the Latino Caucus, it could well be that we will be scrambling to find sufficient funds in the appropriations process for the programs that are identified for Indonesia. Those of you who are interested and concerned about that will have to weigh in with me.

I would like to begin my questions, and then we will proceed back and forth here with Mr. Faleomavaega. Perhaps the first question addressed to Dr. Friend and Mr. Bjornlund in particular.

We have this widespread ethnic and religious violence in the East Timor region which may have set something in motion in places like Aceh, Irian Jaya, the Spice Island areas, and so on. How much of what happened in East Timor, in your judgment, has influenced what is now happening in those parts of Indonesia? To what extent do you think a genuine Federal system is a likely possibility, and what do you think the long-term prospects are, as we look at Indonesia today, for maintaining Indonesia's national unity?

Dr. Friend, do you want to try first?

Dr. FRIEND. Yes, sir. Thank you for those penetrating and provocative questions. I think the terrible atrocities in East Timor have chiefly affected Aceh, because there is an analogy of army behavior there going back to 1989 to 1992 when there was ruthless suppression of the previous insurgency; also one in the seventies.

The very apparent looseness of national unity as a result of all the things we have seen since the Asian economic crisis has helped produce an environment in which the other four separatisms have emerged, of which the one with the greatest historical persuasive-

ness, though not as compelling to me as to Congressman Faleomavaega, is in Papua. I would put the others in descending order of seriousness. Riau, for instance, just had a provincial popular Congress within days, and they voted more than half against independence and some for autonomy and some for federalism. I think that would be true in most places. So, I think high profile Aceh is really critical, and the others are of descending seriousness.

What are the chances for federalism, your second question. I believe it is not a lovely word to Indonesians, as you know, because the Dutch used it in a kind of ploy in the late forties, a really strategic ploy to keep part of Indonesia. So, Gus Dur tried to say "we can't say it; but what other word is there? We need to be Federal." I just wish he would say, "Well, let us have more regional autonomy," and I think he is saying that, and they are doing that now, and the new minister for regional autonomy is a very able woman. So, I think whatever it is called, a decentralized and better-coordinated Indonesia is within view; it should be within view, and can be achieved.

Your third question, the unity question, I think is probably answered, at least within my terms, by my answer to the second one, that some careful form of decentralization is the best guarantee of long-term unity.

Mr.BJORNLUND. I think that the problems of East Timor have certainly complicated the situation for Indonesia and have encouraged some independence sentiment in some parts of the country. Federalism or something like federalism is part of the response to that, and I think we should be encouraged that there are many political elites in Indonesia, including the president of the country, who recognize that the grievances of places like West Papua and Aceh are grievances about past human rights abuses and about control of resources as much as they are a security issue. They recognize that this is a political and economic problem, not a security problem.

The concept of federalism itself is controversial, and in recent months it has seemed that sentiment has swung away again from calling it that, but the important question is whether there is some kind of national deal, whether there is some kind of negotiated process about the nature of the state and about the relationship between the center and the regions that has broad support in the regions, including in the places where there is strong separatist sentiment or strong independence sentiment, and that that deal is somehow constitutionally protected or entrenched in some way that it doesn't just become a question of the good will of future governments as to whether that deal is honored.

We are optimistic about the possibilities that that process will be reasonably successful and will have broad political support, including in the difficult parts of the country, and that there will be much more regional autonomy, much more local democracy, much more local control of resources. We are optimistic that greater regional autonomy will somehow will be constitutionally protected and that the national unity of Indonesia isn't necessarily threatened.

Chairman BEREUTER. Thank you, Mr. Bjornlund.

Dr. Friend, I wanted to mention that I specifically appreciated the six areas of specific recommendation you made to us, most of which involve our government to some extent. Some would be primarily directed to the NGO community, and I noted with interest that your comments that the free press in Indonesia was launched by a retired general while serving as the Minister of Information who learned Jeffersonian principles at Fort Benning.

When I visited with the Chief of Staff and the entire general staff about 3 years ago, every single officer in that room—about 10 to 12—had been to a U.S. military school. Several of them gave me a high-five when they realized I had attended Fort Benning Infantry School, too a long time ago. I am not surprised that the retired general had been through some military exposure in the U.S., but, unfortunately, we have lost a generation or perhaps a half-generation of field grade officers who have never had that American experience.

Dr. FRIEND. Yes, sir.

Chairman BEREUTER. Mr. Gadbaw, a question for you. Some have criticized the IBRA for moving too slowly to dispose of assets and dealing with banking and company debt restructuring. They say it is too weak or too bureaucratic. What is your view of IBRA's performance at this point, and what would you like to see it do differently for the benefit of Indonesia and, for that matter, for American business who might be increasing their activities in Indonesia?

Mr. GADBAW. I think the private sector would share the assessment that it has been a very slow process, and indeed they have even stumbled a bit in their first efforts. I think that we had the opportunity to meet with the new head of IBRA Mr. Cacuk, who I think is an individual, who holds the kind of possibility to bring together the unique set of political and economic and commercial talents that IBRA needs in order to succeed.

When we met with President Wahid, he clearly set the political objective, which is that IBRA move forward very quickly to begin to dispose of those assets that it holds, and indeed it holds a good part of the country's assets, and begin to sell those back into the private sector, and that is indeed the test for IBRA's effectiveness. We are seeing in the way that IBRA handled the Astra sale that they have been able to make some progress on that front. Mr. Cacuk told us that he is very open to American business participating in those sales. The test will be what kind of deals, what kind of structures can be put together to make that possible?

There are companies, my company included, that are working with IBRA. The reports we have gotten really even since our visit, which was now some 3 weeks ago, are that there is a new atmosphere, a new working relationship with the private sector, with the foreign investment community that has been brought in by the new IBRA leadership. I think the test is clearly now before them to see if they can produce the results that are needed to recycle these assets back into the private sector, to bring the kind of management combination of foreign and Indonesian management talent that will restore private investment, both domestic and international, to Indonesia.

Chairman BEREUTER. Mr. Gadbaw, Undersecretary Geithner talked about the need for autonomy of the Central Bank, and he

talked about the privatization of some of the banking structure within Indonesia. I know this is not your personal area of involvement in the business sector, but I think he said he expected that we might more likely see a greater degree of foreign interests possible in the banking structure early versus some years from now, which was an interesting statement and I think somewhat encouraging. It may, however, just reflect the degree of the crisis they have in their banking structure.

To what extent do you think American and foreign banks would be likely to be permitted to be involved in what foreigners call retail banking, in Indonesia? With a larger presence of American banks and their ability to deal not only in investment banking but also in what is called retail banking, how much of a factor is that in encouraging American business enterprises in Indonesia?

Mr. GADBAW. I think that is an excellent question, and you are right that my crystal ball doesn't go very far. I will say that within our delegation we had a number of American banks represented that are looking into that very issue. I can say for my company, GE Capital has been active in Indonesia. They have been in the nonbank financial sector. They have credit card operations, they have auto finance activities, and they have personal credit activities.

Interestingly enough, they reported to me that the incidence of failure to repay debts, the measurements that they have in Indonesia, they are performing better than virtually anywhere else in the world; that is to say they manage their portfolio very carefully, but there is a community of middle-class individuals that are able to carry debt and to manage that debt effectively, and I think that does give one hope for the future.

It is clear that there are American banking and financial institutions that are in Indonesia right now working with the ministry of finance and looking for the varied licenses that you have identified in the retail banking area. I don't think we will know what the real prospects are until we see one of those deals actually get structured and succeed. It hasn't happened yet. Some of the examples, obviously, the Bank Bali incident has really set a negative tone in that area, but it is something that the government has said they are open. They are open to all the possibilities.

The reports we have are that this is very much in the forefront of discussions, so there is a lot of optimism in the air, but the test will really be what kind of deal is actually structured, what kind of foreign participation will there be, and will those institutions actually begin to function effectively in the economy?

Chairman BEREUTER. Thank you very much.

Mr. Faleomavaega, you have been very patient.

Mr. FALEOMAVAEGA. No problem.

Chairman BEREUTER. Please proceed with your questions.

Mr. FALEOMAVAEGA. Thank you, Mr. Chairman.

Just a couple of questions. Am I to understand correctly, at least from the previous witnesses, the total business investment that the U.S. has in Indonesia is about $7 billion? Is that correct, Mr. Gadbaw?

Mr. GADBAW. The figures that we have are that it is close to $8 billion. I can share with you a document that we put together that gives at least a chart. This is the total——

Mr. FALEOMAVAEGA. I am sorry, I am little blind here. What is it again? It is about $8 billion?

Mr. GADBAW. It should show approximately—excuse me, $7 billion. I believe what Undersecretary Geithner said was 6.9, and the bar chart, if you can discern it, shows for 1998 cumulative direct U.S. investment of closer to $7 billion.

Mr. FALEOMAVAEGA. Almost $7 billion.

Mr. GADBAW. That is correct.

Chairman BEREUTER. Without objection, I would like to have this entered into the record.

[The information referred to appears in the appendix.]

Mr. FALEOMAVAEGA. Please, by all means, Mr. Chairman.

Mr. Gadbaw, do you have a breakdown in terms of the kinds of businesses that we have from the U.S. that are making investments in Indonesia? Is this primarily from the lending institutions or menu factoring industries? Do we have a breakdown?

Mr. GADBAW. I think we can certainly work with the Department of Commerce to get you a more detailed breakdown than I can give you, but I would say that from my experience, it is clear that the oil and gas and the mining sectors are the largest areas. What we saw, however, before the crisis was that there was a significant increase in the manufacturing and service areas, and companies like my own that are in manufacturing——

Mr. FALEOMAVAEGA. When you say the crisis, do you mean the East Timor crisis or——

Mr. GADBAW. I mean the financial crisis.

Mr. FALEOMAVAEGA. The financial crisis.

Mr. GADBAW. I was referring to the financial crisis. Of course those coming simultaneously complicated the matter.

Mr. FALEOMAVAEGA. Sure.

Mr. GADBAW. But it is clear that there is a lot of interest on the part of manufacturing companies. The auto companies were all present on our delegation. The telecommunications companies are all actively pursuing, looking at opportunities in the service area. There are companies across the board that want to get involved in the full range of services.

Mr. FALEOMAVAEGA. So, you are saying that basically out of the $7 billion, of U.S. total investment, maybe $4 billion is in oil, gas, and minerals and the sort?

Mr. GADBAW. I would say that is the largest piece. I am not able to say whether it is $4 billion or not, but that clearly is the largest piece.

Mr. FALEOMAVAEGA. You would say the majority.

Mr. GADBAW. That is true.

Mr. FALEOMAVAEGA. How does it compare to investments from the European countries, our investment?

Mr. GADBAW. We are, with Japan, one of the largest investors, so if you compare it to individual European countries, we would be larger. I think the EU, as a whole, probably would start to come close to ours.

Mr. FALEOMAVAEGA. There was a question earlier, Dr. Friend, about reinstituting military training for our Indonesian friends. It is a paradox that we find ourselves in. Nicaraugua's dictator Samoza was also a cadet at West Point. He was one of the friends that we had in Central America who was later ousted because of his dictatorship.

I wanted to ask you, over the years, as you know, the military top brass in Indonesia has been trained by the U.S. Is this a positive thing that we, as a country, should do to train the military of other country's with the expectation that they become pro-democracy? Do they in fact become supportive of democracy?

Dr. FRIEND. I am sure we could get a roster of cadets who turned out badly, Congressman Faleomavaega.

Mr. FALEOMAVAEGA. Except for those that went to Fort Benning.

My question to you, you can talk about Sukarno in the mid-sixties and you talk about Suharto, and I am positive that many of the top officers that we now have in the military in Indonesia were U.S.- trained. Given the problems that we have had, as I have said earlier, historically about what happened to West Papua and East Timor and other places, has U.S. military training been effective and do you see where I am going?

Dr. FRIEND. I believe I do so. I am sensitive to it. I think I recognize the seriousness of the point. I think the point applies, as you have already mentioned, to Latin America and may apply to other places as well.

Mr. FALEOMAVAEGA. See, we always give you good intentions.

Dr. FRIEND. Congressman, it is my trust and I hope it is not just democratic faith, that in the end if there were an ability to strike a full balance on this, we help more than we hurt. I can't really make a scientific statement; I can't even make a social-scientific statement, but I do believe that it is better to engage these militaries in short segments of advanced training where they can read Jefferson for the first time or read Hamilton or read Ralph Waldo Emerson.

Mr. FALEOMAVAEGA. Do you think any of these soldiers knew anything about Jefferson and Emerson and——

Dr. FRIEND. Very few in Indonesia. It is a real eye opener for General Yunus Yesfia, who is the man I am talking about and referred to, a real eye opener. I mean, he just was enlightened by being in America and at Fort Benning. When he got the opportunity, under President Habibie, he was given a wide portfolio, and he immediately started issuing licenses for publication and has kept on going to the point that now there is no need even for a license. Now, we have the opposite problem coming at us—or coming at Indonesia, which is the licentious ultra-free press, and that is why I mentioned in my paper the need for media grants to help train people in the limits of a free press.

But to come back again to your question, which is very serious, my answer has to be on faith, on balance. I reiterate, if you will allow me, what Chairman Bereuter said a moment ago: We have lost a half-generation of contact there with leading military officers, and we need to regain that contact as we do in the all the ways that Mr. Bjornlund was talking about, all the ways Mr. Gadbaw was talking about. We need that kind of contact, too.

Chairman BEREUTER. Will the gentleman yield for a second?

Mr. FALEOMAVAEGA. I would gladly yield, sure.

Chairman BEREUTER. I think, for the record, it probably should be pointed out that the training we provide through IMET or EIMET is basically very senior enlisted personnel or generally officers in the major, lieutenant, colonel era. They do not receive their basic education or training in a military sense in this country, but they do have this exposure for 4 to 12 months, and I think exposure's what we are talking about, not basic training for either enlisted or officers.

I thank the gentleman for yielding.

Mr. FALEOMAVAEGA. I thank the Chairman for enlightening me on that.

We have a very interesting dialogue here. The gentleman is an officer; I was just a grunt in Vietnam, and it came to the point I wanted to shoot every general there was given the situation that we ended up with in Vietnam. These were highly trained officers, mind you, some even went to West Point and the Naval Academy.

The point here is that we have good intentions. We have done this with other countries, not just Indonesia, with the hope and the desire that these military officers will respect democratic government. Thank God that the history of our country reflects the military has always acquiesced to civilian authority.

So, I am glad the chairman is correct in the fact that these are very senior officers in Indonesia that were being trained. Now, I am talking about the grunt out there that was ordered by these senior officers that went out there and started doing the killing. If you can call it killing—there is a difference between killing and murdering, you know. The mass taking of life by the military during the dictatorships of Sukarno and Suharto have not been examined by any international court of justice. The authorities committed in East Timor and West Papua and throughout Indonesia during periods of political upheaval several hundreds of thousands of lives, or murder for which no one has been held accountable.

Dr. FRIEND. I hope if I insert a word, Mr. Congressman, that my history will get that on paper and available to readers.

Mr. FALEOMAVAEGA. I look forward to reading your book when you publish it.

Dr. FRIEND. My deadline is June 15, 2001, sir, and I am marching along on schedule.

Mr. FALEOMAVAEGA. Just one more question, Mr. Chairman.

Mr. Bjornlund, in our discussions on Indonesia, I have not heard one instance where a Muslim country has given assistance to Indonesia. Are the Arab countries giving any assistance to Indonesia, economic assistance?

Mr.BJORNLUND. I don't know. I don't know about economic assistance. Maybe Mr. Gadbaw knows. In terms of supporting the democratic transition process, the United States plays a very important role, and United States programs take chances that many other countries are not willing to take. I think that is something to recognize about U.S. assistance in the democracy area around the world, that there are programs that American organizations with American government funding are willing to carry out that are some-

times risky and are very important that many other countries in the world are not able or willing politically to take on.

In Indonesia, the United States was clearly ahead of the Europeans, for example, in providing assistance to the democratic transition process, as I think the U.S. should have been.

Mr. FALEOMAVAEGA. Of course there is also the paradox that we find ourselves in when promoting democracy and the rights of women around the world, but you don't talk about that in Saudi Arabia. Saudi Arabia happens to be ruled by a king who some call a dictator, but who is very pro-American. They have an entirely different set of values in terms of democracy and the rights of women. We talk about abuses that as far as their culture is concerned are perfectly all right, because it is in line with the Koran. I don't question that either because of the cultural difference on how we perceive things.

Mr.BJORNLUND. There is been a sentiment among many in Indonesia for many years that the government was not concerned about Islamic values and was not representing the point of view of religious people in the country, that the past governments were nationalists, secular in their outlook. I think that concern, to some extent, continued right through the selection process of the current president.

But what I think Indonesians will increasingly come to realize is that a democratic Indonesia has to be concerned about religious people. Because it is a country that is so predominantly Muslim in its makeup, a democratic Indonesia will obviously protect religious values in the country.

The nature of Islam—Dr. Friend can talk about this much more than I can—but the nature of Islam in Indonesia is very different from the nature of Islam in the Middle East.

Mr. FALEOMAVAEGA. That is right.

Mr. Chairman, thank you very much.

Chairman BEREUTER. Thank you very much, Mr. Faleomavaega.

I have a final question, and I will direct it to you, Mr. Bjornlund, but Dr. Friend and Mr. Gadbaw may also like to make a comment.

Your No. 7 challenge is reforming the judiciary and establishing the rule of law, including addressing the problems of corruption and human rights abuses. I would like to know now, during this hearing, what you might say to us about where we ought to direct those funds and by what channels in an aid program we might begin for fiscal year 2001, the upcoming budget?

Also, I would like to know whether you would be willing to followup and after giving it some thought help us write some directive language which we would try to put in the appropriations process, if we don't have a separate authorization bill. At this point, not quite off the top of the head, but how do we proceed in this important area?

Mr.BJORNLUND. I think the area is enormously important. It is important over the longer-term as much as in the shorter-term. Many of the interventions that are possible from the international community, many of the ways in which international assistance can help, can only contribute to real change over time. Establishing the rule of law is something that can't be done by some particular intervention or foreign assistance program in the next few months.

So, we believe it is an enormously important area and deserves support from the United States and from the international community. Ar the same time, there are also needs in the political participation area, including many that are more immediate, and institutional decisions that need to be made, as I talked about earlier.

In the rule of law area, certainly one question is the judiciary and there are opportunities perhaps to try to help increase the professionalism of the judiciary. The legal profession, in general, is demoralized and standards are low, and many in the legal profession think there are opportunities to benefit from international engagement as to how to raise the standards of the profession, its credentialing process, its educational system.

The question of addressing past problems helps to reestablish confidence in the integrity of the legal process, certainly.

Chairman BEREUTER. And that was with respect to the Commission of Inquiry and the 33 people and perhaps already indicated on indictment. If in fact the Indonesian government does not proceed with bringing these people to justice in very general terms, then would you encourage an international tribunal?

Mr.BJORNLUND. It is important to try to allow the Indonesian process to work its way through the various compromises that need to be made and the interests that need to be balanced and to try to deal with the problem, because I think there are people in the government and in the human rights community that want this process to succeed, that want justice to be done, that want real investigations to happen, that want people to be held accountable, and to the extent that they can succeed, they not only address those past abuses, but they reinforce the institutionalization and consolidation of democracy.

Chairman BEREUTER. I agree with you. It is very important to give them an opportunity to do it themselves first, and maybe we shouldn't even think about a worst-case scenario.

Mr.BJORNLUND. I think that they are likely to succeed more or less in that process.

Chairman BEREUTER. With regard to the Human Rights Commission, which is about 4 or 5 years old, is it an institution worthy of our support and encouragement?

Mr.BJORNLUND. Absolutely. It is been a very important institution. It was important under Suharto, and it is only more important now.

Chairman BEREUTER. Who else would like to comment on this? It looks like both gentlemen.

Dr. Friend?

Dr. FRIEND. Yes, sir. I agree strongly with your emphasis implied in the question, and I address it in point 5-E of my concluding remarks. I would be happy to join with Mr. Bjornlund, who probably has more resources and connections in this regard than I do, to come up with some language with a little help from your staff, because I think this is a long-term project, and I don't think American bar associations, law institutes, law schools are alert to it the way they got onto the opportunity and the need when the Berlin Wall fell. We have got a different kind of wall having fallen, different opportunities and needs, and our not-for-profit institutions generally have not responded enough yet.

Chairman BEREUTER. I would like to take you up on your offer and hope Mr. Bjornlund will also agree.

Mr. Gadbaw?

Mr. GADBAW. Yes. This is one of the most important issues I think that the private sector sees when you ask the question about return of foreign investment capital to Indonesia. I think the rule of law and judicial reform is really very much at the top of the list.

A couple of points: When we met with President Wahid, he made an interesting statement, echoing what he said when he was here in the United States. He said, we value very much doing business with countries and companies that share our value system—democracy, rule of law, and political accountability.

When we met with the attorney general, Marzuki Darusman, he said, Indonesia is in a transition from a country whose system is based on political stability to one that the system will be based on the supremacy of law and respect for human rights. I think that means that there is at the political level a commitment to make the kind of changes.

I think there are two challenges when it comes to judicial reform: One is creating professionalism and accountability and an integrity in the system, and the other is creating political independence. There is a debate going on over what the right sequence is, because if you get independence before you are able to get professionalism and integrity, you may compound your problems. So, I tend to feel we have got to put as much emphasis on the latter to get that right as on the former.

I think that what we ought to focus on is twofold: One is creating some kind of focal point for a strategy where some group is able to lay it all out but at the same time engage all of the different groups that have to be engaged. As our Ambassador said, this effort will have to be a multiyear, multidonor, comprehensive strategy which actually engages both the private sector and the public sector across a whole spectrum of problems that will only address the issue if they can get all of these individual pieces right.

So, if you can get the focal point right and you can create ways to make linkages, whether it is bar associations, universities, fellowships, groups like NDI, linking up with counterpart groups, you create this network of both public and NGO-type institutions and the private sector. We have a need for an effective court system, professional, legal, and judicial individuals, all of which has to work effectively.

So, I think that kind of two-part strategy following under what I think our Ambassador there and the World Bank seems to be working on, which is again a comprehensive, multiyear, multidonor strategy, is the only thing that holds any chance of being successful.

Mr. FALEOMAVAEGA. Would the gentleman yield?

Chairman BEREUTER. I would be happy to yield.

Mr. FALEOMAVAEGA. I just want to make a little observation that sometimes when we have these expectations of a country like Indonesia that has just come out of a 30-year dictatorial rule, we have to give them some space. It has taken us almost 100 years, over 100 years, to recognize what civil rights are about, what the rights of all citizens under the Constitution should be. It is very easy for

us to say that we have got to do this or they have got to do that, but given the infrastructure and the complexity of a nation like Indonesia with all the problems attending it, I say let them do it at their own pace and their own ability to cope with each problem. Otherwise, I think we ask for something and get something quite different or probably even worse. That is just my little observation.

Chairman BEREUTER. Mr. Faleomavaega, thank you very much for that reminder.

Mr. Gadbaw, you really made a very interesting suggestion, and I think most people would embrace it. It certainly implies, at least, an international effort, not one that is a bilateral arrangement between Indonesia and the United States. I recall that an election assistance we gave came under a U.N. umbrella which was a very advantageous approach. But there is, in my quick examination of this, no logical international organization to do that. I would like to think it could be done. The IMF is only a small part of it, but the issue deserves some attention.

I wanted to say to Mr. Faleomavaega, I appreciate all of his continued assistance and interest in the Asia-Pacific region. We will hope you relay that to him for his involvement here today.

Gentlemen, thank you very much for your time with us today, for your testimony, and for your written statements. I very much appreciate it, and I hope we can count on you for future assistance to the Subcommittee in our efforts.

The Subcommittee is adjourned.

[Whereupon, at 4 p.m., the Subcommittee was adjourned.]

A P P E N D I X

FEBRUARY 16, 2000

Opening Statement

The Honorable Doug Bereuter
Chairman
Subcommittee on Asia and the Pacific

"Indonesia: Prospects for Political and Economic Stability"
Wednesday, February 16, 2000

The Subcommittee on Asia and the Pacific meets today in open session to receive testimony on the ongoing transition to democracy in Indonesia and the prospects for achieving political and economic stability and maintaining national unity. When the Subcommittee last held hearings on Indonesia on September 9, we were faced with a crisis situation in East Timor, as military sponsored militia were systematically killing, looting, burning and destroying the country. Attention was naturally focused on that crisis situation. At the same time, Indonesia was preparing for historic democratic elections which against considerable odds were conducted in a free and fair manner. They then had to select a new President and Vice President which resulted in the establishment of the first democratically elected government in that country in many decades.

Last week, the Subcommittee held a hearing on East Timor which discussed the situation and prospects for that newly emerging country. Today I emphasize for members of the Subcommittee, it is my intent that we focus our attention on the serious political and economic crises facing Indonesia, as it struggles to institutionalize a new democratic and decentralized system of government. Undoubtedly, this is a critical juncture in history for Indonesia and the stakes are high for it and the entire region. Indonesia is both the fourth most populous nation in the world, and the country with the largest population of followers of the Muslim faith. It is a country of stunning geographic and ethnic diversity, occupying an archipelago stretching over an area wider than the continental United States. Moreover, Indonesia is key to the entire Southeast Asian region. It was an original founder of ASEAN,, the Association of Southeast Asian Nations, and has emerged as the natural leader in that organization's emergence as an important contributor to stability and economic progress in that part of the world. Finally, Indonesia is a good friend and important trading partner of the United States. I believe it most surely is in America's national security interests to help Indonesia achieve the economic and political reforms necessary to ensure future stability and prosperity.

However, the situation in Indonesia remains troubling. The consequences of further economic and political collapse would be extremely serious and would adversely impact regional stability and U.S. national security. The necessary and painful economic reforms Indonesia must undertake would be daunting even for a well-established democracy. Indonesia must boldly undertake this action while at the same time, with the most minimal experience, undertake massive political reform.

To date, I believe that President Wahid has made a promising beginning in guiding Indonesia during this difficult transition and dealing with the myriad problems facing the

country. He has taken appropriate steps to help end the violence in Timor and acceded to the majority will of the people of East Timor to become independent. He has given priority to resolving regional conflicts and opened a dialogue with disaffected groups in such regions as Aceh and Irian Jaya. He has moved to re-establish the rule of law, undertaken judicial reform, established a commission to investigate serious human rights violations and indicated that those found responsible will be held accountable. In this context, former Armed Forces Chief General Wiranto was removed from his position in the Cabinet as Coordinating Minister for Politics and Security on February 14 after being found importantly culpable for the mayhem in East Timor by the Indonesian Commission which investigated that catastrophe. This assertion of civilian control over the military is a welcome and historic step.

President Wahid has also begun to take important steps to stabilize the fragile economy and has thereby won international financial support from the IMF, World Bank, ADB, the International Consultative Group on Indonesia, and other multilateral and bilateral sources. He has begun the daunting task of re-capitalizing the banking and corporate sectors through the Indonesian Bank Restructuring Agency (IBRA) and dealing with the enormous problem of corruption and cronyism.

While these reforms have been welcome, they are tenuous and face determined opposition from entrenched interests. The newly appointed Ministers, though intelligent and well meaning, have little experience in managing a deeply suspicious burcaucracy. In my judgment, the U.S. is correctly providing financial, technical and political support for Indonesia in an effort to bolster these positive efforts. Yet the separatist unrest and religious and ethnic strife in Aceh and elsewhere, and the resistance of some military and political leaders to the winds of change, underscore how fragile and volatile the situation is in Indonesia. Given the many serious problems facing the country, it appears probable that the armed forces will continue to be a key stabilizing force to ensure the secular integrity of Indonesia.

I believe that previous well-intentioned congressional actions which were reactions to the violence in focused on East Timor, such as the suspension of the International Military Education and Training program and the denial to Indonesia of an E-IMET program specifically aimed at human rights training, have largely been counter-productive and have resulted in America losing access and leverage in Indonesia, particularly with the military. That was made apparent by our limited ability to influence and temper the military's actions in East Timor.

The need for responsible US-Indonesian military-to-military engagement is even more important today, because the Indonesian military is already undergoing significant changes as President Wahid has transferred reform-minded generals and admirals into new positions of authority. For the first time since the 1950's, Indonesia has a civilian defense minister. That is a move we should applaud and do what we can to reinforce. Responsible U.S. assistance and engagement can help promote and shape these positive developments.

I am pleased today that we will have the opportunity to hear both from the Administration and a distinguished panel of private witnesses. Testifying for the Administration will be the Under Secretary for International Affairs of the U.S. Department of the Treasury, the Honorable

Timothy F. Geithner, and Assistant Secretary of State for East Asia and Pacific Affairs, the Honorable Stanley Roth. We welcome both these distinguished gentlemen and look forward to hearing their testimony. We will begin with Under Secretary Geithner and then hear from Assistant Secretary Roth, who was just up here last week testifying on East Timor.

We are also honored to have an excellent second panel of distinguished witnesses. Dr. Theodore Friend who is President Emeritus and Trustee of the Eisenhower Fellowships and is a senior fellow at the Foreign Policy Research Institute. Among his many distinguished past positions he served as President of Swarthmore College from 1973 - 1982. He has tremendous expertise on Indonesia, recently visited widely throughout the country, speaks the language fluently and is the author of numerous articles on the country.

We are also pleased to have as a witness Mr. Eric Bjornlund, Senior Associate and Director of Asia Programs at the National Democratic Institute for International Affairs. Indonesia currently is NDI's largest program and Mr. Bjornlund has recently returned from a visit to Indonesia to oversee the program there. I understand that you are the proud father of your first son and third child born on Monday. Our heartiest congratulations and appreciation for taking time out on this joyous occasion to testify before us today. In addition, we are fortunate to have with us Mr. Michael Gadbaw, Chairman of the U.S. - Indonesia Business Committee of the U.S. - ASEAN Business Council. Mr. Gadbaw is also a senior vice president for General Electric Corporation and recently led a large business delegation to Indonesia which met with senior business and government leaders.

Secretary Geithner, as we have two panels today, I would ask that you and Secretary Roth limit your remarks to approximately 10 minutes each in order to allow sufficient time for members' questions and discussion. Without objection your written statement will be included in its entirety into the Record.

I now turn to the distinguished ranking member of the Subcommittee, Mr. Lantos for any comments that he may have.

Testimony before
The House International Relations
Asia Pacific Subcommittee

"Indonesia: Confronting the Political and Economic Crises"

By Stanley O. Roth
Assistant Secretary of State
For East Asian and Pacific Affairs

February 16, 2000

Mr. Chairman, last week I testified before you and Senator Thomas to review the dramatic developments that have occurred regarding East Timor over the past year. At the same time, Indonesia was going through an equally remarkable transformation of great significance to the United States' interests in peace and stability in the region.

I need not tell this committee how Indonesia's strategic location and size make its future important to the United States. The success of its current efforts to establish a secure, democratic and prosperous nation will have a direct impact on stability and security in the entire region. This afternoon, I would like to review for you what Indonesia has accomplished, what remains to

interested parties are doing to meet the challenges ahead.

This is a remarkable accomplishment, one of which the Indonesian people and their leaders can be justly proud. Nonetheless, the challenges still facing the Indonesian people are as great as the challenges they have already overcome. No one ever expected that President Wahid or his new government would be able to resolve all of Indonesia's problems in the first 100 days, or even 1000 days.

To note just a few of the most salient of these challenges and the promising start the Government has made in responding:

President Wahid asserted civilian control of the military. He placed the armed forces under a civilian defense minister for the first time in 40 years and appointed an admiral rather than an army general as the commander of the armed forces.

President Wahid released the full report on the Bank Bali scandal. That was a positive signal that will hopefully mean he will work to break through the web of influence and corruption, which threatened to undermine Indonesia's economic recovery, and cleared the way for resuming programs with the IMF and the World Bank.

President Wahid's government signed a new memorandum of agreement with the IMF on January 20, 2000, leading to IMF Board approval of the program, the release of a new tranche of IMF funding, and coinciding with renewed disbursements from the World Bank.

The Parliament, no longer a rubber stamp, has begun to act as a co-equal partner in a government of checks and balances.

President Wahid freed virtually all the remaining political prisoners from the Soeharto era by December 1999, a total of 196 prisoners.

In Aceh, the government undertook a complex negotiating process with some of the many different factions demanding a new political arrangement for that troubled province.

Significant Challenges Remain Ahead

-- Economic Reform

There is no more critical requirement for the stability of Indonesia in the medium and long term than economic and financial reform. Since the East Asian financial crisis, Indonesia has been far less successful than other countries, such as Thailand and South Korea, in resolving the weaknesses that helped drive them into the crisis.

Previous governments in Indonesia were unwilling to make the structural reforms necessary to ensure recovery.
Now that Indonesia has a democratic government, it needs to make and implement the tough choices to build a viable sustained recovery. My colleague from Treasury will review these for you in a moment.

-- Civilian Control of the Military

One of the greatest challenges facing this government is the need to institutionalize civilian supremacy over the military and to remove the pervasive influence of the military throughout government and society, which characterized the Soeharto years. As I have already mentioned, President Wahid used the appointment process at the creation of his new government to put those committed to reform in key jobs. First, he appointed the first civilian Minister of Defense, Juwono Sudarsono. Second he appointed Navy Admiral Widodo to be the chief of the Indonesian Military (TNI), the first chief of TNI, denying the dominant service, the Army, the role of chief of TNI for the first time in history. Last month, President Wahid announced that active-duty military officers serving in the cabinet, including General Wiranto, would be required to retire from the military effective March 31.

Shortly after taking office, President Wahid faced down an overt challenge to civilian authority when the military spokesman, Major General Sudrajat repeatedly rejected government policy as stated by the President. First, Sudrajat called for martial law to be imposed in Aceh even though the President had made it clear that the Government had decided against such a step. Later, he asserted the Government did not have the authority to interfere in military affairs. As a result, in December, President Wahid dismissed the military spokesman.

All this set the stage for the dramatic developments of the past two weeks. On January 31, the National Human Rights Commission released the report of its Commission of Inquiry on Human Rights Violations in East Timor (KPP). This report detailed many of the brutal acts that occurred in East Timor over the past year. In addition, it identified 33 specific individuals, including General Wiranto and other senior TNI officers, whom it recommended the Attorney General investigate further.

While still overseas, President Wahid announced that in the wake of the report's findings General Wiranto should resign from the cabinet. As you know, Wiranto refused to resign, insisting that he must meet with the President upon his return to Jakarta this past Sunday, February 13.

You all know the outcome of this dramatic test of wills, that General Wiranto was suspended from the cabinet, and a replacement, Suryadi Sudirdja, was sworn in. Though the sequence of events through which this occurred was unsettling, it is important to note that there was never

-- Aceh

The new government got off to an uncertain start in responding to instability in Aceh. While President Wahid's decision to become personally involved in resolving the issue was welcome, his initial call for a referendum raised expectations that there would be an opportunity to vote on independence. In the face of overwhelming opposition to independence for Aceh by the Parliament, the military and a range of non-governmental figures across Indonesia, Wahid subsequently indicated that this would not be an option. He indicated that a referendum, if there were one, would be limited to the question of whether to place Aceh under Islamic law. The U.S. and other key countries, including ASEAN, made clear our support for Indonesia's territorial integrity.

Since then, President Wahid has made considerable progress in moving the future of Aceh away from the arena of armed struggle into the arena of a political settlement. It opened a dialogue with a range of groups in Aceh -- students, religious leaders, businessmen, and even proponents of armed struggle -- through two negotiating tracks.

The first track was opened by President Wahid's Minister of State for Human Rights, Hasballah Saad, himself an Acehnese who had previously led an Acehnese NGO. Saad has been working with a number of groups to pull together an All Aceh Congress in order to resolve one of the fundamental problems facing the Government in Jakarta -- whom do you negotiate with? President Wahid expressed his frustration to me personally, asking "What's the address?" Thus far, it remains unclear whether this effort will succeed or whether more than one congress will emerge with a claim to represent Aceh.

The second track has been opened through an NGO in Geneva, the Henri Dunant Center, which has been facilitating discussions between the Government of Indonesia and representatives of different factions of the Free Aceh Movement (Aceh Merdeka or GAM). In a potentially significant breakthrough, Indonesia's Permanent Representative to the UN in Geneva has met with two major GAM factions seeking to reach agreement on a cease fire and conditions for providing humanitarian assistance to the people of Aceh. Although no final agreement was reached, the very fact of these meetings is a significant step forward. Both sides have agreed to meet again later this month, and it remains to be seen if a cease fire agreement can be reached. While not a direct party to either of these tracks, the USG has been deeply engaged with the GOI on the Aceh question. We have strongly supported Wahid's efforts to focus on a political rather than a military solution and provided technical assistance on "lessons learned" from other cases in which autonomy problems have been handled successfully.

-- Sectarian Violence in Ambon and Lombok

The violence in Ambon and Lombok is a humanitarian tragedy and one which poses very significant challenges to President Wahid's government. First, the inability to control sectarian violence has caused some to question the competence of the central government. Second, the awful imagery of this violence, seen on TV screens across the globe, has certainly undermined the government's efforts to promote investor confidence (both foreign and domestic). Third, this

sectarian violence has provided an unfortunate propaganda bonanza to some of the Islamic parties in Indonesia, which have sought to increase their power base through inflammatory charges of massacres of Muslims by Christians. The January 7 rally in Jakarta, at which the Speaker of the Constituent Assembly, Amien Rais, participated, and which featured numerous speakers who called for a "jihad", was the most chilling manifestation of this phenomenon.

The origins of this conflict go back to the misguided policies of previous governments. Once a model of Christian-Muslim harmony, transmigration policies changed the balance between these two communities and laid the ground for the present tragedy.

Unfortunately, there is no simple solution to the problem of sectarian violence. Clearly the government needs to do a better job in protecting its own citizens and preserving order. The government has recognized this fact and moved, at least in part, to address this problem by replacing officials (police and military) who were ineffective at containing the violence. But, at the same time, the government has been understandably reluctant to "unleash" the police and military to engage in the kind of repressive practices that led to the human rights abuses of the past. Furthermore, the Indonesian police, severely undermanned and poorly trained, are ill equipped to respond effectively to random violence, which can arise suddenly at far flung points in the Indonesian archipelago. There is no simple short-term fix to this difficult problem, which will have to be addressed on multiple fronts.

-- Managing the End Game in East Timor

Since I addressed the issue of East Timor at some length during our hearing last week, I will not discuss this issue at any length today. Nonetheless, the issue of East Timor has been of such consequence for our relationship with Indonesia that it is appropriate to offer a few observations today.

First, in East Timor itself, security has largely been reestablished. 135,000 of the refugees who fled or were forced to West Timor have returned. The question now is reconstruction, the development of democratic institutions and preparation for independence. This is not to minimize in any way the scale of the challenge facing East Timor and the international community effort there or the need for substantial aid to support that effort.

Second, over 100,000 refugees remain in West Timor, and it is unclear what portion of those [redacted]

conditioned by the Leahy conditions contained in section 589 of the Foreign Operations Appropriation for FY 2000, as you know. Until these conditions can be met, and it is my judgment that they cannot yet be fully met, there will remain significant constraints on our ability to have a full normal relationship with Indonesia.

[redacted]

T he U.S. has a profound interest in seeing a successful democratic transition in Indonesia -- a fact reflected in the Secretary having identified Indonesia as one of the world's four priority emerging democracies. Nor is our commitment merely rhetoric. The President welcomed President Wahid to the Oval Office shortly after he assumed the Presidency. UN Ambassador Holbrooke and Secretary of Treasury Summers have both visited Indonesia since President Wahid took office.

In response to the urgency and importance of the need, U.S. bilateral assistance to Indonesia is being increased to $125 million for FY 2000. The bulk of this assistance will likely be used to help strengthen Indonesia's nascent democratic institutions. We are awaiting the recommendations of an inter-agency team that visited Indonesia in January to gauge how this U.S. investment can most effectively accomplish this and other goals. Helping the Indonesians build an effective and just judicial system, promote civil society, spur continued economic reform, and professionalize national and local parliaments will be among our priority concerns.

A Concluding Comment

Mr. Chairman, in your February 2 speech on U.S. Security Policy in Asia you observed that President Wahid has "exceeded most reasonable and informed international expectations," but "continuing levels of violence underscore how fragile and volatile the situation is in Indonesia." I completely concur. With those challenges in mind, the United States must in our own interest do what we can to help the current transition succeed.

EMBARGOED UNTIL 1:30 P.M. EST
Text as Prepared for Delivery
February 16, 2000

- Growth across the region has recovered more rapidly than expected, with most economies in the region estimated to have expanded at a rate of 4 to 9 percent in 1999.

- With the restoration of investor confidence, currencies have stabilized, and interest rate spreads over U.S. securities have approached pre-crisis levels (and in some cases fallen below).

- The process of repairing financial systems has begun, and corporate restructuring is underway.

- Current account surpluses are adjusting to more moderate levels as domestic demand strengthens.

[redacted]

dominant lesson of the financial crises of the last several years is that countries that react rapidly with strong, credible stabilization and reform programs are likely to fare better than those that find it difficult to do so.

In Asia, the common elements of success were:

and more protracted and recovery much more difficult to establish. This is, in a sense, the story of Indonesia since the fall of 1997.

Indonesia's Economic Challenges

Indonesia has taken some important steps to lay the foundation for economic recovery.

The macroeconomic environment has stabilized, and output has begun to expand again. After the deep declines of 1998 and early 1999, the economy is expected to expand at an estimated 1.8% annual rate in FY1999 (ends March 31), and the government expects it to grow 3 – 4% in FY2000. Inflation has been reduced sharply to near zero, from a high of more than 75% in late 1998. Nominal interest rates have fallen dramatically, with the yield on one-month central bank certificates now only 11% (down from around 65% in late 1998). Real interest rates have also declined from their peak in mid 1999. The rupiah has strengthened significantly from the depths of the crisis, though it is still estimated to be about 25% below the pre-crisis level in real trade-weighted terms.

The new government has adopted a new framework for economic policy, with the support of the IMF, World Bank and Asian Development Bank, which holds the prospect of maintaining macroeconomic stability and creating greater confidence among domestic and foreign investors. On February 4, the IMF Board of Directors, with U.S. support, approved a new three-year program for Indonesia. Now, Indonesia must focus on implementation of its policy agenda.

In our view, Indonesia faces four main economic challenges.

1. The Macroeconomic Dimensions of Growth

Indonesia can take considerable comfort in the progress achieved in stabilizing inflation, the recovery in the exchange rate, and the fall in interest rates.

Going forward, Indonesia faces a difficult balance between the near-term need to stimulate the economy, invest in social programs and recapitalize the banking system, and the longer term challenge of reducing public debt and reducing dependence on foreign official assistance.

In the economic program outlined in the agreement with the IMF, the government decided to avoid a further expansion in the fiscal deficit (targeted in the program at nearly five percent of GDP for FY2000). With ambitious targets for government asset sales and privatization of state-owned enterprises, the government hopes to begin to reduce the large public debt burden.

Over the medium term, once the recovery is more firmly established, the government will have to put in place a credible program for reducing the public debt burden further, and as it moves toward fiscal decentralization, will have to ensure that the transfer of fiscal resources to the regions is accompanied by a commensurate transfer of responsibilities and capacity.

In this context, it is critically important that the government commit to preserve the independence of the central bank, whose policies have been responsible for much of the return to stability.

program, Indonesia would no longer need exceptional balance of payments support or further debt rescheduling.

2. *Financial Sector and Corporate Sector Restructuring*

This is why the work of the newly appointed Indonesian Attorney General is so important to the success of the economic program. This is why the U.S. and other countries, working with the international financial institutions, made judicial reform a centerpiece of the recent consultative group meeting of donors.

Foreign investment and domestic flight capital are unlikely to return to Indonesia in the amount necessary to finance future growth until investors are more confident that they will be treated fairly by the legal system, that they will be protected from discrimination, and that they will be safe from the selective assignment of privileged economic rights that prevailed under the Suharto regime. This confidence is critical to an effective process of unwinding the complex interests tied up in the claims now held by the government.

The IMF program outlines measures for greater transparency in many areas, including fiscal management (both in central and regional governments), the operations of the central bank, the judicial system, and commercial bank and corporate governance (including accountability and

[redacted]

disclosure standards).

The IMF LOI includes a strong commitment to audit the Indonesian military, including extra-budgetary sources of income, and to report findings to civilian authorities. The Indonesian Coordinating Minister for Economics and Industry, Kwik Kian Gie, has assured us that the audit has begun and will be completed by August 31.

- Building on past successes in community-based provision of basic social services, with greater decentralization and transparency and wider participation to

- Maintaining and extending the impressive efforts that have been made to keep children in school through the crisis -- an investment that will pay off many times over in faster growth and greater social cohesion in the years to come.

- Focussing on greater and more effective provision of critical health services -- particularly basic preventive care.

In the area of labor conditions, Indonesia has made considerable progress during the past year in affording its workers rights of association and collective bargaining. Partly in response to the urging of the United States and the IMF, Indonesia ratified ILO Convention 87 (Freedom of Association) in 1998. During 1999 Indonesia ratified ILO Conventions 105 (abolition of forced labor), 111 (employment discrimination), and 138 (child labor), becoming the first East Asian country to ratify all seven of the core ILO conventions. We have been informed that Indonesia intends to introduce new labor legislation by October of this year, which would bring its laws into conformance with the ILO conventions.

An Agenda for Immediate Action

Our hope is that the new Indonesian government will move quickly to take advantage of its electoral mandate, and the broad political support in favor of economic reform, to move quickly to implement the new program. Among the most important steps the new government could take to establish its credibility with its citizens and with investors are:

- Demonstrating that officials of IBRA, Bank Indonesia, and other economic agencies can carry out their official duties without fear of inordinate political interference or constraints.

- Indicating the government intends to get out of the banking business, by transferring controlling shares of government-owned banks to the private sector. An important step will be IBRA's sale of shares in Bank Central Asia (BCA), which is expected before end-March.

- Replacing management responsible for the large losses of state-owned banks.

- Demonstrating progress on disposal of assets by IBRA, even where this means writing down debt. An important indicator will be the planned sale of IBRA's stake in the leading Indonesian vehicle maker Astra International. This would be a significant step toward meeting IBRA's key end-March asset sales target.

- Sending a clear signal to large debtors that unless they cooperate, they will be prosecuted and their assets seized. Specifically, IBRA needs to pursue high-profile recalcitrant debtors through the insolvency system.

- Demonstrating a willingness to see foreign investors as part of the solution to Indonesia's corporate and financial sector debt problems -- and not part of the problem -- through the sale of a substantial stake in a large Indonesian corporation or bank to foreign investors. As is has been true elsewhere in Asia, foreign banks could be an important source of support for financial sector modernization in Indonesia, not only as sources of needed capital but greater financial resilience in the future.

- Investigating and prosecuting judges who have engaged in corrupt practices. The word must go out that in a new Indonesia, no one is above the law and the laws will be fairly enforced.

Conclusion

The United States and the international community should be prepared to help Indonesia with its ambitious reform agenda. On the economic and financial front, we can be most effective in the following areas:

- Supporting an adequate scale of official finance in this period of economic distress and transition. The new IMF supported program approved earlier this month will provide approximately $5 billion in financing -- dependent on continued and forceful implementation of conditions -- over the next three years. The World Bank and Asian Development Bank together have about $7.8 billion in already-approved loans in the pipeline that have yet to be disbursed.

- Focusing the international financial institutions on the core challenges facing the new government, with reforms concentrated on those steps necessary to restore an environment conducive to private enterprise and new investment, an adequate safety net with important investments in health and education, and growth oriented macroeconomic policies.

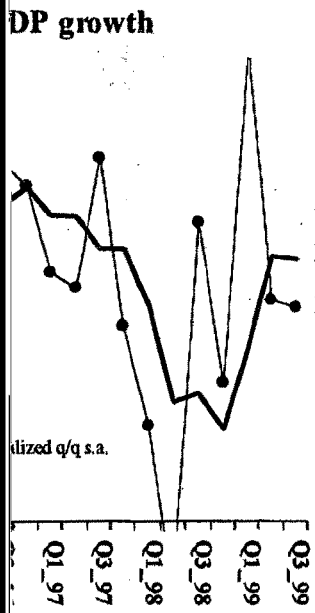
- Supporting an appropriate breathing space on external debt service, including a rescheduling of Paris Club obligations. We have signaled that we are ready to work with other Paris Club creditors to achieve a further rescheduling of Indonesia's obligations. This would provide another two years of relief to strengthen the government's capacity to carry through with its economic policy agenda.

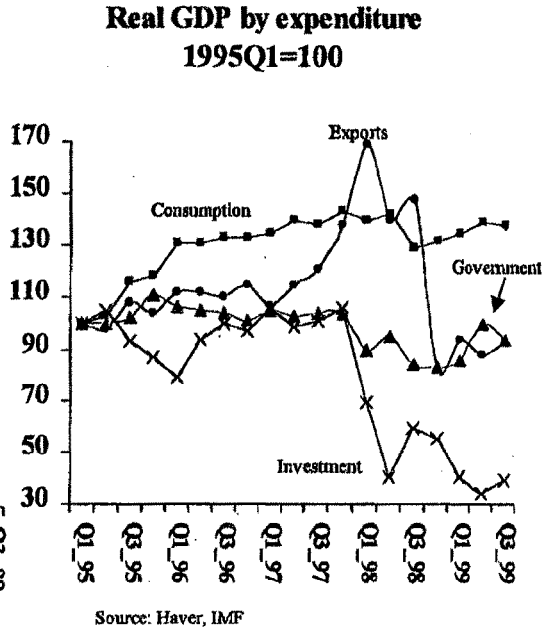
Providing an expanded program of technical assistance, in cooperation with State, AID and other agencies, targeted toward public debt management, fiscal decentralization, financial and corporate restructuring, and law enforcement.

Indonesia's most pressing economic challenges are in many ways more political than economic. Progress depends critically on the political capacity of the government to act.

The new government has outlined a credible program of political change and economic reform. Combined with the general improvement in the economic environment in Asia and the world economy as a whole, this creates the potential for substantial and enduring improvement in economic conditions for the people of this important nation.

Q1999 marked the first increase in real GDP
is) since 4Q97. Investment is still weak.

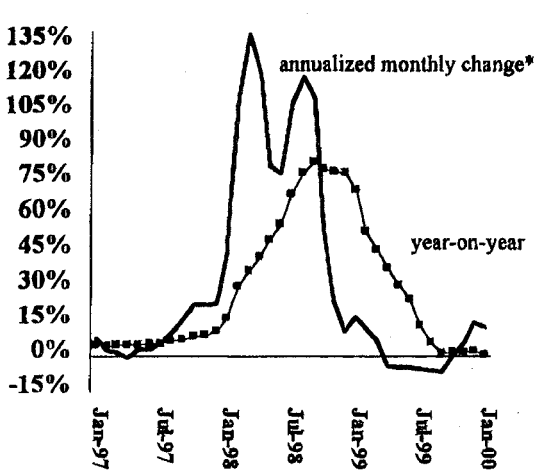




Source: Haver, IMF

Inflation has come down, money demand is strengthening...

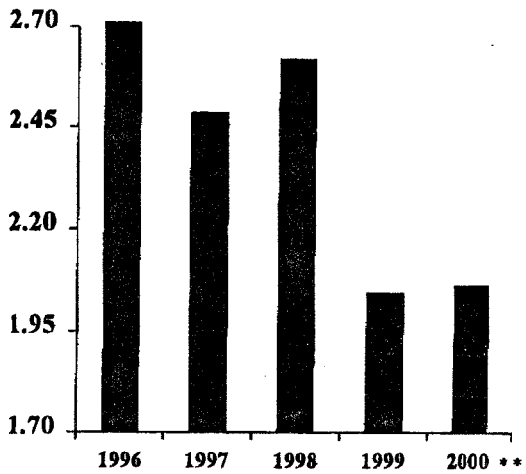
CPI



* annualized m/m change in 3-month moving average

Source: Haver

Rupiah M2 Velocity*

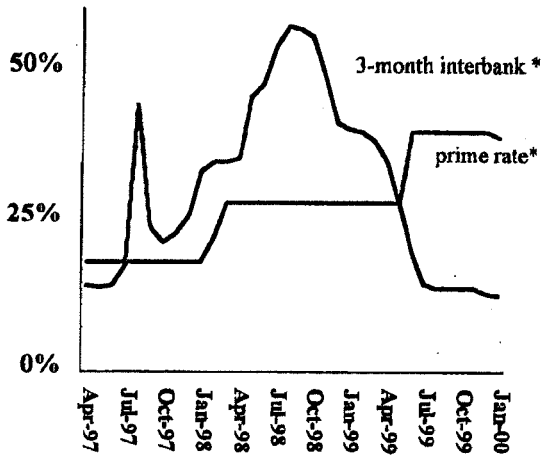


* GDP in year t / average (M2-fx deposits) in year t
** Forecast

Source: Bloomberg, Haver, IMF

...and real interest rates are positive and falling.

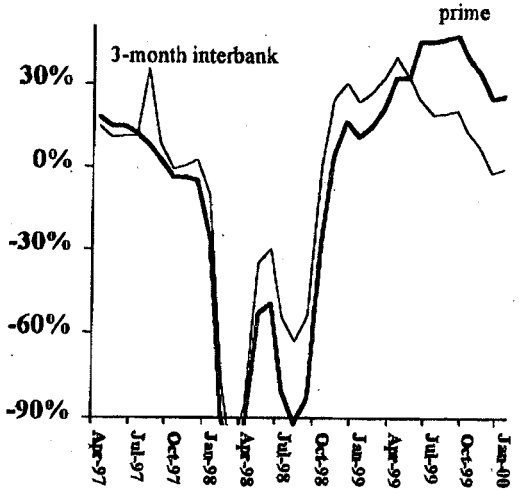
Nominal rates



* rate quoted at end of period

Source: Bloomberg

Real rates*

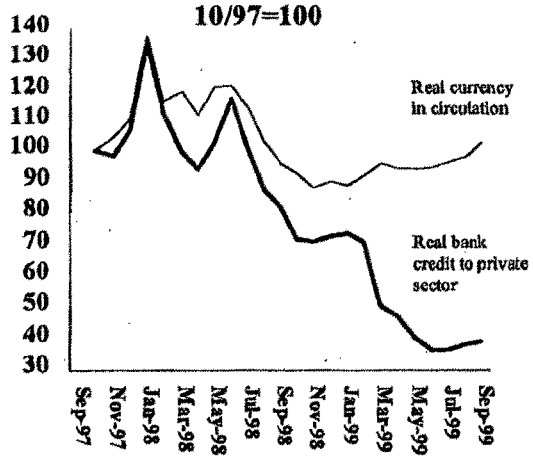


* Nominal rates less annualized CPI inflation on a 3-month moving average basis.

Source: Haver, Bloomberg

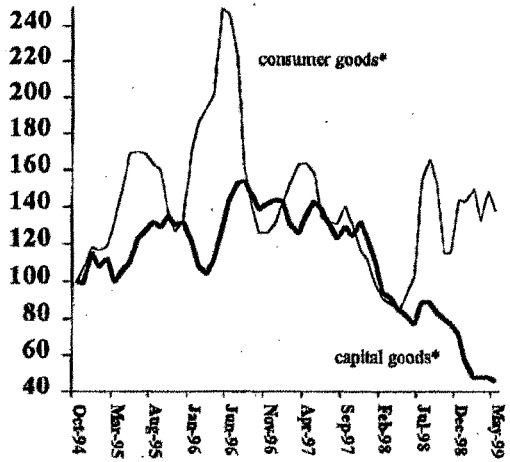
But financial restructuring, corporate weakness, and political unrest are impeding bank credit and investment.

Real currency in circulation
real bank credit to private sector*
10/97=100



* Data for March 99 are affected by closure of 38 banks, data for March and June 99 are affected by the transfer of loss loans from the state banks to IBRA.
Source: Bank Indonesia, Bloomberg, IMF

Import composition
Oct. 1994=100

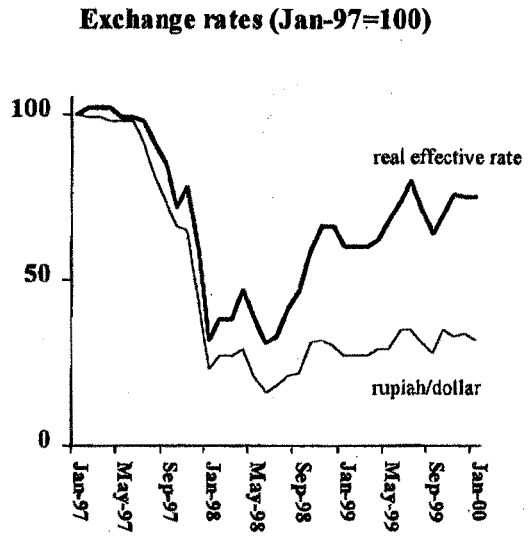


* Three-month moving average
Source: Bloomberg

Externally, exports have recovered and the real exchange rate remains more competitive than pre-crisis levels.

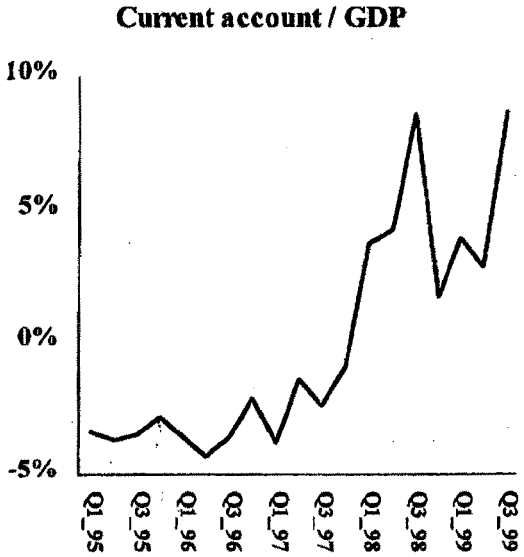
* Three-month moving average

Source: Bloomberg

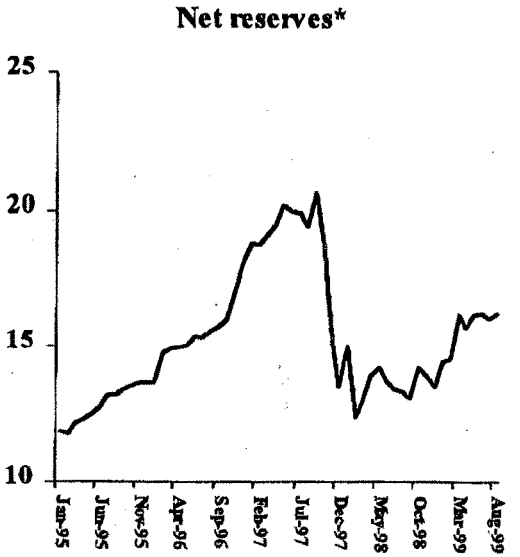


Source: Haver, Bloomberg

The current account surplus is supporting reserves.



Source: Haver, IMF

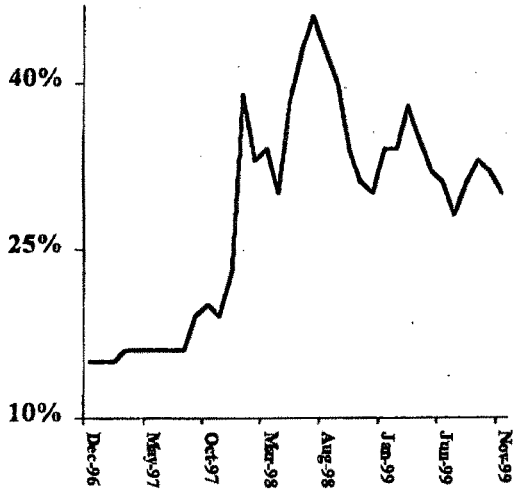


* Net reserves less gold and IMF credit and loans outstanding

Source: Haver, IMF

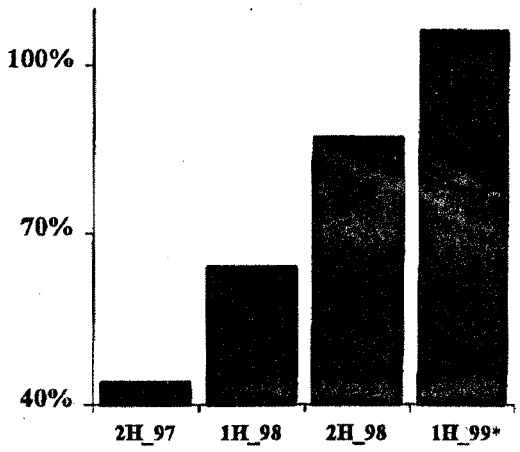
Official borrowing is reducing short-term vulnerability ...

Gross reserves / M2



Source: Haver

Gross reserves / external debt due w/in 12 months*

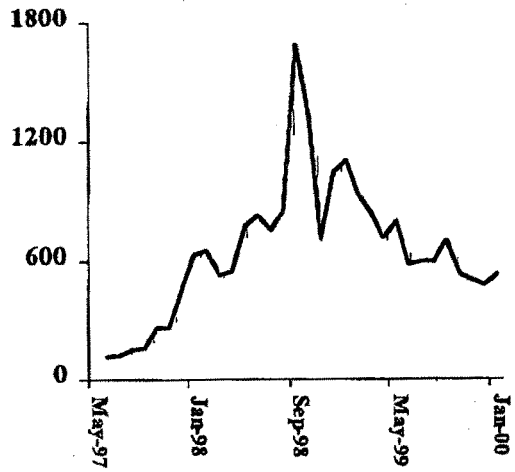


* Does not include official bilateral or multilateral claims.

Source: Bank for International Settlements

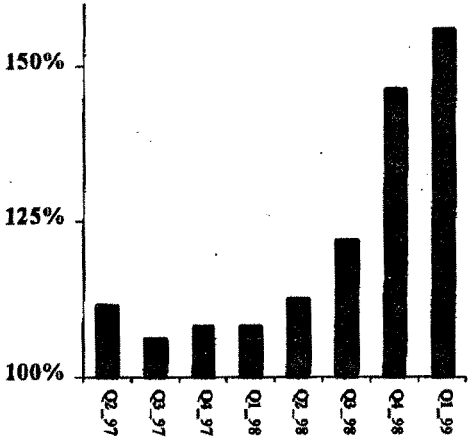
… and restoring confidence, but substantially adding to the long-term debt burden.

10-year sovereign bond spread (basis points over US Treasuries)



Source: Bloomberg

Public external debt / exports*



* Consolidated external debt of central government and state-owned enterprises over previous 4 qtrs of exports

Source: Bloomberg, Bank Indonesia

overy,
creases

[redacted] 2002

Testimony before the
House Committee on International Relations
Subcommittee on Asia and the Pacific

Statement of R. Michael Gadbaw
Chairman of the US-Indonesia Business Committee
of the
US-ASEAN Business Council
and
Vice President and Senior Counsel
General Electric Company

February 16, 2000

I am pleased to be here on behalf of the US-Indonesia Business Committee of the US-ASEAN Business Council. On its behalf, Chairman Bereuter, I want to thank you for

- Attorney General Marzuki Darusman
- Minister of Industry and Trade Yusuf Kalla
- Minister of Mines and Energy Yudhoyono
- Minister of Transportation and Telecommunications Agum Gumelar
- State Minister for Investment and State Enterprises Development Laksamana Sukardi
- New Chairman of IBRA Cacuk.

IBRA is very similar in function to the Resolution Trust Corporation. Due to the depth of the 1997-1999 economic crisis, it now controls a significant portion of the nation's assets. Cacuk became chairman on the week of our visit and as one of his first orders of business sought out our delegation of potential investors - an encouraging sign. His team struck us as quite capable and committed to carrying out its responsibilities.

We also met with:

- Chairman of the Indonesian planning agency BAPPENAS Djunaedi
- Chairman of the newly formed Business Development Council Sofian Wanandi and members of his Council
- Chairman of the newly formed National Economic Council Emil Salim and members of his Council
- New President Director of PLN (Indonesia's state-owned energy company) Kuntoro.

In addition to these government meetings, the group consulted with U.S. Ambassador Robert S. Gelbard and the embassy country team, whose assistance was critical to the mission's success, AmCham Indonesia, World Bank Country Director Mark Baird, and the Jakarta Japan Club Foundation.

Our delegation concluded that the Government of Indonesia, under President Abdurrahman Wahid, is committed to implementing changes necessary for full economic recovery. It is a challenging task. As the January 14th edition of Asiaweek suggested, Wahid's is probably the "toughest job on the planet." However, we believe President Wahid has made an important start in naming key individual to posts that will be critical to his success.

Among our mission's major findings and themes were the following:

- The Wahid Government has prioritized resolving regional conflicts, re-establishing rule of law, civilian accountability over the military, judicial reform, and recapitalization of the banking and corporate sectors. It is apparent that capable individuals have been placed in positions of authority with reasonable hope of implementing some of these reforms. It is also apparent that leaders of the Parliament are generally supportive of the Governments efforts in these priority areas.

- While there is a consensus among the Government and business leaders that foreign investment in Indonesia is a fundamental element of the economic recovery, it is clear that there is a wide range of definitions of acceptable levels. The spectrum seems to run from IBRA's leadership, who seem to favor moving assets into the market to revive and promote the efficient allocation of the country's productive sector, to the Business Advisory Council, which recommends that the "old owners" be given ongoing equity in bankrupt companies that are partially sold to new investors.

- Regionalism will be a continuing trend, and power will devolve from the central government to the province and district level.

- The legislative branch will demand more focus by the Council and its members, both in terms of policy work and business development strategy.

- Sale of IBRA assets is likely to proceed more aggressively than in the past in the first part of this year, but it remains to be seen what type of financial structure will be allowed. Most agree that the optimum chance for 100% foreign owned deals will come earlier as opposed to later in this process.

- Corporate restructuring looks unlikely to move quickly, as vested interests seem to have placed themselves strategically in key advisory roles and are likely to lobby hard for protection in legislative branch.

- Bank recapitalization will take enormous political will by the Wahid government, and is not likely to get completed quickly. There are serious questions about where the required capital would come from to make this a comprehensive and efficient process.

Our business mission was in Indonesia at an auspicious moment. The same week that our 48-member business delegation was there, the Wahid government and the IMF signed a new Letter of Intent that cleared the way for an additional $5 billion in IMF support. The government also reached agreement on a new government budget, which is no small task in a coalition government. When presented to parliament on January 20th, the budget was cast as a blueprint to reduce the size of the deficit and Indonesia's reliance on external financing. Significantly, the budget seeks to defuse regional tensions by addressing the need for fiscal decentralization. Two weeks later, in response to this good news, Indonesia's international donors, under the umbrella of the Consultative Group on Indonesia (CGI), approved an additional $4.7 billion in new assistance for Indonesia.

In addition to our delegation, Secretary of the Treasury Summers was in town the week of January 17th expressing support for Indonesia. This is evidence of a concerted U.S. government effort to engage Indonesia at this critical time in its economic and political transition. We also applaud the initiative by Senator Kit Bond in bringing a delegation to Indonesia, and we encourage other such Congressional visits.

In another critical development that week, the government announced that it would drop its lawsuit against energy company P.T. Paiton. In return, the power plant sponsors agreed to withdraw their international arbitration, and both sides agreed to begin earnest negotiations under the leadership of the new PLN President Kuntoro. This is a two-year dispute over contract terms negotiated with a previous Indonesian government. Many in the U.S. private sector view resolution of this dispute as a barometer of the new Indonesian government's commitment to contract sanctity. The commencement of negotiations is therefore an encouraging turn of events for stakeholders in Indonesia's economy.

Despite this incredible effort on the part of the new government to address its most basic economic problems, the international media that week focused on social disturbances. In no way would I want to minimize the human cost of the disturbances. They are, indeed, very serious. In the particular case of Aceh, the underlying political issues pose a threat to the nation's unity. However, I am suggesting that focusing almost exclusively on these conflicts has created an incomplete and distorted image of what is going on in Indonesia. The Indonesian government is making a concerted effort to resolve the complex social/communal conflicts that have given rise to many of the disturbances. This is a country as big in area as the United States and only slightly smaller in population. A riot in Lombok has no more impact on social stability on Java - or its closest island neighbor Bali for that matter - than a riot in L.A. or Seattle has on the social fabric of Denver or Chicago. The Indonesian government is capable of dealing with these disturbances and at the same time successfully addressing broader issues. And when as many positive developments come together as did they did January 17-21, they certainly deserve more recognition.

Recent developments aside, there is no place in the world that has been in more dire need of context. Forgive me for reciting the facts on Indonesia, but I think it is worth reiterating just a few factors that determine Indonesia's central importance to Southeast Asia and the United States. It is the fourth largest nation and the largest nation by far in Southeast Asia. Comprised of 17,000 islands and 207 million people, it spans the strategically critical juncture between the Indian and Pacific oceans. Despite its commanding size and location, Indonesia historically has sought not domination, but regional consensus.

Indonesia is also the largest Muslim nation in the world, its population almost as large as the entire Arab world. Impressions in the media to the contrary, the vast majority of Indonesia's Muslim faithful maintain a secular approach to government, economy, business and international relations. The vast majority of them are traditionally, almost instinctively, tolerant of other religious communities. Religious tolerance is enshrined in the Indonesia constitution.

On our mission to Indonesia, we raised many core business issues both with the Indonesian government and with our counterparts in the private sector. We presented to them a detailed set of policy issues from power deregulation to telecommunications reform to agriculture reform that are critical to U.S. business interested stimulating

additional trade and investment. We also discussed the importance to American business of on-going US governments programs, including ExImBank, TDA, and USAID.

[redacted]

engaging on our most pressing concerns. We will continue to work these issues with our friends in Indonesia. Investment and trade depend on the resolution of such issues as the reform of the energy sector, the development of consistent rule making processes, and the avoidance of self-defeating programs like the "national car policy." It depends on bank restructuring, the establishment of the legal institutions for the ethical enforcement of the rule of law, and the efficient reallocation of productive assets. Only by addressing these microeconomic issues will Indonesia ever return to its former economic growth trajectory.

The US-Indonesia Business Committee has also sought to maintain a stable framework within which to address these issues. For that reason, much of our focus has been on getting the "process" right. We have sought to create a dialogue with the Indonesian government and private sector that transcends politics. Our business missions

INDONESIA: CONFRONTING THE POLITICAL AND ECONOMIC CRISIS

Testimony before the House Committee on International Relations
Subcommittee on Asia and the Pacific
16 February 2000

Dr. Theodore Friend
Senior Fellow, Foreign Policy Research Institute
Philadelphia, PA

Mr. Chairman and Committee Members:

I feel privileged to be asked to contribute to this committee's ongoing exploration of the situation in Indonesia. This committee, having last week pursued matters as they are improving in tragically afflicted East Timor is wise, allow me to say, to confront now the issues of democracy, development, security, and human rights that Indonesia, with its 212 million people, represents.

As the committee is aware, but Americans generally may not realize, if you superimpose the Indonesian archipelago across the USA, it would reach from New York City to Seattle. It has 80% of our size of population in 20% of our land area. It has three times as many people as the Balkans, and more people than the Arab Middle East. But it has not usually generated as much trouble as the Balkans, and only produces a fraction of the oil of the Middle East. So we as a people have been slow to see Indonesia's global importance: now the third largest democracy in the world, and the only Muslim democracy besides Turkey. Because Indonesia envelops the sea lanes between the Indian Ocean and the Pacific, and is the largest geopolitical factor in Southeast Asia/Southwest Pacific, the destiny of its democracy is vitally important to the region, to American values, and to our interests.

WHAT HOLDS INDONESIA TOGETHER?

What holds Indonesia together? It took the Dutch three hundred years to hammer it into one colony. Along with the UN, we supported the latter stages of the national revolution, to independence in 1949. What has held Indonesia together since? An ideal of a national democracy, many peoples becoming one. A national language, spread by national education. An army. And the presidency. Across half a century there were only two presidencies. Sukarno for twenty years, and Suharto for more than thirty.

Sukarno held things together by force of personality, by balancing nationalism, religion, and communism; by distracting confrontations with Malaysia, the Dutch, the UN, the US. By ignoring development and theorizing perpetual revolution. All that collapsed in an attempted coup and the ensuing murder of hundreds of thousands of communists in 1965.

Suharto held things together with the Army, first of all. With development secondly -- not only economic, but social. Indonesia's story since the late sixties is one of great gains in life expectancy, in literacy, in per capita income (from under $100 to beyond $1,000 before the Asian financial crisis slashed it), and in all social indicators. Many lesser developed countries achieved such gains, but Indonesia's were still impressive. The achievement was threatened, however, and the regime undermined itself by overconcentration of power at the top, and

amoral greediness in the first family and its cronies. Add to that repression of thought, speech, and assembly; tightly rigged elections, loosely rigged business dealings, and false-front foundations; the use of senior army officers as territorial business magnates and as state enterprise executives; and use of ordinary troops as political police. All this, we know, broke down in riot in Jakarta, 13-15 May 98, with 1200 dead. Suharto yielded to enormous pressure from a combination of students, NGO and middle class activists, and moderate Muslim leaders. International financial forces, represented by the IMF, held back money

early 1990s cannot be repeated. And Gus Dur's personal charisma, well received in much of Java, is not so in Aceh.

Irian Jaya, now renamed Papua in a spirit of acknowledging regional distinctness, is mineral rich, feels ethno-culturally discriminated against, and is probably the site of the second most significant separatism. It does, however, appear susceptible to division in three provinces; and new revenue sharing formulae might satisfy enough political and economic appetites to retain this huge area in the Republic.

If one takes all other sharp or soft separatisms into account -- Riau, East Kalimantan, Southern Sulawesi, and Maluku, and adds them to Aceh and Papua as percents of Indonesia's pre-crisis GNP, one gets 17.2%, or about one sixth of the national total:

Province	Principal Industry	corporate presence	Indonesia GDP as %
East Kalimantan	oil and gas	Mobil, Unocal	5.0%
Riau	oil and gas	Caltex, Conoco	4.7%
Aceh	gas	Mobil	2.9%
South Sulawesi	agricultural commodities	--	2.3%
Irian Jaya (Papua)	copper, gold, gas	Freeport, Arco	1.6%
Maluku	timber, agr. com-mod., gold	Newcrest	0.7%
			17.2%

[based on Far East Economic Review, 2 Dec 99, p. 20]

If all potential separations actually occurred, the present nation, to improvise on one Indonesian commentator's remark, would become a Bangladesh (Java) encircled by a couple of Congos, some Arab sheikdoms, and a West Indian republic. But it won't all happen. For most of the archipelago there is still more pride and synergy in being part of a great republic than concocting a small one.

2. **Ethno-religious tensions**

These are numerous enough. They do not appear, however, to threaten

where the overall population divides 57% Muslim and 37% Protestant. Such

achieve substantial progress by sustained effort in these tasks, its fifth successive democratic election in 2019 could see it standing proud among the world's democracies. With synergy among all enterprises mentioned, that goal could be achieved by its fourth, or even third, such election.

AMERICAN INTERESTS AND LINES OF POLICY

Example is the best advice. America, if it is true to itself as a federal republic, an open society under the rule of law, with competitive enterprise and transparent procedures, will continue to have a magnetic power of attraction in Indonesian national behavior.

I believe we should recognize that our major interests there are few and simple. One is ideals; they can be summarized in the thought that both freedom and development advance fastest when they are allowed to be mutually reinforcing. The other is concrete: it can be summarized in the fact that no hostile technology or power can soon make the strait of Malacca as danger-fraught as the strait of Taiwan. The sea lanes through Indonesia stand for our geostrategic interest there, especially the flow of oil to allies in Japan and Korea. With these factors in mind, we must quietly help Indonesia to realize a reformed political economy that will allow it both to fulfill its democratic dream and to resume its role as the center of gravity in a reorganized ASEAN.

In what ways may we help?

(1) Explicitly support the values that the reform government represents. Nourish Gus Dur as the elected leader with moral support, without overpersonalizing the relationship.

(2) Endorse what I understand to be a proposed expansion of the AID budget for Indonesia, still at a modest level, but intended to bolster legal reform, local democracy and civil society projects.

(3) Support IMF and World Bank projects, for their invaluable multilateral aid toward Indonesia recovery, in confidence that criticisms since the onset of the Asian crisis have strengthened discipline in the administration of both.

(4) Reinstitute IMET and JCET programs for advanced education of Indonesian military in the United States. Punishing a past administration does not help the present one. Breaking such ties does nothing to advance the reform movement within the military. The current free press in Indonesia was launched by a retired general as Minister of Information, who learned Jeffersonian principles at Fort Benning.

(5) Encourage public and private foundations to form consortia as was done for Eastern Central Europe after the Berlin Wall fell. Now that the Suharto walls have fallen, American foundations should cooperate further for (a) support of community recovery programs; (b) initiatives in educational renewal at all levels; (c) scholarships for Indonesian students now in, or wishing to come to the United States; (d) special programs by media foundations in the disciplines and limitations of a free press; (e) special programs by bar associations and legal institutes to advance the capacities of young Indonesians in law, procedure, and regulation.

(6) Stand fast in the whole Southwest Pacific. Pull away no military assets. Remain what Lee Kuan Yew asked us to be many years ago, "the sheriff of the

Pacific." Recognize that Islamists in Southern Malaysia are expressing sympathy with arms and money to separatists in Aceh. Tactical moves and

SUPPORTING THE DEMOCRATIC TRANSITION PROCESS IN INDONESIA

STATEMENT

of

ERIC BJORNLUND

SENIOR ASSOCIATE AND REGIONAL DIRECTOR FOR ASIA

NATIONAL DEMOCRATIC INSTITUTE FOR INTERNATIONAL AFFAIRS

before the

UNITED STATES HOUSE OF REPRESENTATIVES

COMMITTEE ON INTERNATIONAL RELATIONS

SUBCOMMITTEE ON ASIA AND THE PACIFIC

February 16, 2000

Mr. Chairman, members of the subcommittee, thank you for this opportunity to comment on the prospects for the consolidation of democracy in Indonesia.

Indonesia is an enormously important country in the midst of a profound but still fragile transition to genuine democracy. In the less than two years since the end of President Soeharto's authoritarian grip on Indonesian politics, Indonesia has been dramatically transformed. In the wake of substantial political liberalization and democratic elections, Indonesia has an historic opportunity to consolidate its democratic system. Yet democratization in Indonesia still faces many serious challenges, both over the next few weeks and months and during the next several years. It is essential for the United States and the international community to recognize the historic window of opportunity that exists and to support the efforts of Indonesian democrats to protect their fragile new democracy.

Many in the international community have yet to fully recognize the extent to which Indonesia has changed. In fact, the changes since Soeharto resigned on May 21, 1998 are nothing short of astonishing. Restrictions on the freedom of the press have been lifted. Political parties have been allowed to organize. The legal framework for the country's political institutions has seen substantial reform. In June 1999, under the watch of independent domestic and international election observers, Indonesia held democratic national elections whose results were accepted by virtually all political forces in the country.

Perhaps most significantly, late last year a new government took over in the most democratic and peaceful transfer of executive power in Indonesia's history. On October 20, 1999, Abdurrahman Wahid was elected the fourth president of the Republic of Indonesia. Chosen through an indirect process by the People's Consultative Assembly (*Majelis Permusyawaratan Rakyat* or MPR) as provided in the Indonesian constitution, Abdurrahman Wahid thus became the first democratically elected president in Indonesia's history. The next day the MPR also elected a new vice president, Megawati Sukarnoputri, who headed the most popular political party in the 1999 elections.

The establishment of a legitimate government with broad support heralded a new era of democratic consolidation in the country. Now, there is broad agreement that efforts toward a more democratic political system must continue in order to address the country's ongoing social and economic problems. But the new president and his multiparty, national unity government confront enormous challenges, including dealing with separatist and communal violence, overcoming the economic crisis, addressing past human rights abuses and dealing with the military's deep involvement in politics.

The National Democratic Institute for International Affairs (NDI) has been working in Indonesia since early 1996 with support from the National Endowment for Democracy and the U.S. Agency for International Development. Soon after the resignation of former President Soeharto in May 1998, NDI initiated programs to (1) facilitate public input into the development of a framework for the political transition, including the process of constitutional and institutional reform; (2) aid political parties to compete effectively in a more democratic environment; (3) work with civil society efforts to advocate democratic elections and conduct nationwide election monitoring campaigns,

which resulted in among other things in the deployment of several hundred thousand pollwatchers, the largest ever domestic election monitoring effort; and (4) encourage civilian capacity to provide leadership, direction, management and oversight of the military. In the course of the domestic election monitoring program, NDI worked with one university monitoring network to design and successfully implement the most complex parallel vote tabulation ever conducted.

In addition, NDI has extensively monitored and reported on Indonesia's transition to democracy, including all phases of the 1999 election process. The Institute organized, in conjunction with the Carter Center, a 100-person multinational team, led by former President Jimmy Carter, to observe the June 7 elections. NDI's public reports issued during the vote count and immediately following the final tabulation of election results contributed to public confidence in the outcome of the election by providing a detailed analysis of the aggregation of the results and reassuring the Indonesian people that the tabulation process was generally transparent, accurate, fair and open to scrutiny. (A more detailed discussion of NDI programs in Indonesia is attached.)

Challenges to the Consolidation of Democracy in Indonesia

In its effort to consolidate its transition to a more open, democratic political system, Indonesia confronts a number of serious challenges. The process of electing new representatives at national and local levels, the indirect election of a new president in October 1999 and the formation of a new government have marked significant steps in the political transition. Yet, that transition still has a long way to go and could yet be largely undone. The country must successfully address at least eight critically important issues in order to effect fundamental political reform and ensure a successful transition to democracy. These are:

1. ending the military's extensive role in politics;
2. addressing the violence associated with calls for independence or ethnic conflict in some regions of the country;
3. reforming the constitutional structure of government, including the process of electing the president, the structure of the legislature, and the constitutional relationship between the national and lower-tier governmental authorities;
4. establishing the system of electing the president and legislatures;
5. establishing the appropriate distribution of powers and financial resources among the different levels of government within the Indonesian state;
6. empowering the legislative branch, at the national, provincial and local levels;
7. reforming the judiciary and establishing the rule of law, including addressing the problems of corruption and human rights abuses;
8. enhancing the ability of civil society – including political parties, advocacy organizations, labor unions and other civil society organizations – to participate effectively in democratic politics.

The first seven of these are challenges of institutional reform. They are questions of whether the new, democratically elected government, national legislature and political establishment can reform and establish institutions that protect and build on the profound but nascent gains already made. Several of these pose immediate challenges that threaten to become crises for the new democratic order. The last challenge is one of demand for effective governance, accountability and

transparency. It is the question of whether political parties and civil society organizations can participate effectively and constructively in the political life of their country.

Successful resolution of these issues, in turn, is essential to efforts that can reverse the country's profound economic crisis. Democratic consolidation will contribute to political stability and the restoration of investor confidence, both international and domestic. At this point in Indonesia's history, genuine democracy is absolutely essential to renewed economic growth.

I will address each of these challenges in turn.

In January, the President fired military spokesman Major General Sudrajat for publicly questioning the President's role as commander in chief. More recently, when an Indonesian human rights commission implicated former Armed Forces Commander and Defense Minister General Wiranto for the military's involvement in atrocities in East Timor, the President suspended Wiranto from the cabinet. (Wiranto had served as Coordinating Minister for Political and Security Affairs.) Although it followed nearly two weeks of uncertainty, Wiranto's dismissal seems to provide a good indication of the strength of the new democratic government and President Wahid's commitment to establishing civilian supremacy over the military. But while the chances of a coup by elements within the military are remote, there remains the possibility that some within the military or with connections to past regimes may undertake efforts to undermine the new president's ability to govern.

2. Violence, Calls for Independence and Ethnic Conflict

In the wake of East Timor's strong vote in August 1999 for independence, Indonesia confronts grave threats to its future as a single, united country. Independence movements have gained momentum in Aceh, Irian Jaya (West Papua) and elsewhere. Armed conflict continues to leave people dead in Aceh in particular, even though the new President has correctly identified the roots of the violence in past human rights abuses and central government dominance of local resources. Meanwhile, the country has been increasingly plagued in the last year by sectarian violence in the province of Maluku in Eastern Indonesia and elsewhere. These strong challenges to governmental authority represent create profound difficulties for the country's new political system.

The resolution of these problems is critically linked to the question of accountability of the military and others for human rights violations, and also to the outcome of the debate on central-regional relationships within Indonesia as a whole. It is, however, now increasingly being accepted that, in Aceh in particular, the achievement of any settlement acceptable to a sufficiently wide range of opinion to hold will require special constitutional and/or practical autonomous arrangements.

3. Constitutional and Institutional Reform

The establishment in late 1999 of new legislative bodies and a new national government marked the end of the first major phase of the Indonesian transition to democracy. The next phase, which has already begun, will include the process by which the elected institutions grow into fully functioning democratic bodies and the debate over new constitutional arrangements and associated legislative and institutional changes.

Between now and August of this year, Indonesia will consider fundamental constitutional reforms. Weaknesses in the current constitutional framework include the byzantine process for electing Indonesia's president, which, although it arguably worked well in 1999, risks allowing special interests and undemocratic forces to control the process of choosing the president and vice president. The Constitution also establishes legislative and judiciary branches that are extremely weak, and it contains no guarantees of civil and political rights. More generally, the Constitution, which was written as an emergency document on the eve of the declaration of independence in 1945, contains many vague provisions. This has facilitated its use since 1959 to legitimize authoritarian rule.

address weaknesses in the country's political structure. At the same time, there appears to be broad agreement that the preamble, which establishes the pan-religious, nationalist state ideology of *Pancasila*, should be left untouched. This consensus, even among Muslim parties, means that there is much less chance of reopening the polarizing debate from the 1950s about whether Indonesia should be a *Pancasila-ist*, socialist or Islamic state.

The 700-member People's Consultative Assembly or MPR is the body empowered to elect the president, establish the principles and broad guidelines of state policy, and amend the Indonesian constitution. The MPR includes all members of the national legislature, the People's Representative Assembly (*Dewan Perwakilan Rakyat* or DPR) – including those appointed by the military – and other members chosen by elected provincial assemblies and interest groups. In October 1999, the MPR began a process that could lead to fundamental constitutional reform regarding presidential elections, the balance of powers among government branches, the protection of regional interests, and other issues of great significance.

The 1999 general session of the MPR produced amendments to nine of the Constitution's 37 articles. The MPR decided to follow U.S. practice in amending the constitution, in which the full original text is accompanied by changes to these nine articles, which as a whole are referred to as the First Amendment. The First Amendment focuses on strengthening the position of the legislative and judicial branches vis-a-vis the executive branch. The First Amendment also reaffirms an MPR decree from November 1998 that limits the president and vice president to two five-year terms. Nonetheless, the Amendment does not address the more fundamental problems with the 1945 Constitution.

The MPR did, however, authorize a committee to consider further constitutional change and report to its next plenary session, scheduled for August 2000. Fundamental issues to be addressed include:

a. the possible development of a bicameral legislature with representation for the country's diverse regions in an upper house, perhaps modeled on the U.S. Senate;
b. revisions of the respective powers the national, provincial and district governments, including the possibility of entrenchment through federal provisions in the constitution;
c. the separation of powers and the establishment of checks and balances among the three branches of government; and
d. the direct election of the president and vice president.

In addition, the MPR committee is considering other elements of the constitution, including the possible entrenchment of human rights provisions, the precise role and function of the Supreme Advisory Council and the Central Audit Board, the possible independence of the Bank of Indonesia, and the appointment of senior judges.

Because of the generality and vagueness of the 1945 Constitution, Indonesia has also established the basic institutions and structure of government through laws passed by the national legislature. These include laws enacted in January 1999 governing elections, regulating political parties and defining the structure and composition of national, provincial and district legislative institutions. Moreover, laws governing decentralization of governmental authority and revenue

sharing were enacted in May 1999.

These are important precedents. But to ensure broad acceptance and legitimacy for constitutional reforms, the newly elected government and legislative bodies must initiate a more comprehensive, transparent and participatory reform process. The process of electing new representatives at national and local levels, the election of a new president and the formation of a new government have provided the new representatives with the legitimacy and mandate they need to take on a range of issues that must be addressed in order to advance the democratic transition.

4. Reform of the Electoral System

The electoral system must be substantially reformed. While the legal framework for the 1999 elections provided sufficient basis for elections that were broadly accepted, that framework was flawed and could undermine democracy in the future.

Advised by a team of independent professionals, the previous government in late 1998 proposed a district election system for Indonesia. The drafters sought to increase legislative accountability and improve ties between representatives and constituencies. The previous DPR, however, largely at the behest of new parties, rejected the proposed district system and established a complex hybrid based largely on the proportional system that had been in use in Indonesia since the first elections in 1955. Nonetheless, proponents of district-based elections remain active in their efforts to revive the debate for the future. A coherent electoral framework with broad public support is essential for the legitimacy of future elections and the consolidation of the democratic transition.

Other aspects of the electoral system will require further debate as well. The seats reserved for representatives of the military and police should be abolished at all levels. The composition of the election authorities, in which every party, regardless of its size, is represented on the election commission or *Komisi Pemilan Umum* (KPU) and all other lower-level election bodies, proved unworkable and threatened the very legitimacy of the 1999 elections; the MPR itself has called for a new, independent electoral authority. The election dispute investigation and resolution system will require further restructuring and strengthening. Finally, the laws and regulations concerning campaign financing must be reviewed and improved.

5. The Distribution of Powers and Finances between Central and Regional Authorities

Under Soeharto, nearly all political and economic power in Indonesia was vested in the central government in Jakarta. Provincial governors and district heads (regents and mayors) were little more than Jakarta's administrative and political representatives in the regions. Provincial and district assemblies, by law, were considered part of the corresponding executives. Tax revenues and other proceeds from the major industries were funneled to the central government first, and only then was a small portion returned to the originating region.

The idea of devolving significant authority from the center to the regions gained prominence during the election campaign when Amien Rais, *Partai Amanat Nasional* leader and now MPR speaker, proposed that Indonesia consider adopting a federal system. This proposal was widely criticized, in part because the term "federalism" retains strong negative connotations in Indonesia due to Dutch efforts in 1949 to use a federal system to undermine Indonesian nationalism.

Nevertheless, Rais's proposal began a debate on center-region relations, with many calling for greater regional autonomy as an alternative to federalism. Furthermore, the previous government took the first steps in this direction when the old legislature passed new laws on regional government and on center-region financial relations. These laws devolve specific and substantial powers to provincial and district governments. They also provide provincial and district assemblies a more significant role in the selection of corresponding regional government executives – governors, regents and mayors – and they provide substantial additional resources to local governments. Although many commentators have criticized the new laws, that were enacted by the previous legislature which was not democratically elected, the mood now appears to be that some action on the issue of distribution of powers and resources is urgent and that details and problems can be worked out later.

The original timetable for the implementation of this legislation was 18 months to two years, and a new Ministry for Regional Autonomy has been created. The Minister, Ryaas Rasyid, and his team are working to speed up this timeframe; newly elected provincial and district assemblies are already in the process of choosing their own governors, regents and mayors. There is a strong perception within the Ministry and some other parts of the government that the attempt to resolve the specific issues of Aceh, Maluku and Irian Jaya should not be confused with the general issue of distribution of powers and resources within the Indonesian state.

In addition to the practical difficulties, there is a clear conflict between those who favor decentralization and the ministers and senior officials of some sectoral ministries, who see their sphere of responsibility being rapidly and radically diminished. In addition, fears that devolution will allow some localities to make misguided decisions are particularly pointed; both central officials and environmentalists, for example, worry about the grant of logging permits in tropical forests and the attempt to control illegal logging. The issue of the role of different levels of government in the planning of natural resource use is perhaps the most controversial part of all of the devolution debate.

6. Empowerment of the National Legislature and Regional Assemblies

The democratization process in Indonesia must ensure that the national, provincial and district assemblies play a more meaningful role in public debate, policy development and oversight of the executive branch and the military. Under Soeharto's New Order government, the national legislature (or DPR) was little more than a rubber stamp for legislation and budgets presented to it by the executive branch. The DPR's committee system was weak, and its rules of procedure hampered its ability to function effectively. In addition, the legislature was unable to appropriate for itself the financial and human resources necessary to provide effective oversight of the executive branch.

Even without structural changes through constitutional reform, the new DPR and its regional counterparts already are much stronger and more activist bodies. First, because they have been democratically elected, these bodies have substantially greater legitimacy. Moreover, recruitment of candidates changed dramatically as parties were able to organize freely, choose their own candidates, and compete in a much more open and fair process. Under the new law on regional government, the regional assemblies are now legally separate from the corresponding executive branch institutions. Thus, the new legislators enjoy popular legitimacy and significantly greater independence at all levels. Nonetheless, much work remains to be done to broaden understanding

regional assemblies to serve as effective multiparty lawmaking and representative institutions.

7. Establishing the Rule of Law: Strengthening the Judiciary and Addressing Corruption and Human Rights Abuses

Notwithstanding its rhetoric, the Soeharto regime demonstrated no commitment to or understanding of the rule of law. The Supreme Court is subordinate to the executive branch and has no power to review the constitutionality of legislation. Judges lack independence, as they report to both the Supreme Court and the Ministry of Justice. New legal institutions, including an independent judiciary and a commitment to the rule of law, will be essential to democratic consolidation.

More generally, the Indonesian government and the Indonesian legal system are riddled with corruption. The problem of corruption represents a serious threat to the transition to democracy and establishment of effective, transparent governance.

The reform agenda also must confront profound issues of transitional justice. The Indonesian political establishment and public must debate and decide how to deal with the human rights violations and corruption that were rampant in the past. These issues are inextricably intertwined with the military's role in politics and the grievances of the regions, making them even harder to solve.

8. Building Civil Society and Political Parties

Civil society was unprepared for the sudden opening of opportunity that followed Soeharto's resignation. Under Soeharto's New Order regime, civil society operated within limited political space. The regime sought to organize civil society around various "functional groups." In essence, the government determined which groups to include in national consultations and who would be the representatives of these groups, making for highly centralized decision-making structures within the organizations. At the same time, nongovernmental organizations – especially the new human rights and democracy advocacy groups that emerged in the 1990s, often with US support – developed various strategies to avoid government interference in their affairs, such as eschewing formal membership and retaining control and management of the organizations in a small group of individuals. These survival strategies were important for these organizations, but in many instances they sacrificed internal democracy and organizational development in order to deflect governmental control.

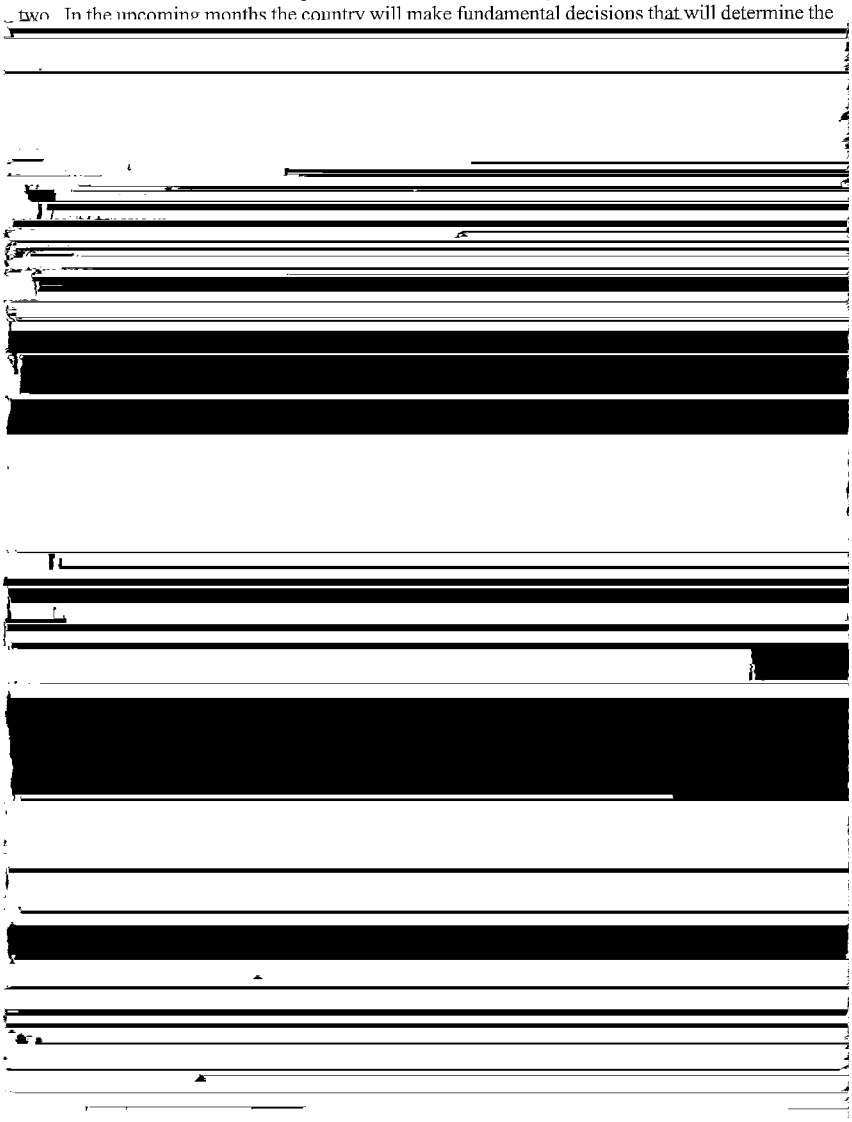
Programs of Indonesian nongovernmental organizations, university-based networks and other civil society groups to educate voters and mobilize election monitors made an enormous contribution to public confidence in the 1999 elections. In addition to improving the quality of the election process, providing a check on fraud and building public confidence, these efforts energized broad civic involvement in the political process and may have begun to transform public attitudes toward national politics. The continued involvement and empowerment of civil society will be essential to the success of the transition to democracy in Indonesia.

Civil society organizations in Indonesia must build on these impressive voter education and

election monitoring efforts by building organizations, maintaining new networks, monitoring government performance, advocating reform, educating the public, and conducting research about policy and public opinion. At the same time, the government must be encouraged to become more

of organizations and institutions necessary to the success of democracy: the new government, provincial and district governments, national and regional legislatures, political parties, CSOs, including monitoring and advocacy groups, the judiciary and the legal profession, trade unions, the media, and the process of constitutional and electoral reform.

The course of Indonesia's political transition will be largely determined in the next year or two. In the upcoming months the country will make fundamental decisions that will determine the



political practices long into the future. At the same time Indonesia must confront profound challenges. International support is particularly essential at this critical time in the country's history. Such support will help Indonesia to secure its place as the world's third largest democracy.

APPENDIX I

NDI PROGRAMS IN INDONESIA

NDI has been working in Indonesia since early 1996 with support from the National Endowment for Democracy and the U.S. Agency for International Development.

1996 to 1998 Programs

Supporting Domestic Election Monitors. In 1996 the Institute began assisting the Independent Election Monitoring Committee (*Komite Independen Pemantau Pemilu* - KIPP), the country's first formal independent election monitoring organization, in its efforts to monitor the flawed May 1997 parliamentary elections. With NDI assistance, KIPP organized a serious effort to monitor those elections and thereby established an important precedent for domestic election monitoring and organized citizen involvement in the political process.

Civil-Military Dialogue. In early 1998, NDI initiated a partnership with the Center for Security and Peace Studies (CSPS) at Gadjah Mada University in Yogyakarta to promote dialogue about pluralism and democracy among young civilian and military leaders. The program brought together participants from Gadjah Mada University and the National Military Academy (AKMIL) in Magelang to discuss transition issues and the role of the military in a democracy.

1998 to 1999 Programs in Support of Democratic Elections

The thaw that began immediately upon Soeharto's resignation in May 1998 enabled NDI for the first time to establish a presence in Jakarta in July 1998. A grant from USAID on September 30 enabled NDI to substantially increase its presence in country and the scope of its democratic development programs. The programs were designed to: (1) aid emerging and pre-existing political parties to compete effectively in a more democratic environment; (2) work with civil society efforts to advocate for democratic elections and to carry out nationwide election monitoring; and (3) facilitate public input into the development of a framework for political transition, including initial steps to encourage and inform dialogue between military officers and leaders of civil society. NDI also organized a comprehensive international monitoring program.

1. Assisting Political Parties

Because effective political parties are important and necessary components of stable democratic governance, NDI has been aiding Indonesian political parties to compete in the new environment. NDI has provided technical assistance to political parties, on a nonpartisan, inclusive basis, through a series of workshops and consultations on fundamental issues such as strategic planning, platform development, communications and campaign methods.

To further support party development, in March 1999 NDI established a resource center to help party leaders and candidates to inform their campaign programs, messages and platforms, to monitor the media, and to practice their interview and message delivery skills. The center has a small, simulated TV studio with a video camera for party and candidate training. The center also

collects and organizes clippings from the Indonesian print media as well as copies of radio and TV political talk shows. It directly provides a daily index of pertinent news clippings and broadcasts to all political parties contesting the elections. NDI has continued to provide these resources and training services to political parties during the post-election period, and has additionally extended its media training to members of the new government upon request.

2. Assisting Domestic Election Monitoring Organizations

NDI has encouraged the development of domestic monitoring efforts on three fronts: (1) promoting and assisting coordination among national and regional monitoring groups; (2) providing information on technical details relating to program implementation; and (3) supporting programs to enhance the public image of, and recruit volunteers for, monitoring efforts and monitoring groups. The Institute worked with three principal national networks that mobilized large numbers of pollwatchers for the June 7 elections: the Independent Election Monitoring Committee (KIPP), the University Network for Free Elections (UNFREL) and the Rectors' Forum for Democracy. NDI has helped with technical assistance on creating training manuals and materials and has provided technical experts to work directly with these groups. In addition, for the June 7 elections, NDI helped the Rectors' Forum to organize and execute the largest and most complex parallel vote tabulation ever undertaken anywhere in the world. NDI also worked with the three national monitoring groups to develop a major public relations campaign to explain the critical importance of domestic election monitoring and to recruit volunteers through television, radio and print media. In conjunction with this campaign, NDI supported a "hotline" service for perspective monitors and served as a reporting point for electoral violations.

3. Facilitating Input into the Transition and Assessing the Framework for Elections

NDI sought to increase the amount and quality of information, especially information about democratic transitions in other countries, available to Indonesians. NDI organized a series of consultations and international assessment missions designed to analyze the electoral process at key junctures, especially surrounding the legislative elections.

After Soeharto's resignation in May 1998, NDI quickly responded to requests for assistance. NDI sent an assessment team to Indonesia in early June 1998. In July 1998, the Institute worked with the University of Indonesia to organize an international conference on political reform. NDI arranged the participation of prominent political leaders from South Africa, the Philippines and Hungary, each of whom had participated in transition negotiations and had served on the election commission in his own country.

NDI again brought small teams of international experts on election systems and political transitions to Indonesia in November 1998, February 1999 and early May 1999. Each of these teams worked with NDI's in-country team to assess the prospects for democratic elections, including the political environment, administrative preparations and the emerging legal framework for elections, political parties and legislatures. NDI prepared public reports that provided valuable input to DPR members, party leaders, civil society activists and the international community. In February 1999, NDI helped organize a critically important meeting between 67 political parties and the "Team of 11," which was charged with determining eligibility of parties to contest the elections.

4. International Observation Program

Building on NDI's assessments in the pre-election period and other democratic development programs in Indonesia, NDI and The Carter Center organized a joint international monitoring program for the June 7 elections. The two organizations fielded a delegation of approximately 100 observers from 23 countries, including political party leaders, elected officials and those who formerly held elected office, election and human rights experts, legal scholars, regional specialists and civic leaders. Former President Jimmy Carter, led the election delegation. Delegates were deployed to 26 of Indonesia's 27 provinces. On behalf of the delegation, President Carter offered a preliminary assessment of the election process on June 9, 1999.

In response to concerns that the aggregation of election results was extremely slow and to allegations of manipulation of the results and election fraud, NDI re-deployed seven teams of observers across Indonesia immediately following the election to monitor and report on the counting process. A second post-election Mission statement was issued on June 20 assessing the reasons for the delay in the announcement of election results and reassuring the people of Indonesia that the tabulation process was generally transparent, accurate, fair and open to scrutiny. On behalf of the joint mission, NDI prepared and issued a third post-election statement on July 15 that compiled and compared election results for each province from the election authorities with those available from several unofficial sources. This analysis confirmed that delays in the vote count neither appeared to have been caused by nor to have created the opportunity for significant manipulation of the vote count and contributed to public confidence in the election results.

On August 26, based on the analysis of NDI, the joint Carter Center/NDI mission issued a report that expressed concern about the process of forming the DPR and the MPR. NDI continued to monitor post-election developments though the presidential and vice presidential elections in late October, and in November issued a report that assessed the MPR session, and highlighted further challenges to democratization that will face the new government.

Post-Election Programs in Support of Democratic Consolidation

Building Civilian Capacity and Facilitating Dialogue. In late 1999, NDI began a new program to strengthen civilian capacity for leadership and oversight of the military. This program builds on NDI's earlier partnership with the Center for Security and Peace Studies. Indonesia is one of the countries targeted by the Partnership on Democratic Governance and Security (PDGS), a global partnership of NDI and civil-military institutes from the United States, Argentina and the Philippines to promote the worldwide exchange of information and analysis about governance and security issues, to conduct country-specific programming to strengthen civilian capacity for leadership, oversight and management of the military in six countries, and to strengthen the capacity of civic organizations in Latin America, Asia and West Africa to address civil-military relations.

NDI has begun a series of activities designed to strengthen civilian institutions in Indonesia critical to civilian leadership, direction, management and control: the legislature, the media and leading universities. NDI conducts training on defense-related issues for the DPR's Commission I, which oversees the military, and the media; offers expert consultations on governance and security in the post-election environment; build the capacity of academic institutions and think tanks to research and analyze security policy and the institutions of the military. NDI will also sponsor regional-level dialogues between civilian and military leaders. Such activities will build on NDI's

prior work in Indonesia and its ongoing global civil-military program.

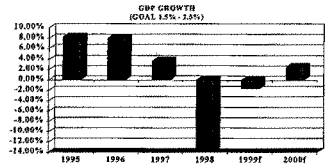
Civil Society Capacity-Building. As part of an effort to strengthen the role of civil society in the post-election period, NDI organized a training seminar on civic advocacy for CSO leaders in September 1999. The Institute has conducted a comprehensive needs assessment of civil society organizations, meeting with more than 30 organizations since the close of the 1999 election process, and this week has convened, in conjunction with Indonesian partner organizations, a national roundtable on the capacity-building challenges facing civil society.

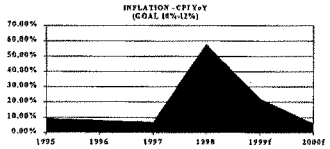
Supporting Constitutional and Institutional Reform. In November and December 1999, NDI organized a series of consultative meetings to discuss political reform issues with MPR members, DPR members, government representatives and civil society organizations. At the request of the MPR Chairman, NDI produced a document outlining comparative constitutional arrangements in 16 different countries, a document which the Institute plans to refine and make publicly available. In December 1999, NDI sponsored a visit to Jakarta by a South African government official with expertise on decentralization and reform of intergovernmental relations to share his country's experiences with Indonesian government officials, civil society leaders and others. Based on the positive reaction to this program, the Institute expects to organize similar exchanges of comparative experiences in constitutional and institutional reform during the year 2000. The Institute also continues to work closely with Indonesian partner institutions to encourage a civil society voice in the reform process.

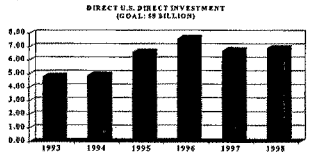
Encouraging Democratic Legislative Practices. Also in November and December 1999, NDI conducted a needs assessment with the new DPR and, in conjunction with leaders and members of the body, identified numerous challenges to the furthering of democratic practices in the national legislature. At the request of DPR leaders, NDI also reviewed a draft code of conduct for legislators and provided written comments on the draft to the code's drafting committee, based on international norms for legislative ethics regulations. To address further the challenges facing the new DPR, in early 2000 the Institute will assist the legislative secretariat to organize a comprehensive orientation session for new DPR members and a program on the development of a parliamentary ethics regime.

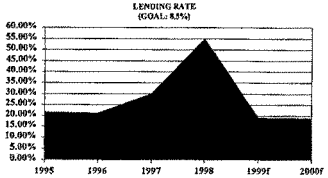
US-INDONESIA BUSINESS COMMITTEE

DASHBOARD – KEY GOALS

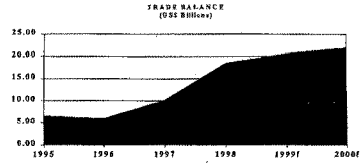


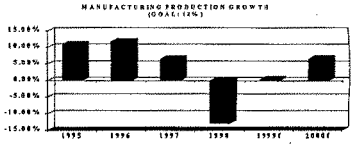


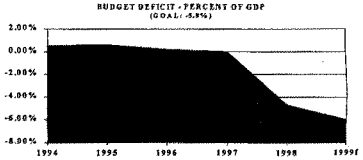


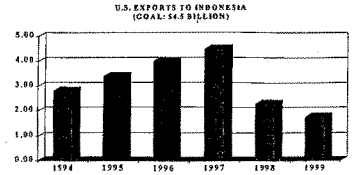


- **Privatization** – Fulfill commitments to the IMF to privatize priority state-owned enterprises and establish firm timetables for the privatization of others.
- **IBRA Asset Sale** – IBRA should price its assets to market and establish a firm timetable to divest them.
- **IPP Issues** – Resolve equitably, objectively and transparently the Independent Power Producers issues of payment and tariff rationalization.
- **Energy Sector Regulatory Reform** – Pass Legislation that will facilitate competition in oil, gas and power
- **Bank Restructuring** – Establish firm foundation for future banking system.
- **Corporate Debt Restructuring** – Continue to facilitate corporate debt workouts through the Jakarta Initiative and other mechanisms.
- **Legal Reform** – Establish the legal institutions for the ethical enforcement of the rule of law.
- **Transparency and Reform of Anti-competitive Practices** – Increase transparency of procurement procedures and the judicial system.
- **Transparency & Rule Making Processes** – Increase transparency of rule-making to allow input from interested groups on the necessity, technical feasibility and economic practicality of proposed rules prior to implementation
- **Bankruptcy** – Ensure integrity of new bankrupcy regime
- **IPR Protection** – Encourage full compliance with TRIPs and effective enforcement of current commitments.
- **Customs** – Address arbitrary valuation for tariff assessments. Need for electronic pre-clearance, 24 -hour customs operations, elimination of export clearance procedures, higher deminimus levels.
- **Customs** – Address restrictions on foreign ownership of ground transport, warehousing and customs clearance companies.
- **AFTA** – Meet AFTA commitments on tariff reductions.
- **Pharmaceutical Product Registration** – Speed process of registration for pharmaceutical products.
- **Sole Agency** – The foreign investment law, administered by the BKPM, is in need of synchronization with the "sole agency" regulations administered by the Ministry of Trade and Investment.
- **Distribution** – Comply with letter and spirit of reform permitting 100% foreign ownership of distribution/retail.
- **Telecommunications** – Decrees designed to implement telecommunications blueprint should foster robust competition in the industry.
- **Telecommunications** – The mobile communications industry urgently requires flexibility to adjust tariffs to market prices.
- **Agriculture** – Adopt policy recommendations proposed by the Open Food System initiative.









DASHBOARD NOTES

INDEPENDENT POWER PRODUCERS

We applaud the Government of Indonesia (GOI) for appointing a special steering committee to address the issues facing the Independent Power Producers (IPPs) and for choosing direct negotiations rather than legal confrontation. The IPPs stand ready to work with the steering committee and with the new President Director of PLN, Mr. Kuntoro.

The IPPs believe that good faith negotiations can lead to a reasonable basis for sharing the burden of the current economic crisis facing the GOI and PLN.

The IPPs invested in Indonesia based on the GOI's announced policy encouraging private investment in electrical power generation (the IPP policy). The IPP policy implemented Law 15/1985 on electric energy which called for private investment in the electric power industry. The IPP policy was encouraged by the World Bank and other international financing institutions to meet Indonesian's projected 15% annual increase in demand for electric power.

From the late 1980s until the onset of the crisis, many reputable experts were forecasting power shortfalls in Indonesia starting in the late 1990s. If the IPPs had not been enlisted to provide additional capacity, PLN and the GOI would have had to do this with direct borrowings.

IPPs can provide important benefits to Indonesia and are not the cause of the economic problems facing the GOI or PLN. The IPPs provide long term investment in Indonesia and will provide power and foreign investment over the life of the Power Purchase Agreements (PPAs).

PLN has always operated at a deficit. This has been GOI policy and would have been true even if the IPP capacity had not been built and only the financial crisis had intervened.

Constructive resolution of the current situation will demonstrate the long-term investment potential in Indonesia and help support one of the key stated goals of President Wahid's government - increasing foreign investment.

The IPPs only ask that they be treated in a fair, open and transparent manner as the negotiations commence and that the economic crisis not be used as an excuse to ignore and nullify their efforts and carefully agreed upon contractual undertakings.

The IPPs understand the tremendous issues facing the GOI and are willing to work with the GOI to arrive at both interim and long term solutions and sustainable tariffs.

ENERGY SECTOR REGULATORY REFORM

Oil and Gas Bill. The Oil and Gas Bill drafted under the previous government would have facilitated competition in the energy sector. It would have made changes in the administration of production sharing contracts (PSC's) and other agreements, and introduced

new competitive rules and foreign investment authorization in downstream oil and gas. The Bill also aimed to establish an independent body to regulate downstream gas, and downstream oil in transition. The Bill died as the last parliament drew to a close, as there was opposition to transferring the administration of PSC's from Pertamina to the government.

Domestic Gas Sector Policy Paper. A policy paper on the domestic gas sector is also eagerly awaited. It will spell out where the gas industry should go, changes needed to get there, and how to introduce greater competition, unbundling of services, an independent regulatory framework for the sector, and the introduction of private investment into the development of gas infrastructure.

Electricity Sector Reform. The Government has been pursuing electricity sector reform since 1993 and a power sector reform policy was developed in mid-1998. This policy should be revisited and revised as necessary, including a new timeline. The policy paper had recommended that an electricity sector reform law be enacted by the end of 1999. An important point is the establishment of a regulatory body for power, which will also require legislation.

Subsidies. Subsidies remain a serious obstacle to reform in the energy sector and a plan for reducing and eventually eliminating them needs to be developed.

Recommendations. We understand the new government is interested in moving forward with these energy sector reforms that will facilitate competition among multiple firms in oil, gas, and power, thereby bringing down the cost of energy.

We urge the new government to proceed with whatever briefings are needed to complete its own position with respect to competition in the energy sector and the provisions of the new oil and gas bill, put the bill into final form, and get it introduced and enacted this year.

We also urge the issuance of the gas policy paper and movement on the electricity reform bill.

Issuance and enactment of these measures will help the benefits to Indonesia from more competition, lower prices, and greater investment to begin as soon as possible.

BANK RESTRUCTURING

We appreciate the complexity of the current need to reform, restructure and recapitalize the financial sector in Indonesia. The magnitude of the undertaking is daunting, however, the results will form the basis of the financial infrastructure necessary for Indonesia to move forward. The sale of assets and restructuring taken on by the IBRA must be accelerated and plans for recapitilization must be based on complete and detailed plans submitted by each of the institutions requesting government funding. We are aware of the process that is in place and would like to see it take on greater transparency and auditability.

Regulation and Supervision of the surviving institutions will be the most important component of the reform/restructuring program. We would like to see a strong program of

compliance. The reporting of key ratios and good on-site supervision will help to identify problem institutions in the future.

The surviving Banks must have sufficient systems in place, both organizational and technical, to ensure that they have the means to manage risk at all levels. This will require an investment in
integrated customer accounting and financial management systems that are capable of giving the respective institutions a complete picture of their financial well-being in a timely manner. We believe that the appropriate supervisory organization should mandate the use of asset/liability management systems as part of the reform program. We believe these systems will be key to the development of a successful and sound banking system in Indonesia.

We also recommend that there be access to associations (possibly the Banker's Association) or other institutions where bankers can receive training on credit management and lending practices that are consistent with world standards in, for example, the G7 countries. This will have
significant impact in reducing the generation of NPL's in the future. This training should reinforce the practices of the Bank Supervision organization and loan classification standards.

While we realize the enormous scale of the undertaking, it is the foundation for a new Indonesia. For this reason, we strongly urge the government to take strong measures to move this process forward and do whatever is necessary to ensure swift completion of this very important task.

NEED FOR TRANSPARENCY IN RULE-MAKING: INDONESIAN TOXIC AND HAZARDOUS (B3) WASTE REGULATION

In February and October 1999, the Government of Indonesia enacted new Toxic and Hazardous (B3) Waste Regulations. The Indonesian Environmental Impact Management Agency, BAPEDAL, which is responsible for managing all toxic and hazardous waste issues

By contrast, the process followed by BAPEDAL occurred in a vacuum without input from other knowledgeable, qualified or interested sources on the need for the new regulations, their feasibility or practicality. As a consequence, to show one example, even drinking water would have been considered a hazardous waste in some circumstances. Moreover, the BAPEDAL regulations were published as final and many industries discovered they may not have been in compliance the day the rules were published.

If left in place, this regulation has the potential to decrease foreign and domestic investment due to the uncertain nature of the types and extent of B3 waste management activities. Existing industries and businesses will find it virtually impossible to comply with the new regulation's overly broad, vague, and ambiguous nature. Future projects on the drawing board may simply be scuttled. With the anticipated large volumes of waste covered by this regulation, it may actually preclude the most hazardous of wastes from receiving the highest priority attention they deserve. Confusion by many in industry may lead to fewer real attempts to improve toxic and hazardous waste management and may reduce actual environmental benefits gained in recent years.

Attempts by various groups working directly with BAPEDAL to find a common ground have proven fruitless. Discussions are currently underway by the American Chamber of Commerce (AMCHAM), Indonesian Chamber of Commerce (KADIN), Indonesian mining, pulp and paper, textile, and industrial associations, as well as academic groups. The goal is to provide a new draft of scientifically based toxic and hazardous waste regulations that protect human health and the environment, while also balancing environmental necessity, technical feasibility, and economic practicality.

We strongly recommend that BAPEDAL and other rule-making agencies of the Government of Indonesia adopt formal, wholly transparent rule-making procedures that adequately consider the necessity, feasibility and economic practicality of proposed new rules and that adequately provide for input from all affected groups – the regulated industries, other Indonesian government agencies, academics and other scientific and technical experts, non-governmental organizations and others.

CUSTOMS ISSUES

Electronic Pre-clearance. To the express industry, electronic pre-clearance means the processing in a paperless environment of all entries and the obtaining of customs release of shipments, preferably at least two hours prior to arrival of flights. The status of any items not released should be part of the electronic pre-clearance. The objective is to achieve the separate release of the shipment for delivery from final submission of the goods declaration and payment of duties. The result is a significant enhancement of companies' logistics efficiency and therefore competitiveness.

Customs' Hours of Operation. Under conditions of the global market place, any country that does not provide twenty-four hour customs clearance is significantly handicapping its companies in competing with its neighbors. Modern just-in-time logistics requires immediate delivery of shipments. Otherwise, expensive warehousing is needed to ensure timely delivery of key components.

Export Clearance. Elimination of export clearance procedures removes essentially a bookkeeping operation that slows down companies' ability to deliver products rapidly. Duties are not collected on exports, and the destination country has import procedures in place to provide regulation of trade. An alternative is to require post-export declarations, which would satisfy record keeping without slowing down trade.

Deminimus. Trade is facilitated by establishing higher deminimus levels, below which formal customs procedures are waived and, in some cases, no taxes collected. Countries with no deminimus levels or very low ones are imposing inefficiencies on their businesses by slowing trade and making it more costly. Below the diminimus level, an airway bill of lading or commercial invoice should suffice. Such shipments could still be subject to spot checks for verification and enforcement purposes.

AFTA

U.S. business fully supports the ASEAN Free Trade Area, and encourages ASEAN to realize AFTA's implementation on or ahead of the schedules to which ASEAN members have agreed. U.S. business is pleased to note that average tariff rates under the CEPT schedule are scheduled to fall below 4% this year, on the way down to 2.6% by 2003. At the same time, delays in the tariff reduction schedules for certain products by some ASEAN members have been announced, or are being considered. ASEAN is encouraged to maintain its commitment to the realization of AFTA by 2002 (later for newer members). AFTA will increase regional trade, boost ASEAN's competitiveness, draw in foreign direct investment, and will support the continuing economic recovery.

The larger, integrated market created by AFTA will allow companies to enjoy economies of scale, and rationalize and streamline manufacturing operations. The lower tariffs will increase the cost competitiveness of manufacturing industries in ASEAN, and an integrated internal market will make ASEAN a more attractive site for foreign investment, particularly vis-a-vis other large emerging economies. Rather than viewing ASEAN as a series of segmented markets, firms will be able to see it as a single market of nearly 500 million people, and will be able to make investment decisions accordingly.

AFTA will promote a new degree of depth in ASEAN's manufacturing sector. This is particularly relevant for local small and medium enterprises. The firms that establish larger manufacturing operations in the region to take advantage of AFTA will seek to source locally, and will also draw in their suppliers, who will over time increase the share of inputs sourced locally. The local sourcing will promote greater depth in the manufacturing sector, and will contribute significantly to the development of local SMEs. These local suppliers will over time be integrated into firms' global operations as cost and quality capabilities are developed.

SOLE AGENCY

The foreign investment law, which is administered by the BKPM, provides for the establishment of wholly-foreign-owned distribution companies in Indonesia; however, with respect to the automotive industry, the old "sole agency" regulations, which are administered

by the Ministry of Trade and Industry and which mandate the appointment by a foreign manufacturer of a wholly-Indonesian-owned distribution agent, have not been formally repealed and continue to exist. As such, the rules relating to the establishment of a wholly-foreign-owned automotive distribution company are unclear, or at least confusing. Formal repeal of the "sole agency" regulations would clarify the rights of foreign manufacturer's to establish and operate automotive distribution companies, *and as a result would provide a stronger basis of support for foreign investment in this area.* This is an area that we can provide examples and help the government synchronize the regulations.

As a result of the continued existence of the "sole agency" regulations, foreign auto manufacturers could be forced to pay "compensation" to sole agents appointed under the old legal regime upon the expiration or termination of the "sole agency" relationship, despite contractual agreements by the parties to the contrary and the fact that appointment of a local "sole agent" is purportedly no longer mandated by law. *Final formal repeal of the "sole agency" regulations would further serve to remove a potential obstruction to foreign investment in the automotive distribution sector.*

Current law prohibits capital investment by foreign companies in the retail trade sector in Indonesia (other than in so called "large scale retail trading"). *The opening of the retail trade sector to foreign investment would serve as an impetus for further investment and allow manufacturers to more easily provide customers with better and more complete and cost-effect services (e.g., e-commerce).*

TELECOMMUNICATIONS ISSUES

We applaud the Indonesian government for its efforts to reform the telecommunications sector. The newly adopted Telecommunications Law provides a strong foundation for deregulating the market and fostering competition. Moving forward, the Indonesian government faces important challenges in adopting decrees to implement the law. The Committee strongly urges that the implementing decrees fully support the development of true competition in the market. The unprecedented rise in demand for communications services will be most effectively satisfied through a pro-competitive framework. In addition to the overall industry structure, in order to achieve the vision of the new Telecommunications Law, it will be important to construct a regulatory framework that provides for cost-based interconnection, seamless network access and reasonable universal service funding guidelines.

Acknowledging the progress that has been made, the Committee has concerns about specific proposed measures that could have an adverse effect on the future health of the industry and on-going operations of the existing industry players.

Our major concerns fall into three main areas:

- The direction of the decrees that will be used for implementing the newly enacted telecommunications blueprint.
- The need for meaningful relief in tariff setting consistent with the normalization of rates for post paid cellular services.

- The need to understand the overall plan driving the structure of the industry going forward including the future plans for Indosat and Telkom.

In the area of implementation of the newly enacted telecommunications blueprint there is a need to ensure:

- That the decrees associated with the telecommunications blueprint need to be geared towards fostering a competitive environment and not support the dominance of any industry player.
- The implementation of cost based interconnection recognizes the problems associated with the current tariff structure, which may in some cases be below cost.
- An independent regulator would have the authority and ability to ensure seamless interconnection between networks.
- Universal service demands do not drive profitability out of the sector.

The rationale for tariff relief for mobile services is necessary and has broad implications for the economy as a whole, strong consideration needs to be given to this for the following reasons:

- Non-normalized rupiah revenues coupled with dollar based equipment costs have led to delayed expansion due to the negative economic implications of new network investments.
- Delays in investments have created quality and capacity issues in the existing network infrastructure. A sub standard telecom sector will effect overall economic growth.
- Tariffs increases in the cellular industry have a very limited impact on the cost of living for the average Indonesian
- The cellular airtime tariff rates worldwide average .20 cents (US) per minute. Post-paid airtime tariffs in Indonesia currently average approximately .5 cents (US). Post paid rates also form the basis for calls between networks whether the caller is a pre or post paid subscriber. Effectively 50% of the existing revenue has not been normalized for the weakened rupiah.

There has been a great deal of discussion in the industry and in the press regarding the organization of the industry. These discussions include various descriptions of the ongoing role of Telkom, Indosat and the KSO's. There is a need for resolution in this debate:

- Any decisions regarding industry structure should foster a competitive environment.
- Allowing for a merger of Telkom and Indosat would not support the creation of any meaningful competition in the foreseeable future.
- Resolution of the KSO issue needs to ensure that the KSOs remain viable businesses worthy of increased investments going forward.

We believe that a preferred approach – one that will best fulfill Indonesia' vision for creating a robust telecommunications sector by encouraging the growth of service providers – is to allow the MARKET to determine rates and pricing structure. We feel that market based pricing supported by a highly competitive environment is the most appropriate model in the long term. The decisions currently facing Indonesia today will play an important role in

setting the industry on the necessary course towards achieving these goals with the next 3 – 5 years.

As Indonesia undertakes efforts to privatize the telecommunications sector, it will be important to provide incentives to investors. Policies that allow competition and a market-driven approach will send a strong and positive signal to potential investors, and will result in improved services for Indonesian consumers.

The policies now under consideration by the Indonesian government will have a major impact on the ability of Committee members to compete effectively and grow the business. Ensuring that these policies are based in fairness and in support of competition and free markets is the key to the success of the industry, and support of the Indonesian economy as a whole.

AGRICULTURE – BUILDING A GLOBAL OPEN FOOD SYSTEM

A global food system is emerging to meet the increasingly urgent task of feeding a growing world population, especially one with an emerging middle class all over the world. The resulting increase in demand and rising expectations cannot be met by domestic production alone in most countries.

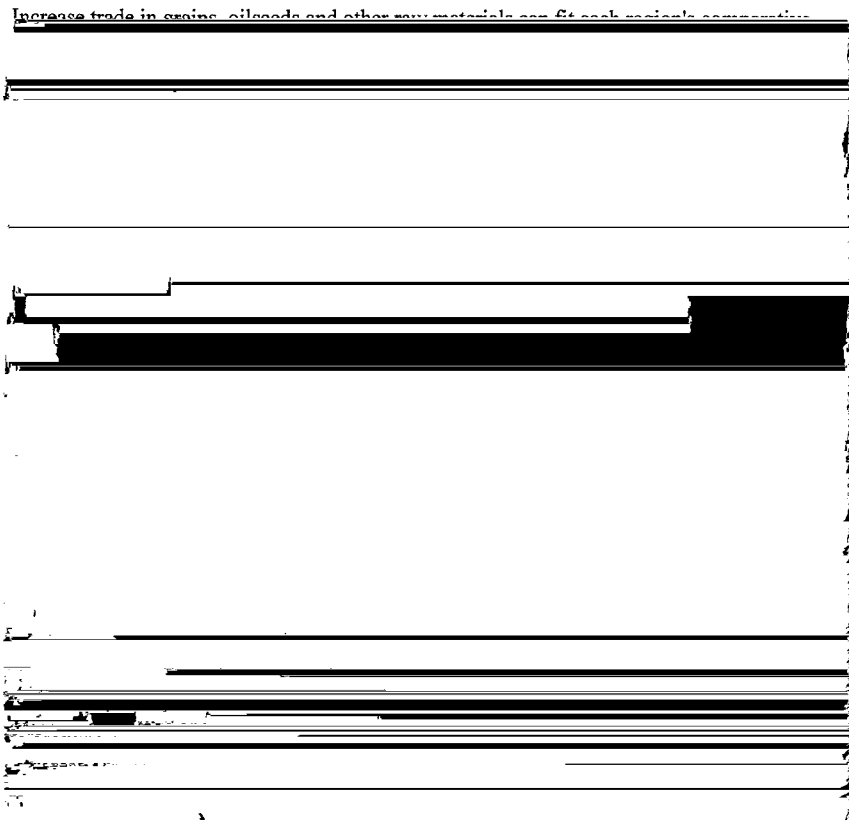
The world will have another 1.8 billion people to feed by the year 2020 – 7.6 billion total. More than half (58 percent) of the world's population growth to 2005 will take place in Asia.

World GDP has grown 91 percent since 1975, and GDP per capita has increased by 32 percent. Again, Asia tops the income growth trend, with 45 percent of the global economic growth to 2005 taking place in the region. Despite recent financial troubles, the growth trend is expected to resume.

The ratio of people to arable land is six times higher in East and Southeast Asia than it is in North America. Asia's also experiencing rapid urbanization and is expected to contribute seven of the world's ten largest metropolitan areas by 2015.

A more market-based, trade-oriented approach represents the emerging reality of the global food marketplace, where food security is achieved through improved domestic production as well as through trade.

Increase trade in grains, oilseeds and other raw materials can fit each region's comparative



Wednesday, February 14, 2000

Testimony Submitted by AmCham Indonesia
To the House International Relations Sub-Committee on Asia-Pacific

Chairman Bereuter and distinguished members of the committee, AmCham Indonesia is honored to be able to submit testimony to this committee on the current economic and business developments in Indonesia.

Over the course of the past year tremendous changes have occurred in Indonesia.

The most notable change is the democratically elected parliament, president and vice-president. The result is that Indonesia is now the world's largest democracy. A cabinet reflecting the social and political diversity of Indonesia was appointed. During the first hundred days the new administration has had to grapple with a wide variety of problems most of them inherited from the previous regime. These include the having to restructure massive corporate debt, a dysfunctional banking system, a sluggish economy, an ineffective judicial system and ethnic strife in several parts of the country.

These problems had to be addressed in the context of changing social and institutional relationships. The most important of these maybe the civilian military relationship. The President has taken steps to bring the military under civilian rule and this process will continue.

There are other encouraging signs. Recent changes in the leadership and the structure of IBRA, the bank restructuring agency, should result in the acceleration of the sale of distressed assets.

Changes in leadership in several state-owned companies in the energy sector are strongly supported by the private sector and should result in greater efficiency and the reduction of corruption. The government's decision to withdraw its lawsuit against the Paiton energy project and pursue active negotiations is also a positive development.

The president and key members of his cabinet have stressed the importance of the rule of law and stated that all contracts will be respected. Judicial reform has been made a priority with many other reforms being considered.

Americans have witnessed some of these changes on their evening news. Many of the changes however have gone unnoticed. The positive developments however has been overshadowed in the international arena by the tragic events which occurred in East Timor after the UN sponsored referendum and still command the attention of many in the United States.

It is imperative that the United States start to develop a foreign policy towards Indonesia that

recognizes the current reality rather than the events of the past. US policy must focus on supporting the further democratization of Indonesia and the continuing reform of its shattered economy.

The United States played a vital role in supporting the process of democratization in Indonesia. US support for the election process and the development of a credible political system helped chart Indonesia's course towards democracy. US funded advisors have been instrumental in the process of reforming the economy. It is crucial that we continue to build upon these successes.

The following issues should be prioritized for further assistance to support the movement towards democracy and the reform of the economy.

Judicial and Legal Reform – A function judicial system is imperative for the solution of the debt crisis. It will also provide the legal certainty, which will set the stage for future investment and development of the economy.

Governance Capacity Building – Regional decentralization is a continuing process that will devolve greater degrees of decision-making authority to sub-national units. This should result in greater regional development and grassroots democracy. This process however is in its embryonic stages and needs to be supported. Capacity building in the mechanics of governance is the key to the success of this process.

Tax Reform – Greater demands are being made on the Indonesian government budget. Reform and rationalization of the tax system is needed.

Legislative Reform and Capacity Building – Parliament is emerging as a revitalized institution that is becoming increasingly involved in the national decision making process. Regional and local parliaments are also being vested with greater authority under the new decentralization laws. Further legislative reform and capacity building at all levels is needed to make this branch of government effective in the new democracy.

Corporate Debt Restructuring – Progress on this issue has been very slow. Until the problem is adequately addressed the economy will not be able to achieve its potential.

Banking Reform – The banking system is still effectively dysfunctional. The recapitalization scheme is tremendous drain on state resources. The revitalization of this sector is critically important in the process of restarting the economy.

Social Safety Net – In the process of making the sweeping changes in government and reforming the economy, there will continue to be dislocations. These must be mitigated by a social safety net that protects the most disadvantaged members of the society.

In all of these areas US assistance can play a vital role in supporting the progress towards democratization and reform. US funded technical advisors in government, civil society and the private sector have proven to be very effective. Their continued presence and increased support

will support Indonesia's goal of becoming a vibrant democracy with a strong economy.

The most important thing that the United States can do however is give the Indonesian government and its legislative branch is time and understanding. These two things will enable the United States to be an active supporter of democracy in this crucial part of the world.

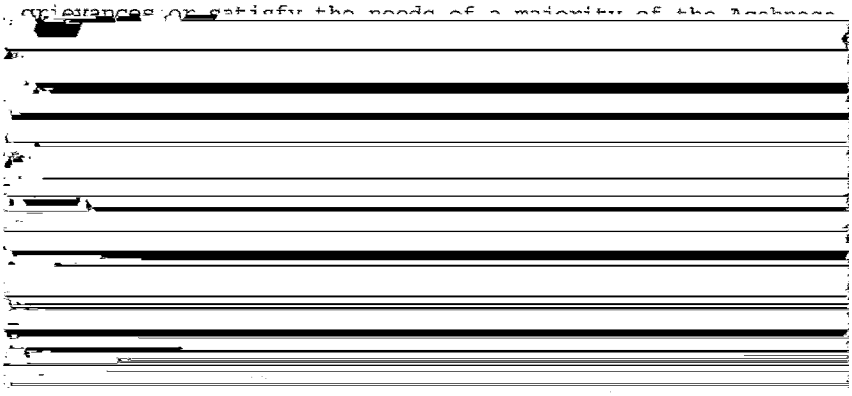
Question for the Record Stanley O. Roth
By Congressman Douglas Bereuter
Joint Hearing of the Senate Subcommittee on East Asian and Pacific Affairs
and the House Subcommittee on Asia and the Pacific
February 16, 2000

Question:

1. What are the prospects that the majority in Aceh will find autonomy acceptable? Is there any sign that the armed separatist movement there is waning and losing public support or conversely that it is gaining strength? Is it possible that the Aceh Merdeka movement could win de facto political and military control of Aceh?

Answer:

We believe there is currently a window of opportunity for the Indonesian government to pursue a broad-based negotiated settlement with Acehnese representatives. We have encouraged the Wahid administration to craft a comprehensive agreement addressing governance, resources, accountability, cultural autonomy, and security issues. It is unclear if an offer of "autonomy", without these other elements, would address the grievances or satisfy the needs of a majority of the Acehnese



people.

Recently the influence and authority of the Aceh Merdeka movement (GAM) appears to have waned from its high point late

of some GAM members in criminal activities -- which has alienated many Acehnese.

The Aceh Merdeka movement is not necessarily in permanent decline, and could easily regain strength in the future -- especially if the Indonesian government fails to seize the opportunity and credibly address the core Acehenese grievances. While it is not inconceivable that GAM could gain de facto control of the province, we do not presently see this as a likely development.

By Congressman Douglas Bereuter
Joint Hearing of the Senate Subcommittee on East Asian and Pacific Affairs
and the House Subcommittee on Asia and the Pacific
February 16, 2000

Question:

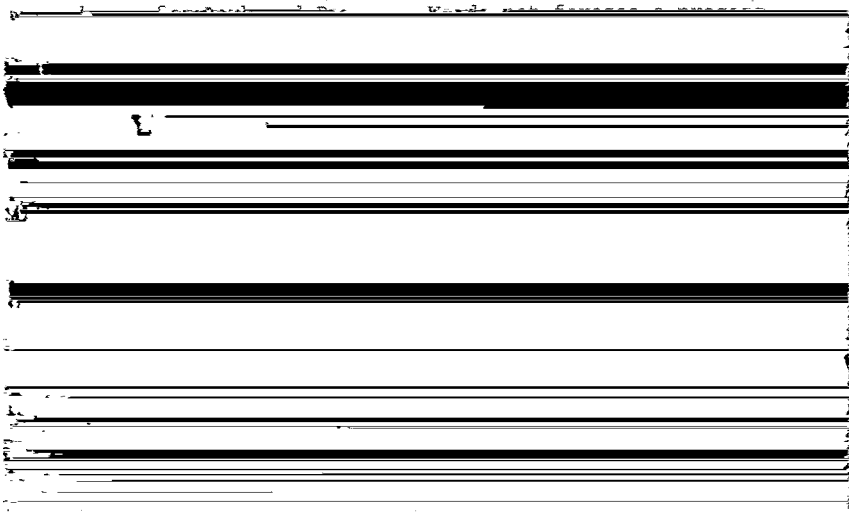
2. Does the Wahid government have a political strategy for dealing with separatist demands for independence? Might it adopt in Aceh, former President Habibie's detailed plan for autonomy for East Timor?

Answer:

President Wahid has declared that he will pursue a political rather than military approach toward separatist challenges, including Aceh. Wahid has opened channels to various constituencies in Aceh, using his own personal and religious connections, as well as the separatist leadership in exile. Wahid's efforts in Aceh have showed signs of progress, at least provisionally. The situation on the ground in Aceh, which was in crisis in November, has grown less dire, although the level of violence remains high. It is clear that any permanent political settlement must be comprehensive and address the full range of Acehnese grievances. These include giving Acehnese greater control over political and economic decision-making affecting the province.

We do not have information that the Government of Indonesia is

Timor. We understand the Government is contemplating a range of autonomy options in accordance with the People's Consultative Assembly's (MPR) decree to craft special autonomy



similar to that in East Timor last year playing itself out in either Aceh or any other region in Indonesia. East Timor was not considered under international law to be a part of Indonesia, and the Government of Indonesia invited international involvement in the question of its future status. This is not the case in regions of Indonesia facing separatist challenges, including Aceh.

Question for the Record Stanley O. Roth
By Congressman Douglas Bereuter
Joint Hearing of the Senate Subcommittee on East Asian and Pacific Affairs
and the House Subcommittee on Asia and the Pacific
February 16, 2000

Question:

3. There are reports of arms and supplies flowing to Aceh Merdeka through Malaysia and southern Thailand. Other reports indicate that Aech Merdeka has received arms and training from radical states like Iran and Libya. What can you tell us about this?

Answer:

We have no evidence of any training or arms received from Iran. However, during the late 70s and continuing through the 80s, Libya reportedly supported the Free Aceh Movement (GAM) through its links with GAM's exiled leader, Hasan di Tiro, and may have provided military training to dozens --- or hundreds, according to some reports -- of young Acehnese. There are also sketchy reports of arms shipments from Libya during roughly the same period, but these are difficult to corroborate.

We understand that most of GAM's arms were likely stolen or bought from the Indonesian army, not procured overseas.

President Wahid has met twice with Prime Minister Mahahtir for talks that included the subject of Aceh. The Malaysian Prime Minister has made clear that his government supports the

territorial integrity of Indonesia and does not support the Aceh independence movement. There has been one recent report that the Malaysian Government has arrested several individuals involved in arms smuggling to Aceh.

Question for the Record Stanley O. Roth
By Congressman Douglas Bereuter
Joint Hearing of the Senate Subcommittee on East Asian and Pacific Affairs
and the House Subcommittee on Asia and the Pacific
February 16, 2000

Question:

4. It has been reported that the IMF opposes a federal system because the central government would lose some control of finances to the provinces. If this is the IMF position, does the administration support it? What discussions has the Administration had with the IMF on this issue?

Answer:

We understand that the IMF does not oppose a federal system. It is, in fact, working with the Government of Indonesia to create the information and budgetary infrastructure and training programs necessary for provinces to plan and manage their own budgets. The concern of the IMF and other international donors is that Indonesian provincial authorities have in place the personnel and systems to effectively manage their budgets before budgetary authority devolves from the central government. It also remains to be negotiated precisely which types of expenditures will be the responsibility of federal versus provincial government and how revenues will be divided.

Question for the Record Stanley O. Roth
By Congressman Douglas Bereuter
Joint Hearing of the Senate Subcommittee on East Asian and Pacific Affairs
and the House Subcommittee on Asia and the Pacific
February 16, 2000

Question:

5. What is the status of the IMET program in Indonesia? E-IMET? Have DoD JCET (Joint Combined Education and Training) programs resumed in Indonesia? If so, under what conditions?

Answer:

U.S.-Indonesia military-to-military relations have been restricted for years because of U.S. concerns about human rights abuses under the regime of former President Soeharto. Among the restrictions, Indonesian military officers could not participate in the regular IMET program and were limited to the narrower E-IMET curriculum, which emphasized resource management, military justice systems, military codes of conduct, civilian control of the military, and the protection of human rights. DoD JCET programs in Indonesia were also frozen in early 1998 when additional abuses by Indonesian military (TNI) units came to light. They have not been resumed.

In September 1999, President Clinton suspended the already-restricted U.S.-Indonesia military-to-military relations, including initiating new training under E-IMET. Some former E-IMET students who were in the U.S. when the suspension was

announced have been allowed to complete their studies using non-IMET funds. Legislation (section 589 of the FY 2000 Foreign Operations Appropriations Act as enacted in the Consolidated Appropriations Act for FY 2000 (PL 106-1113 - the "Leahy Amendment") also conditions resumption of IMET or E-IMET with Indonesia. The U.S. has not initiated any IMET, E-IMET programs in FY 2000, nor conducted DoD JCET programs with Indonesia since they were frozen in 1998.

The Administration will continue to consult with Congress to determine when it would be appropriate to resume training of Indonesian military personnel. Any plan for reengagement with

[redacted]

concrete changes in the situation in Indonesia, including continued progress toward effective civilian control over the military and general military reform. Any reengagement would