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An Economic Reform Agenda for Indonesia?

Paul H. Brietzke* & Thomas A. Timberg**

August 1999

Many needed reforms have already been initiated. But the new Government will be given many reform recommendations, especially about ameliorating the economic Crisis and about promoting economic development (n.1). Rather than simply provide our own list of patent nostrums, we describe a *process* by which Indonesians may want to think through coherent, consistent, and sequenced reforms, to create a level playing field for all Indonesians in the new economy. (A tentative reform agenda is proposed in the separate summary of this paper, however.) A *nine-sector model* of the Indonesian economy is thus described and re-cast as an input-output (or flow-of-funds) *Matrix*, to show how economic imbalance and instability suggest particular directions for reform in Indonesia. Five *precepts* of economic reform are then introduced and applied to the model/matrix, *sector-by-sector*. This voyage, through waters largely uncharted in economics or in law, leads us to some *political* conclusions about the nature of the reform process.

The Indonesian Crisis and the end of the New Order provide both motive and opportunity for the thoroughgoing reforms that were long needed but almost unthinkable several years ago: *see de Tray, 1999*. The “first, relatively easy” steps toward political and economic liberalization have been taken (Carothers, 1998, 95), and deeper levels of reform and an implementation of past reforms are prompted by the now-increased “opportunity costs” of doing nothing: violence and political instability, for example. (n.2)

The task is both one of passing new laws and creating a new system for their implementation. This system must be informed by the best economic and legal intelligence. As Sri Mulyani Indrawati puts it: “fulfilling the IMF’s requests for change in terms of formal legislation is not a problem. ...However, the implementation of the legislation is becoming the bottleneck for Indonesia. [This] depends on structural problems, especially the court system. [T]he ultimate problem of any developing country is to reform itself. ...This crisis has shown us...that we have lagged behind in creating the right institutions to facilitate and regulate economic activity.”(n.3) Lawyers sensitive to economic policy issues can properly claim an expertise in such institutional designs, in dealing with bounded rationality and with moral hazard and other opportunistic behaviors, in promoting efficiency while serving as “transaction cost engineers”, and in promoting a consistency in policies and in values. *See Carlton and Perloff, 1994, 5; Goodin, 1998, 1; Trebilcock, 1997, 51; Ulen, 1997, 71.*

International donors, the motivators of many Indonesian reforms of the recent past, are coming increasingly to agree with Dr. Sri. Until recently, the World Bank, the IMF and donors in general neglected institutional reform (n.4), but the Bank now faults itself for ignoring

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corruption, repression, and a collapsing financial system under former President Soeharto: Sanger, 1999. Dennis de Tray (1999), the World Bank's former Director for Indonesia, now sees Indonesia's "great shortfall" as "too many weak" legal, bureaucratic, and financial institutions, and "one strong but unsustainable institution": ex-President Soeharto and his associates.

Nine Sectors: Why?

The World Bank has shifted focus to a reform of the underlying *institutions*. (n.5) This echoes a growing consensus, in Indonesia and among development theorists generally, that institutional or social capital is more important than the other forms of capital, viewed through a "matrix" of democratic-bureaucratic-legal system development: Trebilcock, 1997, 17-18, 40. We will thus describe a sectoral model of the Indonesian economy (and many others), an economy divided according to the type of institution that characterizes each sector.

The sectors are as follows:

1. Markets – brokers and dealers in goods, services, and finance;
2. foreign-dominated (especially multinational) corporations (MNCs), some with politicians', bureaucrats' or Government participation;
3. domestic companies, some with foreign investors or politicians', bureaucrats' or Government participation;
4. Government-controlled and -regulated enterprises;
5. individual proprietorships of larger than cottage size;
6. cooperatives and other nonprofits, such as yayasans;
7. (near-) subsistence farming, fishing, forestry, and handicrafts/cottage industry;
8. Entities abroad involved in trade and aid, equity, and debt inflows; and
9. labor and consumers, the former selling their labor, the latter consuming goods.

Empirically, these sectors are obviously (Max Weber's) "ideal types", but the different structures imposed on each sector by different bodies of law give them rather sharp outlines and make them "real types" in their economic effects.

Each of these sectors except the last engages in an economic activity which adds value to the goods and services it transforms and sells to other groups. Labor only sells its services, and consumers only buy goods. The terms of exchange between the groups are influenced by market forces and legal regulations. These market forces in turn are influenced by the level and efficiency with which the activity is conducted. Legal and institutional reform is concerned with influencing the terms of exchange to increase production, efficiency, and equity. We hypothesize that some sectors are privileged--government, MNCs, even domestic companies—compared to others – small scale and cottage enterprises, for example. These privileges exacerbate income and power disparities and reduce efficiency and production, by transferring production from more to less efficient enterprises.

Empirically, the different categories of actors may roughly be identified with various Indonesian census categories. Category 5 corresponds to enterprises without legal status and more than two employees, Category 7 to those with less, Category 6 involves the cooperatives and yayasans, and Categories 2-4 are various PT and Persero divided by the mode of control.

The Colonial Government emphasized sector 4 and, to a lesser extent, sector 2, particularly to extract a few primary exports through sector 8. By default, much economic activity remained where the colonialists found it: at a very low level, in sector 7. After Independence, Government's focus remained on Sector 4 and exports (sector 8), plus a few joint ventures in sector 2.

If the story ended there, it would resemble a stereotype of the dualistic economy, with a dualistic legal system to match: Dutch law and (after Independence) Indonesian implementation practices versus *adat*. (n.6) However, as the system opened up, Government developed the capacity to process differentiated demands in undemocratic ways. Government thus began holding 'Coasian auctions': the highest 'bidder' got the legal and economic outcome it preferred. As we know from Coase and others, there are not only markets for goods but markets for laws and institutional arrangements (n. 7). The economically privileged use their wealth to buy the laws they want, and these laws enable them to flourish. Roughly translated, the motto of the Florentine Medici was: "Use the wealth to get the power, and use the power to protect the wealth." This motto would serve elites of a pre-democratic Asia, as a cause and an effect of market and governmental failures alike: *see infra*. These auctions involve a mutuality of Coasian 'bribes': paid to the Government and its officials, certainly, but also paid by the Government—to attract needed capital, technology, etc.

One side-effect of such auctions is the (market) fragmentation of a legal and economic dualism: each of the nine sectors developed its own supply and demand for different laws, depending on the congruence or incongruence of a law with the sector's (actors-in-institutions) aims. The subsistence or *adat* sector had little money and little to barter for favorable legal outcomes, apart from an unorganized and diffuse discontent. Multinational corporations, on the other hand, had much money: something the elite wanted, which could thus be converted into power, Medici-style, or at least into the access denied to the subsistence sector.

Similarly, the World Bank/IMF had very large and very necessary aid and loan packages (i.e., Coasian bribes) to give, conditioned on fulfilling their demands for economic law reforms (and, formerly, implementing neoclassical economics prescriptions). But the logic of Coase's arguments is that the World Bank/IMF will have to return with fresh bribes, to secure the *effective implementation* of these laws. Throughout recent history, there is a yawning gap between legal text and context, a gap filled by Indonesian implementation practices. A new dualism now threatens: *adat* and several other sectors fall by the wayside in the bidding wars, and the main struggle is Dutch law and Indonesian implementation practices versus WB/IMF economic law reforms. (Donor capitalism may succeed crony capitalism.) The outcomes of so many auctions over time are the *legal terms of trade* illustrated in the Matrix (*infra*).

Even if this picture is accurate in outline, how does it relate to contemporary concerns? The point is that the current structure of the Indonesian economy has less to do with economic productivity among institutions over time than with their political productivity: the unstable and grossly unequal power positions that emerged under colonialism, and among winners and losers in the bidding wars, *supra*. More rapid economic growth, and especially development, will result from greater economic *pluralism*: the nine sectors growing more equal in the terms

governing their exchanges of output and performance over time. This pluralism would: diversify economic risks; take advantage of differences in the institutions' abilities to adjust to crises and other changes, to use various technologies, and to raise capital by various means; make it more difficult for a particular elite to dominate Government and the economy; and, above all, increase the number of viable niches in the economy—especially for the poor and powerless. (n.8)

Such institutional remodeling is necessary because neoclassical economics prescriptions are incomplete: Markets (sector 1, *infra*) do not spring up as quickly and automatically, or do as much, as some economists and international donors assume. Rather, markets must be both nourished and regulated, to prevent foreign and domestic corporations, and public enterprises and regulators, from deliberately erecting barriers to others entering the fragile, thin, and fragmented markets that are still too common in Indonesia. (n.9) Such barriers to entry handicap individual proprietorships and coops (sectors 5 and 6) in particular—i.e., the easiest escape routes from subsistence--and the case for a modest but effective competition policy is clear. Along with administrative law reforms, the particular need is to segregate Government enterprising functions from its regulatory functions, reducing but not eliminating both to free resources which can better be used elsewhere: Brietzke, 1999, and *infra*.

Our goal would be a framework of laws which uniformly promotes economic activity (the ease of contracting, reduced risks, etc.) across the sectors—a “level playing field” or a conscious legal neutrality, *except* as legal discriminations enable the poor and powerless *efficiently* to enter more productive economic institutions. Legal reforms would be like a (democratic) handicapping of an economic ‘horserace’: lighten the load on all of the institutional ‘horses’, to make them run better, but lighten the load even more on those which have fallen behind because of particularly heavy burdens carried in the past. (The regulatory burden on all of the horses is currently so heavy that the wonder is their being able to run at all.) Some might see such discrimination as conducive to an economic inefficiency, but it is a “modernist fallacy” (an error in neoclassical economics and a formalist jurisprudence) to assume that ostensibly universal laws will automatically deliver a uniformity and predictability. The ways ostensibly universal (neutral) laws got implemented in Indonesia usually disadvantaged the poor and powerless in the past (n.10), a situation which is likely to continue in the absence of broad reforms.

The Matrix

The Matrix we attach to this paper (Figure 1) can be used empirically to show—subject to the availability and reliability of the statistics—where legal problems are most likely to be found. The Matrix is an Input-Output type matrix segmented not, as is usually the case, by industries identified by broad technology and product group, but by legal status. The volumes of trade between sectors can help us identify where our 9 sectors trade with each other and the values of the exchange. These volumes and values are indicative of where flows are being obstructed or are unequal although, as in international trade, bi-lateral balance is not what we seek. Further, the flows are the result of market and technological factors as well as legal and regulatory ones. There are 81 (9 x 9) fairly specific loci of potential legal problems: the sectoral intersections on the Matrix that are governed by the legal terms of trade between sectors.

Obviously, no such matrix classification can ever be perfectly precise. For example, there is a relationship between labor income and consumption (sector 9) and individual proprietorships (sector 5), since we presume that proprietors pay themselves something for their capital and for their own labor. Indeed, this reality becomes an analytical virtue, since the distinction between these sectors marks a first, modest step in the logic of development (*infra*): working for oneself and for profit--the beginnings of entrepreneurship, through a proprietorship as opposed to working for a subsistence or for another. Identifying why and how this transition occurs helps to unlock the secrets of development.

A value at one of these terms-of-trade intersections which is higher than economic and legal theory lead us to expect is cause for celebration: growth and development are not zero-sum games. But a lower-than-expected value strongly suggests the need for the legal redesign of the terms of transactions within and between institutions and sectors. These 81 intersections are measures of the various sectors' *comparative* wealth and power, reflecting past successes and failures in the auctions, *supra*. But they also measure the sectors' organizational capacity to deploy this wealth and power effectively.

What's past is past, but law can be used to change the future by improving society's organizational (especially contractual) capacity, especially (but not only) in sectors hitherto organized poorly, unorganized, or perhaps unorganizable. Organization by the poor is possible, NGOs forming in a civil society for example, because the Crisis, marketization, and democratization change the Indonesian terms of trade, and even change the rules of the Coasian auctions (e.g., "money politics") that created them. (n.11)

While such uses of the Matrix should never become mechanistic, the success or failure of institutional designs and redesigns can be measured by each sector's *relative* positioning on a tide (hopefully) rising throughout the Matrix over time. Perhaps needless to say, the breadth and depth of reforms implied by the Matrix go far beyond those of a "defensive modernization": that minimum of adaptation which permits an elite to survive more or less intact, perhaps by throwing a few of its most egregious members to the wolves. Nonetheless, even by this standard of defensive modernization – that of the English elite accommodating change in the 19th century and the French elite being unable to do so – the Matrix should prove useful.

Precepts of Economic Reform

Like family law, economic law regulates that which is going to happen anyway, ideally with a developmental bias: relations toward children, intimate relations, and accumulations and satisfactions of various kinds. But these processes frequently fail; governmental deficits and corruption, bankruptcies, and falling below a subsistence are like divorce in their effects on a human potential. The reader will not be surprised when we describe many of these problems as institutional failures, along with the cultural factors discussed *infra*. There is a voluminous (and rather imprecise) economics literature on market and governmental failures, and it suggests our *first precept*: *all institutions fail because they are human*, especially (but not only) if they are poorly designed, are never allowed to develop adequately in the first place, and/or are pushed too hard. (As in analyses of market and governmental failures in economics, "failure" is literally a matter of definition, of what we want the institution to do that it is not doing.)

The reformist implications seem clear: design the best institutions you can (*infra*); recognize that growth, development, and the (other) transitions Indonesia is experiencing put enormous strains on all institutions, so refrain from imposing unnecessary regulatory, strains on them; give institutions a chance to develop by reforming them as part of a coherent and sequenced plan (*infra*), rather than changing them every few years (bankruptcy reforms are instructive here); and then live with the (much-reduced) institutional failures that will inevitably remain. The goal of these designs and their underlying plan is to minimize the *net* of failures throughout the economy.

From this perspective, politics and the state are neither (nearly) all bad nor (nearly) all good. Rather, politics and the state are prone to fail about as often as other institutions, and politics and the state are the problem and the solution (for growth and development) in roughly equal measures. The policy goal is thus to suppress the governmental mischief wherever possible, and to advance the governmental remedy wherever necessary.

It is fortunate that a *private* process of institutional evolution and reform is also going on, a process which can also be strengthened through legal reforms. While marketplace exchanges obviously involve the use of contracts, actors also use many different types of contracts to create the market *surrogates* that displace one or more market functions in sectors 2, 3, 4, and 6, *supra* and *infra*. For example, companies and contractual relations within and between companies emerge when arms-length transactions across markets (perhaps fragile, thin, fragmented, or regulated markets) fail to achieve the private actors' aims. (n.13) Obviously, there must be some regulation of this process: for example, the failure in question may be an actor's inability to achieve an economic and political power frowned upon by the Competition Law. Also, too many surrogates can forestall the development of markets, as under some New Order business practices. But much legal flexibility must be preserved, so that actors can reduce risks and transaction costs by creating their own legal regimes: specific rules to suit specific transactions and created by contractual means.

The economic need for a large measure of autonomy among private economic actors—an autonomy which many economists see as essential for democracy also—raises an interesting jurisprudential issue with significant practical implications for reform. To formulate it as our *second precept*: *Indonesians must decide what is private activity, and thus subject to private law, and what is public activity, and thus subject to public law.* The policy problem is that any large allocation or reallocation of resources acquires a public character because of its impact on development prospects. In other words, it becomes a public good—or public bad, given the scarcity of resources that could be put to a better use under some alternative paradigm.

Economists would be right to say that, especially in a civil law system like Indonesia's, lawyers tie themselves in knots while making the elaborate private/public law distinctions that should be matters of analytical convenience only. Lawyers could then properly reply that economists do exactly the same thing, with their micro/macroeconomic distinction: a false dichotomy which is neatly congruent with the lawyers' private/public law dilemma. The regulation of pollution, for example, is an unwelcome interference from the factory owner's, private law, microeconomics perspective. But the same regulation *may* be a necessary corrective for failures in markets, and

in individual and organizational behavior, from the community's, public law, macroeconomic perspective. Which perspective should be adopted, in which circumstances, since lawyers and economists are unable and unwilling to collapse their cherished dichotomies into a single standard?

As a result of this analytical dualism, there is much confusion, in Indonesia and elsewhere, about the causes and effects of economic reforms. For example, Indonesian bankruptcy law reform is essential to long-term growth, and especially to strengthening markets: efficiency and competition require an ease of exit from markets (for failure, etc.) as well as an ease of entry. As we are forced by our concepts to conceive of it, however, bankruptcy reform is a private law, microeconomic solution—under private creditors' negotiation and control. Contrary to the beliefs of some, it will thus provide little or no relief from the macroeconomic consequences of the Crisis: the massive currency devaluations, etc. that led to business failures on a scale with which no bankruptcy law on earth could cope. On the other hand, weak Indonesian banks are both a private law/micro problem and a public law/macro problem, a major reason why they resist easy solutions in law or in economics: *see infra*.

What is private and what is public is ultimately a political decision for Indonesians: *see* the property rights discussion, note 40 and accompanying text, *infra*. Lawyers and economists would have to adjust their analyses accordingly, but we would speculate that the “public goods” character of development implies a renewed emphasis on macroeconomics and public law. Such an emphasis puts a premium on effective administrative law reforms, *infra*. However, in Indonesia and elsewhere, elites are constantly trying to change what is private and what is public, in self-serving ways which masquerade as “the national interest.” (n.14) How, politically, are Indonesians going to determine which justifications for reform are valid, and which are merely “business as usual”—bids in new Coasian auctions, for example? All democracies struggle with this challenge, of defining the national interest/common good in ways which command a consensus.

The *third precept* is as easy to state as it is difficult to explain: *law tends to over-determine what it under-categorizes*. This jurisprudential insight struck us while considering Indonesian reforms, probably because a traditional civil law/regulatory system like Indonesia's offers an extreme example of tendencies present in all legal systems. (n.15) A civil law system attempts to attain a highly-prized coherence and consistency by exhaustively enumerating institutional types and functions (i.e., by fully stipulating statuses) in advance. Economic actors are expected to fit all of their activities into these statuses. Perhaps for reasons of a legal “science”, and due to a failure of legal changes to keep pace with economic changes, the categories of statuses permitted by Indonesian law are insufficiently rich to facilitate the many niche activities that characterize a complex modern economy. In other words, Indonesian law under-categorizes economic activity and, apparently to regulate activities in detail and to conserve coherence and consistency, Indonesian law permits relatively little “customizing” of institutions and transactions, by private parties using contractual means. (n.16).

Arguably, Indonesian law thus over-determines what it under-categorizes: Indonesian bank loans which can only be secured through outmoded notions of fiduciary transfers offer an instructive example. Fewer types of property can be secured in fewer ways, and at higher risk

and transaction costs, under fiduciary transfers in Indonesia than elsewhere. As a consequence, less money is lent to Indonesian debtors, at higher interest rates. Many, similar arrangements in an Indonesian civil law, with its accompanying regulations, create significant inefficiencies, and inhibit market activity, by imposing an old-fashioned straitjacket on economic activity. Some or much Indonesian economic activity thus becomes “informal” (*infra*): technically illegal, affording opportunities to receive bribes for officials who are willing and able to ignore legal strictures. Legal rigidities thus forestall the integration of “formals” and “informals” in the same economy, as well as hindering the development of more dynamic market processes. Such law most inhibits the potentially most entrepreneurial of Indonesian businesspeople: those who would deliver new goods and services in new ways.

The need for reforms of now-cumbersome, costly, and sometimes purely formalistic regulations and civil law rules seems clear: *see infra*. Otherwise, Douglas North’s “institutional sclerosis” will continue to plague the Indonesian economy. (n.17) Some need for (a more transparent) regulation obviously remains, where clear *social* danger threatens: for example, the Mafia represents clear efficiency advances over other production processes among Sicilian peasants, yet it is regulated nonetheless. But rules and regulations that merely protect incumbent (New Order, etc.) institutions and rent-seeking opportunities serve little purpose other than to retard development. A useful expedient would be to permit many small innovations—formalize niches for the informals in cheap limited-liability partnerships and closely held companies, and allow NGOs to conduct business in their own name—and later regulate only demonstrable social dangers.

Combining the first three creates a *fourth precept: design and redesign institutions to embody clear goals, a good ‘fit’ with other institutions, and the best incentives and organizations that selectively adapt and adopt existing cultures*. Of course, institutions also arise by accident and through an evolution: changes in ways that favor particular groups, perhaps as a result of Coasian auctions, *supra*, or as a result of people “voting with their feet”—entering or avoiding an institution out of a self-interest. Design issues should focus on minimizing institutional failures, creating a “level playing field” subject to a bit of “affirmative action” for previously disadvantaged groups, and avoiding both under-categorization and over-determination—all *supra*. Institutions should be flexible and robust: capable of adaptation and a limited experimentation that are consistent with maintaining a stability of business expectations. (n. 18)

The function of incentives within institutions is to alter preferences among a wide variety of economic actors and in more developmental directions. Incentives must be sensitive to a cultural and motivational complexity, including the idealism that should be evident in, e.g., cooperatives (*infra*). Sanctions should be rigged in favor of complying with institutional purposes, but should not be so extreme as to focus exclusively on the “deviants” and thus frustrate the “idealists.” The effect of many incentives is only marginal, but they frequently serve to overcome the inertia that otherwise prevails in institutions. (n.19)

The main goal of the organizational aspects of institutional design is to promote efficient resource use, and the related reductions in transaction costs and curbing of opportunistic behavior. One of us deals extensively with these matters elsewhere—Brietzke, 1999—and there is no need to repeat these analyses here. At the least, organizational designs should make it easy

to identify and sanction those who are responsible for delay, carelessness, and corruption. While there should be a clear chain of command and control in the larger economic institutions, Rachel Haverfield recommends that “the hierarchical, clientelistic nature of interpersonal relations in Indonesia” be changed. (n.20) The structures and interrelations of administrative agencies should also be modernized, to reflect Government’s new roles: Brietzke, 1999.

The interrelations of institutional incentives and organization, on the one hand, and institutional and general cultures in Indonesia, on the other hand, are perhaps the most complex and sensitive matters treated in this article. Clearly, they affect each other in many ways, some of which are unexpected—especially by foreigners like us. We hazard a few generalizations nonetheless. The issue used to be treated simply, as a need to respond to “Asian values”, but the public is increasingly aware of how these values are manipulated in self-serving ways by their pre-democratic advocates. (n.21) Some cultural changes are desirable and even essential to an institutional and a general development in Indonesia, but there are also many ways of designing institutions, and re-designing those responding more to archaic forms of Dutch culture, like fiduciary transfers (*supra*), to respond to (democratically-expressed) Indonesian needs and desires.

The often-agonizing ferment Indonesians are experiencing—economic recession, social unrest, marketization, democratization, etc.—can have two contradictory effects. It makes people seek renewal or a sense of direction in some traditional way of doing things, while also exposing shortcomings in these ways and encouraging certain kinds of cultural experimentation. Policymakers may seek to bend this melange in developmental directions, and the development of markets is also a powerful counterweight in this direction.

Perhaps the best place to start is the bureaucracy. Bureaucrats resist change, especially in response to bribe-opportunities and signals from imperfect markets, and they are also potent change-agents once their culture is transformed--through reformed incentives, organizations, and even ideologies. For example, we would like a bureaucrat to respond to a bribe-offer with: “I am not a criminal, but a civil servant.” This transition from serving the State, or serving patrons and clients who pay for services in various (Coasian) ways, to serving the public that pays only a salary—the transition from bureaucrat to civil servant, in other words—is imperfect and time-consuming everywhere. Hangovers from “business as usual” in public and private activity will delay, disrupt, and even defeat some reforms. As we recollect Mao saying for a different purpose, it is a long march through the institutions. But in the long run, democratization and an improved access to an improved education will promote working smart as well as working hard, and the sophisticated nationalism of wanting to contribute to Indonesian development. (n.22)

This section closes with a *fifth precept: the need to devote attention and resources to the effective implementation of reforms*. Otherwise a mismatch arises, between ambitious changes in substantive laws and an underdeveloped institutional capacity to apply them—especially in courts and administrative bureaus. As Portia says: “If to do were as easy as to know what were good to do, chapels had been churches and poor men’s cottages princes’ palaces.” (Shakespeare, Merchant of Venice, I, ii, 13-15.) Predictable enforcement is required for a stable institutional environment. Predictability requires marked reductions in corruption, effective incentives (adequate pay, for example), appropriate organizations, and cultures among the implementers,

and adequate training and investigative and managerial resources: Lindsey, 1999a, 8; Ratliff & Buscaglia, 1997, 314.

Administrative reforms are discussed *supra* and *infra*, so this is a good place to sketch judicial reforms. They must be so comprehensive as to become part of a judicial culture: to increase legal certainty and thus a stability of business expectations, and to enforce the democratic notion that civil dispute resolution is a service to citizens—rather than a control over them and an opportunity for bribes. Genuine judicial independence is the essence of reform, but independence becomes dangerous in the absence of transparency and accountability. An independent judicial commission should thus oversee these reforms, and perhaps even require sitting judges to prove their competence by passing exams. A strict ethics code, and publication of commission disciplinary decisions under it, would educate judges and citizens alike. (World Bank, 1998, 2.)

Similarly, all but the very lowest court decisions should be published—scanning decisions onto the Internet is a cost-effective means—to build up an Indonesian *jurisprudence* and to expose the consequences of bribes or judicial incompetence to scrutiny by academics and practitioners. Improving poor people’s access to the courts is particularly important, by reducing or eliminating the fees they pay, simplifying procedures, reducing backlogs and adjournments, creating an efficient legal aid service, and increasing reliance on ADR and small claims courts. Enforcement of court judgments should be improved by training and supervising the police (to decrease bribe-opportunities, for example), and by improving their record keeping. (n.23) Judicial review of the constitutionality of Indonesian laws and Governmental actions could even be considered. (n.24) In sum, the pursuit of an economic efficiency and of justice in a democracy would reinforce each other through judicial reforms.

Sketches for a Reform Plan, Sector-by-sector

It might seem to be stretching the point, to treat *markets* as institutions. With obvious exceptions like *pasar* and the Jakarta Stock Exchange, markets have no physical embodiment and exist mainly as ideas. Yet they fit our definition of institutions, as involving deliberate and repetitive *human* activity. This classification rejects the neoclassical economists’ tendency to treat markets as forces of nature, to be interfered with only at a nation’s peril. (This naturalistic fallacy is the economists’ equivalent of the lawyers’ description of companies as juristic “persons.”)

In transition economies, markets do not develop as quickly and as fully as international donors and hopeful new entrants would like. Trebilcock, 1997, 47, notes that the “personalized exchange relationships that characterize informal activity [*infra*] depend heavily on repeat dealings, reputational effects, ethnic networks, informal sanctions, and corruption....” Transitions to markets thus have “a Mafia-like quality...in their early stages”, and markets must attract a political constituency in order to develop adequately. Many of these problems can be attributed to the behavior of elite institutions that fear loss of their relative wealth and power: the *apparatchiks* and *nomenklatura* who are seen to be slowing down marketization in Eastern Europe have their counterparts among bureaucrats and some crony capitalists in Indonesia.

As mentioned *supra*, a reduction in governments' regulatory barriers to competition, and a restrained enforcement of the new Competition Law against private actors on a leveled playing field, will strengthen and integrate markets. Such markets will ameliorate the effects of an economic dualism, stabilize expectations, increase the flow of information to a wider range of economic actors, reduce other transaction (especially monitoring) costs, and even promote an unforced national unity—decrease strains by reducing the number of things which must be decided politically. For example, the main reason for a breach of contract is the prospect of a better 'deal' elsewhere, a contingency which is much less likely when contracts are formed under competitive conditions that foster similar terms and a transparency of transactions.

Markets won't eliminate all need for regulation, of course: asking how a few bureaucrats know better than markets is like asking how a few doctors know better than nature what is best for a patient. The question should be: Can the bureaucrats'/doctors' actions sufficiently improve on market/(supposedly) natural outcomes to justify the admittedly higher transaction costs that arise from intervention? Consider tendencies frequently neglected by economists, which nevertheless threaten substantial harm to the poor: oligopsony (only a few buyers, of cloves for example) or monopsony: a single buyer, which formerly existed for coffee in East Timor and for cashews in Kabupaten Sikka, Flores. Near-subsistence farmers have no choice but to sell their produce for as low a price as the oligopsonist or monopsonist determines. Absent the enforcement of competition policy that opens such markets to other buyers, farmers can only burn or sell. (n.25)

Many small changes in *property and contracts law* would increase the efficiency of, and access to, markets over time. These "private" laws are designed to give free rein to individual projects, which are usually (but not always) in the national interest. These projects should thus be regulated only when they create a clear social injury. "Private" property and "freedom" of contract are the 'constitution' of the economy.

Prof. Mariam Darus's "academic" draft reflects a good beginning in contracts, one which establishes Indonesian links with the transactional flexibility of the U.N. Convention on the International Sale of Goods and other "international standard" regimes. Property law regimes should be treated similarly, to maximize the efficiency of resource (i.e., property) use at the lowest possible transaction cost. Indonesian property law comes nowhere near the exhaustive allocation of rights in all valuable resources (a sandalwood tree growing in "your" yard that the State sees as part of National Forest Land, for example) that many economists (following Coase, 1960) see as the precondition to allocative efficiency. (n.26)

The virtues and vices of *multinational corporations* (MNCs) in developing countries receive a balanced treatment elsewhere—e.g., August, 1997, 147-211--and we can thus be brief. On the one hand, MNC's global risk diversification, and economies of scale and scope, can translate into an economic growth within Indonesia. On the other hand, their long time horizons and easier access to capital ("deep pockets") can be used to erect barriers to others entering the many fragile and thin markets of Indonesia. We have not seen detailed analyses for Indonesia, but the governmental tendency elsewhere is to pursue foreign capital and technology through an under-regulation of MNCs *de facto*, *relative* to an over-regulation of domestic companies: *see infra*. This absence of a level playing field is exacerbated by the MNC's ability to conceal the information needed for a sensible regulation, in a bewildering maze of corporate structures and

accounting practices. MNCs thus tend to face a petty harassment rather than regulation: mostly, solicitations for the bribes that are treated as costs of doing business and then passed on to domestic consumers.

Mandelely, 1999 and UNCTAD, 1997, argue that trade liberalization and the rapid growth in foreign direct investment (*infra*) will greatly increase the power of MNCs in the future, especially when they deal with unorganized domestic producers and consumers. It will be interesting to see how the new Competition Law is applied to MNCs, but we counsel a cautious approach. Other countries' attempts to "tame" their MNCs have staunched the inflow of foreign resources, with few compensating benefits since the MNCs simply do business elsewhere.

Some *domestic companies* amount to the "conglomerates" that seek to emulate the MNC's structures (through holding companies, tiers of subsidiaries, etc.) and practices at the domestic level, especially the erection of barriers to entry that will attract the Competition Commission's attentions. (n.27) Companies law is especially important from an economics perspective because it combines property law (the *allocation* of who gets to use resources within the enterprise) and contracts law (*delegations* of these rights to use resources) with additional regulations, to complete the economists' trilogy in an *aggregation* of resources (labor, capital, etc.) for a larger-scale and frequently-efficient production.

We have yet to do a detailed analysis of Indonesia's Company Law of 1995: *see* Pakpahan, 1995. But it does not provide enough niches for economic activities: it under-categorizes and over-determines these activities, especially for the poor and powerless, *supra*; *see* Roy, 1998, 2564. Like companies laws elsewhere, it seems to be cumbersome, unrealistic (full of legal fictions, for example), and otherwise inefficient. Models from other countries suggest a likely "corporate governance" reform menu: increased duties of disclosure, to provide the information that promotes transparency, accountability, and sensible regulation; "international standard" auditing requirements as essential to this disclosure; expanded fiduciary duties owed by managers, to creditors, shareholders, employees, and perhaps consumers and the citizens injured by pollution; the *locus standii* to enforce these duties in court; a revised *ultra vires* doctrine that enables companies to engage in a wider variety of activities; and a shrinking of that which shields a company against responsibility for, e.g., inefficiency, and which goes by various names—including the "business judgment rule." Brietzke, 1994, 45-49; Gie, 1999. These reforms would lead to a more dynamic Stock Market, and thus more equity finance for Indonesian companies (*infra*), but separate reforms of securities laws should also be considered.

In many circumstances, the law can simply hold the company responsible, leaving it to disaggregate the burden among the actors involved. This relieves regulators and courts of the costly burden of determining which biological person is "actually" responsible. Beyond legal stipulations like that of a limited liability, it would also leave company actors free to contract among themselves for the monitoring, etc. that best reduces violations in particular situations. (n.28) All of this is important because "bad governance in the private sector is just as nightmarish" as it is in Indonesia's public sector: Hasilbuan, 1999.

Having said all of that, registering a company shouldn't be more complex than registering a vehicle—which is complex enough in Indonesia. Official discretion should be limited to simple

details, such as whether the company name is already in use or whether enough officers have been named. Trebilcock, 1997, 40; compare note 29, *infra*. The reforms just suggested admittedly create regulatory burdens, but they can safely replace almost all of a complex, onerous, and shifting patchwork of Indonesian regulations—even many of those applicable to specific industries. The net effect would be significantly to lighten the burden carried by companies in Indonesia’s economic ‘horserace’, *supra*. The burdensome costs of existing Indonesian regulations are effectively demonstrated by REDECON, 1998. (n.29)

Intermediaries are the MNCs, domestic companies, etc. that are particularly underdeveloped in many countries like Indonesia: banks, less formal and small-scale lenders like credit unions, insurance companies, equity brokers operating through the Stock and Commodities Exchanges, other financial intermediaries, and cooperatives and the creative use of contracts that lengthens time horizons by facilitating enterprise planning—a use of contracts currently truncated in Indonesia. (For example, the precise legal status of currency futures, as all or part of a contract, is unclear to us.) These intermediaries perform vital roles in growth and development, by diversifying and spreading risks, by communicating much information cheaply—and also generating much speculative “noise” in the process, by helping to hold other economic institutions accountable, and by strengthening markets and access to them. (n.30) Letters of credit are vital to small merchants entering into international trade, for example.

This sub-sector is so damaged—archaic transactional formats and poor risk management were subjected to the *force majeure* of the Crisis—that it obviously deserves a separate, reformist treatment beyond the scope of this paper, one deeply informed by new learning in the economics of risk management and by parallel reforms in administrative law. In the meantime, Government and international donors must undertake some risk-spreading functions themselves, IBRA for example, but only in narrowest ways needed to re-start the economy. Otherwise, new and “morally hazardous” subsidies for elite activities will be created. (n.31)

We include *State-owned enterprises and heavily-regulated enterprises* in one sector (somewhat misleadingly called “sovereign” in legal terms) for two reasons: to show the magnitude and scope of State-sector economic activity and its many interactions with all of the other sectors on the Matrix, and to stress the need to segregate State enterprises from regulating activities. Otherwise, one of the contestants also gets to be the handicapper of a correspondingly less pluralistic Indonesian ‘horserace’, *supra*. In other words and to mix our metaphors, the economic playing field can never be leveled if state-owned enterprises remain prime beneficiaries of the regulatory regime. Reform of this sector is a particularly daunting task, in economics and in law (Brietzke, 1999), and should not even be attempted without a firm and abiding commitment by the new Government.

As Hernando De Soto (1989) puts it, perhaps too starkly--“It is not rulers who produce wealth: they sit behind desks, give speeches, draft resolutions and supreme decrees, process documents, inspect, monitor, and levy, but they never produce. It is the population who produce. That is why good laws are so important.” Administration must cease being an extension of the presidential household, Trebilcock, 1997, 27. Legal over-determination and under-categorization (*supra*) reach a peak in Indonesian administrative laws, calling forth the needs for

re-determined and richer incentive-categories for administrative conduct preferred but not required and conduct disfavored but not prohibited.

Regulations are powerful because they usually enable intervention without a significant expenditure of state funds. If these interventions are viewed from the perspective of private economic actors, and their (developmentally) legitimate interests are balanced against legitimate State interests, few Indonesian regulations pass muster—at least in their present, incoherent and authoritarian, form. While regulations may forestall the development of markets or make them less efficient, regulations can also increase social welfare in uncompetitive markets. In sum, boldness in deregulation, and a thoughtful caution in a simultaneous and planned re-regulation, would move the Indonesian bureaucracy in more developmental directions—despite its limited capacity and the opposition of vested interests. While decentralization and delegation of authority make a great deal of sense in theory, and may now be essential politically, such policies can impair bureaucratic quality and integrity because of a scarcity of managerial capacity, and they may provoke fiscal and technical collapse. (n.32)

The economics literature is full of assertions that regulations are like taxes and subsidies, which are often the subject of bargaining and are not always enforced (during Coasian auctions, for example). Adams, 1989, 57; *see supra*. Within the State sector (and other sectors of course) everybody seeks to be a Coasian “free rider”: take the benefits (Government services) without paying for them (through various taxes). This is as true of the crony capitalist or the *yayasan* as it is of people in the informal (e.g., subsistence) sector. As Coase recommends (*see note 7, supra*), the legal and economic solution is to formalize all transactions on the same footing—e.g., transform narrower taxes (bribes) into broader taxes, and reduce transaction costs: chiefly the information costs of Government finding out about taxable events and the enforcement costs of tax collection.

The corruption that flourishes in the absence of an administrative transparency and accountability is a major counterweight to reform. The steps recently taken to curb corruption are thus encouraging, especially as integrity is an inescapable precondition to bureaucratic efficiency and legitimacy. More effective, informal enforcement requires anti-corruption to become part of official and citizen cultures, and this takes time. But Indonesians should also deal with the fact that bribery is sometimes “efficient”: a cost-effective means of defeating regulations so inefficient as to merit a hasty demise. (n.33)

The conventional economists’ solution for state-owned enterprises (SOEs) is to privatize them. Privatization sometimes moves at a speed that outpaces a state’s organizational capacity and the resources of probable buyers. This has not proved a problem in Indonesia, where the assets of SOEs (some of which belong to the military) may have been so undervalued during the Crisis that a leisurely pace was called for. Otherwise a pseudo-privatization could have occurred: crony capitalists or foreigners pay next to nothing for State assets, and especially for the market power they represent. Amsden, et al., 1994, 7, 127. Morally, these assets belong to the public, in the sense that the public was forced to postpone consumption so that the State could acquire these enterprises.

For whatever reason, the World Bank/IMF substantially reduced their pressures toward privatization, and Indonesia now seems to be drifting in the other, reorganization direction and toward a "mixed" economy for the foreseeable future. (n.34) While many economists draw unflattering distinctions, between SOEs and correspondingly large private enterprises, legal insights can be assembled to show that their problems are quite similar and similarly bureaucratic: incentives, organization (including failures of information to flow efficiently up and down rather strict organizational hierarchies), culture, transparency, accountability, and a scarcity of human capital—managerial, legal, economic, accounting, statistical, (other) technical, etc. Public and private enterprises recruit similar resources (skilled labor, for example) in similar markets, and many SOEs are as independent of government control as are their (regulated) private counterparts.

In other words, the playing field may be more level than it appears to be initially, among public enterprises and the larger private ones. But this does not mean that the performance of SOEs cannot be improved. Trebilcock, 1997, 26, 33 recommends medium- or long-term, performance-based contracts, between government and a SOE and/or between an SOE and a private management enterprise. Creative contracts could approximate the best of both worlds (public and private, *see supra*), especially for large "infrastructure" projects (build-operate-transfer contracts, BOTs, for example), by increasing efficiency and decreasing a political micromanagement. Also problems of SOE market (monopoly) power could be dealt with by divesting part of the SOE and/or reducing legal barriers to entry by private competitors.

Individual proprietorships straddle the line between formal and informal economic activity, and it is hard to evaluate them in law or in economics. Their effects are often diffuse and only estimated in official statistics. But studies elsewhere show that they lift their self-employed proprietors' incomes, without loss to others. Proprietors' returns can be astronomical, since they often absorb the unemployed or underemployed labor that has opportunity costs of (close to) zero: *See* Timberg, 199 and *infra* for additional and comparative analyses. The owner-operator has low transaction costs and the highest incentive—higher than that of a manager of a publicly-listed company, for example—for monitoring performance and adjusting to changes in consumer demand: Amsden, et al, 1994, 132; *see infra*.

Beyond a few obvious exceptions like drug dealers, Trebilcock, 1997, 40, this argues that "at a minimum, the state should remove all self-imposed impediments to small scale indigenous entrepreneurship." A comprehensive deregulation of this sector is probably the quickest Crisis 'fix', the easiest enhancement of economic pluralism, and a partial response to the concerns of Indonesian populists. *See* Zain, 1999. Many informal proprietorships have done better during the Crisis than their larger, formal counterparts, precisely because they are more flexible and less dependent on finance from banks and the Stock Exchange. (n.35) But, as things stand now, the time, costs, and bribes needed to formalize something like a proprietorship are similar to those for a much larger company: REDECON, 1998. This could all be replaced by a simple notice-filing system to formalize proprietorships (rather than corruption-prone licensing systems), which would automatically generate the relevant tax registration numbers, etc.

Proprietorships rely primarily on financing by self, family, and friends. But they would clearly benefit from better and cheaper regulation of the less formal end of the intermediaries sub-sector

that is more likely to cater to their needs: *supra*; credit unions and money changers, for example. However, the State's allocation of particular funds to proprietorships, as demanded by Indonesian populists, would reduce efficiency and forestall the development of Indonesian financial markets that are already badly retarded: Sianipar, 1999. International donors provide some advice and support in this area and they could do more, especially in reducing the transaction costs and risks of lending to SMEs—so that more “venture capital” would flow to proprietors. Roy's (1998, 2565) analysis of India's multi-sector textile industry could be read broadly, across several Indonesian sectors: “Removing the backwardness, inefficiency, underinvestment, and institutional failure accumulated over many years of excessive regulation and irresponsible governance is not the job of a textile policy.” In other words, particular promotional schemes are much less efficient and effective than are systematic, multi-sector reforms.

Cooperatives have rather a sorry history in Indonesia, and many other countries as well, a history which points up directions for reform in institutions which are likely to remain serious economic actors. There was no legal transparency or accountability to their members, and coops thus frequently served as vehicles for the power of elites. Also, coops often extracted the slender and inconsistent surplus from the subsistence sector—especially when given the localized monopsonies over, e.g., the cash crops that could otherwise prompt an emergence from subsistence. *See supra*.

Properly configured, coops represent the “moral” (even non-capitalist) economy that appeals to Indonesian idealists, especially if they are of a populist persuasion. Coops admittedly adjust to change slowly—a stabilizing factor, when added to institutions that adjust quickly and perhaps imperfectly, and coops seldom have the means to tempt capital and technology away from more “modern” institutions. But coops can produce the kinds of goods and services needed by lower-income consumers, can efficiently add to export earnings from primary products, can economize on the use of bits of capital which cannot be effectively mobilized in other ways, and can act as counterweights to the growing inequality characteristic of the early stages of development.

Legal reforms should focus on empowering coops to obtain and act upon marketplace information, and to act as institutions accountable to and for their members. Some politicians have recently promoted programs which reserve additional funds and functions for coops. These would reduce coop and marketplace efficiencies, without insuring that the poor and powerless can incorporate these subsidies for their own, long-term benefit. (n.36) Juan Peron and Huey Long offer historical examples of the elite politics and patronage that can result from such policies.

Similar stories could be told about yayasans, of clearly legitimate, charitable activities sometimes corrupted for inefficient, elite purposes. Similar legal reforms seem indicated, plus a revision of the tax laws to curb abuses (e.g., “money laundering”) and increase disclosures so that only charitable activities and a *reasonable* overhead are exempted from taxation. Yayasans and coops could then become valued parts of the “civil society” that is building in Indonesia (*infra*), a “nonprofit” sector which could alter the legal terms of trade (*supra*) by counterbalancing the strength of MNCs and domestic companies. Such a pluralistic counterbalance will be effective only if an independence of these nonprofits is maintained under law.

One advantage of coops, even as presently constituted, is that they provide a legally sanctioned institutional framework which the *subsistence* sector lacks. While there are a number of (extremely diverse) *adat* institutions that could be adopted or adapted for developmental purposes, these are all but ignored by State law, by banks, and perhaps under a politics of mutual incomprehension and distrust. (Violence periodically erupts under this politics, a trend likely to continue in the absence of thorough reforms.) While the Matrix accurately reflects this sector's unfavorable legal terms of trade (*supra*), it likely understates the sector's contributions to the economy.

Land is the main resource (as well as safety net) for most in the rural areas, and they resent its being deemed, e.g., "national forest land", when their families have lived on it for generations. Reforms in this area are too important, complex, and sensitive to be more than sketched in this paper. But reforms arguably involve the creative adoption (and a bit of adaptation) of communal tenures and institutions, formalizing and thus integrating the informals. This could proceed at the same time as the time- and resource-consuming individualization that the World Bank and some others see as essential to all of Indonesian rural life. (n.37) Indeed, this individualization of tenures and institutions could lead to an unforced transition to (attractively-formed) proprietorships, while many communal institutions would likely evolve into (attractively-reformed) coops over time.

Once subsistence is reliably secured, as happens in most areas in most years, cash cropping, forest and fishery products, and handicrafts (much injured by cheap, plastic substitutes) would be the vehicles for an institutional/sectoral evolution away from subsistence. This process arguably requires three types of assistance from Government and international donors. First, there is much "social overhead capital" that the subsistence sector cannot afford: roads, extension advice and the few inputs that are not otherwise available, etc. Second, Government and the Competition Commission must insure market access to the sector, by curbing the monopsonistic and oligopsonistic middlemen (including special privileges for coops) that frustrate capital accumulation by (near-) subsistence producers. Third, the beggar/musicians at Jakarta stoplights, and even the cleaners of Government offices, are the tip of an urban subsistence iceberg. A "job corps"—unemployed people hired to clean up urban areas and improve infrastructures, as well as proprietorships and coops, would be useful means to reduce an urban poverty.

The *international* sector of trade and aid, debt, and equity inflows has been discussed at several junctures. It is treated briefly here because much of it is beyond Indonesian reformers' control. Little progress has been made on international-level information exchanges about, and perhaps a minimal regulation of, competition, MNCs, or the equity and debt transfers that can jump in and out of a country at the click of a computer mouse. Mandel & Foust, 1998; World Bank, 1998a, 6. An Indonesian development cut off from this international sector seems a virtual impossibility, but the best Indonesians can do is to implement some or many reforms like those discussed in this article. This would convince donors that Indonesia's is a more transparent transition worth supporting, and other foreigners that a business climate with abundant natural resources, low wages, and a huge population on the verge of a mass consumption, is now even more congenial. (n.38)

Trade promotion and especially finance are areas where Government and, e.g., the World Bank's International Finance Corporation can take a more active role. The institutions able to make additional contributions to export earnings are mostly labor-intensive and decentralized, and they have special financial needs. A new export finance agency was announced in November, but it is yet to operate—apparently because the relevant bank is tied up in the broader reorganization and recapitalization process. Roy, 1998, 2565; *The Economist*, 1999, 38. Bilateral negotiations with foreign banks are proceeding slowly. Bank Indonesia funds are available in theory, for banks which guarantee letters of credit and rediscount facilities, but they have been suspended—perhaps temporarily. *Id.*, 38-39; “Bank Indonesia...”, 1999; “Rationality...”, 1999, 22. Something should be done and quickly, through viable and transparent export finance institutions.

The law of the final, *consumption and labor* (or household) sector has received little legal attention until recently. A restrained enforcement of the new Consumer Protection and Competition Laws should, over time, reduce prices and increase the quality of goods and services. (Such promotions of “consumer welfare” are important ways of gaining votes in most democracies.) But labor law has not received similar attention: *see* Fehring, 1999. Past policies of labor repression, presumably designed to keep wages low and forestall a political opposition, will be unacceptable in a democracy, and union militancy and costly strikes have been common in recent months, Zain, 1999. The legal solution would be (once again) to formalize these informals. This would stabilize business expectations and give unions a legally-sanctioned responsibility—a necessary precondition to their behaving responsibly in the future, as valued members of an emerging civil society (*infra*).

Markets can (soon) be trusted to keep wages roughly in line with increases in labor productivity. Wages are bound to rise anyway, as reforms and an end to the Crisis increase the opportunity costs of using labor—under conditions of a reduced unemployment and underemployment. This will have salutary effects on consumption, particularly of the produce of proprietorships and coops—at least initially. MNCs have few alternatives for moving their production overseas because wages are increasing worldwide. Finally, environmental problems reflect an involuntary consumption by all of us, one which increases personal and social costs in many ways. Significant legal reforms are unlikely, at least until the end of the Crisis, but implementation of existing laws is vital to the welfare of workers and of households generally.

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A full elaboration of the Matrix, *supra*, would create greater refinements and specificity in the menu just outlined, especially on questions concerning the sequence of reforms. Everything cannot be done at once, yet each piece of reform should fit with all of the others. We thus outlined a rough plan for reforms that Indonesians might want to consider, so as to lengthen the time horizons of economic actors by stabilizing their expectations.

These reforms attempt to increase an economic pluralism, through a conscious legal neutrality that reduces under-categorization, over-determination, and barriers to market entry and exit. The regulatory, etc. burden should be reduced on all sectors, but especially on those sectors carrying the heaviest burden in the past, chiefly as a result of implementation practices. Such policies can be characterized as “formalizing the informals,” in the proprietorship, subsistence, and labor

sectors. This handicapping admittedly involves some re-regulation, as well as much deregulation, by a fairly activist Government.

Many pieces of the reform could be implemented as political circumstances permit (*infra*), without creating chaos or even significant inefficiencies—so long as consistency with an overall plan is kept in mind. But judicial and (ideally) administrative reforms are best carried out quickly and in their entirety. Even a partly reformed judiciary or bureaucracy would continue to create inefficiencies that would frustrate the implementation of other reforms. Also, the effects Indonesian reformers can have on MNCs and foreign aid, debt, and equity inflows are significant but indirect: dependent on the overall success of other reforms. Government thus plays a vital but limited role in what we call the *logic of development*.

Economic activities will occur in many institutional ways (in markets and their surrogates) and for many purposes. Some of these will fail (*supra*), but there is little the State can or should do about this, other than provide facilitative laws and a viable bankruptcy regime. (In a democracy, citizens are *autonomous*; they have a right to fail as well as to succeed, free of elite and paternalistic State interference.) Depending in part on macroeconomic conditions, some or many economic activities will prosper.

Many of the economic actors who prosper will begin a logical transition through institutions, and a customizing of their institutions and transactions through contract law, in search of increased profits: reduced risks and transaction costs, and an expansion of activities through additional sources of debt and equity financing. Individualized economic activity begins with an entrepreneurship, segregated from subsistence or working for another by the quest for profit. It initially takes the institutional form we call proprietorship. Ideally, there would be new and inexpensive stopping points—limited liability partnerships and closely-held companies, for example—between these proprietorships and expensive, publicly-listed companies.

Group or communal economic activities start in *adat* institutions or in coops. These could later customize their institutions and/or evolve into more sophisticated NGO “nonprofit” institutions, able to do business in their own name and apply the proceeds to projects which preserve the group’s “moral economy” status. Pluralism as well as democracy requires that each be an institution acting for itself, with ease of entry, exit, and evolution across institutional boundaries, so that each economic actor finds the institution most suitable for profit or any other object of its quest. Government would have to trace these transitions, but only to collect on the taxable transactions and to prevent clear social harm.

Some Political Conclusions

Ideally, movement toward an Indonesian democracy will be used to build a consensus around further developmental reforms, and especially around the implementation of reforms in the face of opposition from vested interests. The new Government has an historic opportunity to legitimate its policies, in ways denied its less democratic predecessors, but an explosion of pent-up party and citizen demands will likely make it difficult to adhere to a consistent reform plan. (n.39) Without pretending to an expertise in the new Indonesian politics, we close with questions and observations on the politics of economic reform.

Article 2 of the new Competition Law requires business activities to be “based on economic democracy....” What does this mean, when a political democracy is still evolving, and when the larger private and public economic institutions will likely remain rigidly hierarchical: subordinates are fired or not promoted if they refuse to follow their superior’s orders? (The “Motherhood” clause (b.) to this Law defines economic democracy as “equal opportunity for every citizen to participate...in a fair, effective and efficient business environment....”) Further, how does this goal relate to, and get balanced against, the other goals listed in Articles 2-3, the *jurisprudence* of the Law: efficiency, “equilibrium” between business and public interests, equality of opportunity among businesses of various scales, and “the people’s [consumers and laborers?] welfare?” We submit that the reforms we sketched earlier are a useful synthesis of these partly contradictory, worthy goals.

Perhaps the most distinctive feature of democracy is the demands citizens make, for the recognition of rights known to be irrelevant in pre-democratic states. Free speech, press, association, and participation are rights near and dear, but economists expect citizens to also demand the *property rights* that are stipulated imperfectly in ordinary Indonesian laws (*see* notes 26, 37, and accompanying text, *supra*) and not stipulated at all in the Constitution of 1945 or in international human rights covenants. Will this be a broadly Indonesian concern, since property rights provoke intense interest and disputes in other democracies?

In other democracies, many citizens demand very broad property rights in theory—“That’s *my* sandalwood tree (or ancestral forest)” —only to reject outright the unequal distribution of wealth and power that necessary flows from enforcing these strong rights in practice. (The fondness of the wealthy for strong property rights is easy to understand, but the poor support them as well—to keep and develop what little they have, in expectations of getting more through hard work.) This intransitive preference, as economists might describe it, endangers political stability since, among other things, government cannot afford or effectively implement the “welfare” programs needed to protect those with little or no property.

The only apparent escape from this (Kenneth Arrow’s) dilemma is democratically to implement community standards which *limit* property rights—to pollute, for example. These limited but more democratic rights in turn serve to limit governmental power—“government can’t do that to my property”—and to legitimate the power that they limit. (n.40) Such a process involves a delicate balance, of the economists’ allocative efficiency and citizen desires for autonomy and a measure of distributive justice. A government which takes too many property rights away can become undemocratic and will reduce incentives to invest and produce. (This is another way of saying that too many of the wrong kinds of regulations and elite interventions retarded marketization and development in the Indonesian past.) But a government with too few property rights reserved cannot regulate sensibly or engage in the limited redistributions characteristic of a social democracy.

Judicial and other reforms in Russia and some Latin American countries show that external aid and demands by, e.g., the IMF and the World Bank are no substitute for a domestic will to reform. This domestic will was shaky in Indonesia’s recent past, and we thus analyzed it as an outcome of a Coasian ‘game’: *see* notes 7-8 and accompanying text, *supra*. The recent election

seemingly offers a mandate for fundamental reforms, but a stable reformist coalition strong enough to overcome the opposition of vested interests has yet to be created.

Vote-maximizing democracies tend to please the majority by taking privileges away from the minority, Backhaus, 1997, 233-38. Such a process may result in an equalization of the legal terms of trade among Indonesian sectors (an increased pluralism), but public inattention and lack of full understanding of the relevant issues make such reforms problematic. In any event, reform resources are limited, and implementation by courts and bureaucracies will be slow at best. Reformers can take advantage of anti-statist attitudes which are natural after years of authoritarian rule (Amsden, et al., 1994, 19, 116), but some Indonesians seem content to wait for the State to do things which they could and should do for themselves. "Technical" reforms are often easier to implement, although these can become politicized in unpredictable ways: consider Indonesian bankruptcy reforms. Deregulation has strong opponents as well as strong supporters. (n.41)

The optimal degree of reform and re-regulation is thus a political judgment, based primarily (but we hope not exclusively) on political considerations. For example, are constitutional amendments necessary or desirable, concerning a separation of powers or stronger guarantees of democracy and human rights? See Djiwandono, 1999; Hasani, 1999. What is clear is that citizens will increasingly demand that politicians effectively ameliorate the Crisis and promote development. The nature and effect of these demands depends on how the media and civil society organizations come to shape the public debate.

Papers delivered at a Tokyo Conference blamed the Asian crisis in part on the absence of independent civil society organizations, involved in development processes as a check-and-balance running from society to government and the economy: Salim, 1999. The hope is that strong and independent civil society organizations will obtain information about, support, and closely monitor the pockets of reform that always exist within a system subject to many political distractions. Carothers, 1998, 105; Sen, 1999b; Ulen, 1997, 102. For example, pornography is a legitimate social concern, but opponents of reform should not be allowed to use it to curb a free *political* discussion in the media; that would be the pornography of power.

An NGO-led "democracy from below" would help make the economy work for ordinary people, by mobilizing the previously unorganized or unorganizable through institutions which are accountable to them, rather than to some elite politician. Even in a highly-regulated place like Hong Kong, consumer organizations play important roles in promoting competition and trade liberalization: World Bank, 1998a, 9.

A final and distinctively legal value that deserves a strong political constituency is "the rule of law" that is tied to an independent and competent judiciary and DPR: as the second of six demands on a huge banner, hung on Jakarta's Welcoming Statue by the Student Forum in June 1999, put it--"Respect the Supremacy of Law" (Tegakkan Supremasi Hukum). This rule of law would displace socio-economic hierarchies and a Dutch model of Guided Democracy, in the mediation of rights and reforms. (n.42) Fitzpatrick (1999, 75) says that Indonesians love syncretic compromises. We hope that the compromises over economic reforms can be structured into a consistent plan, to give Indonesians the laws they have long deserved.

Footnotes

1. In Indonesia, there has been more economic growth than development: the growing respect for human dignity that is inseparable from both democratization and an amelioration of poverty--through a wider access to more productive economic institutions. Buchari, 1999; Madeley, 1999 (quoting Klemens van de Sand); Sen, 1999a; "Indonesia Ranked...", 1999 (Indonesia ranks 105th of 174 countries in the UNDP's Human Development Index); "Ranks...", 1999 (BPS estimates that the number of poor people in Indonesia increased almost 100%, to 49.5 million, from 1997 to 1998). Development would frustrate the peddling of bogus cures by populist politicians: de Soto, 1997, vi. See Camdessus, 1999 ("equity, equality of opportunity, and participation of all are...key conditions for sustainable development."); Elucidation, Indonesian Competition Law, No. – of 1999, General, para. 3: "The business opportunities created during the last three decades have in fact not enabled all levels of society to participate in development.... [Government policies led] to market distortion [and] the development of the private sector has..been mainly the result of unfair business conditions."
2. Amsden, et al., 1994, 7. See Djiwandono, 1999 (discussing Indonesian constitutional reforms): "We must not miss this golden opportunity to really carry out the mandate of the people for genuine total and fundamental reform. The representatives of the people would need adequate knowledge and understanding of reform and its overall implications, moral courage, political will and the necessary skill to go about it. Otherwise, we will be back to square one."
3. "Rationality", 1999. 19-20. For Cooter (1997, 140), the World Bank's checking off of a country's new laws and regulations constitutes a "commodity fetishism" that does not measure a legal modernization.
4. Amsden, et al., 1994, 18; Brietzke, 1999. Through a mixture of altruism (a desire to help) and self-interest, a World Bank/IMF/neoclassical view of the world saw idealized free agents acting through idealized markets and constrained only by a lack of capital and technology, and by a rent-seeking, misallocating state. Buscaglia, 1997, 17; Carothers, 1998, 103; Goodin, 1998, 7; Trebilcock, 1997, 19 (citing Douglas North). Shrink this state—deregulate and privatize—and, according to neoclassical economists, markets will grow so quickly and automatically as to drag the rest of the economy upwards. Institutional influences are assumed away as a "stickiness", Goodin, 1998, 8. An East Asian *dirigisme* contradicted this philosophy, and it thus tended to be interpreted as a *laissez faire*: Amsden, et al., 1994, 3-5,15. A World Bank/IMF conditioning of aid on structural adjustment programs worsened economic crises, and the plight of the poor in particular: Madeley, 1999. Joseph Stiglitz, the World Bank Chief Economist, has won adherents by criticizing the high interest rates and balanced budgets that the IMF first prescribed for crises in Asia: Guttsman, 1999. Advocacy of policies like a full capital account liberalization, before a country like Indonesia is ready for it, has proved indefensible (*ibid.*).
5. An institution is a formal system of actors and repeated transactions that transforms inputs (resources) into some valued output: e.g., democracy or (other) marketplace exchanges. See

Carlton & Perloff, 1994, 10. It has a history, a cultural context, and a more or less interchangeable economic and political power. This power is used to resist changes, to change other institutions and environments, and to otherwise shape and constrain individual and institutional preferences and choices. Institutions can create a structurally induced equilibrium, where disequilibrium formerly prevailed. For example, democracy is stabilized through institutions that decrease the stability of political cartels, and decrease the transaction costs of resistance to tyranny. Cooter, 1997, 135-36; Goodin, 1998, 7, 12; Trebilcock, 1997, 45. According to Douglas North, the constraints in a neoclassical economics are those of technology and income, to the exclusion of constraints of human organization. Trebilcock, 1997, 19. *See* North, 1990, 27-28, 34 (institutions reduce uncertainties stemming from incomplete information about the behavior of other actors. In contrast to the (near-) elimination of government advocated by a neoclassical economics, institutional economics is concerned with the quality of (a somewhat reduced) public sector governance: Buscaglia, 1997, __. Good institutions are at least as important as good laws and personnel, given the institutional context of underdevelopment and problematic repetitions of behavior: Seidman & Seidman (1997), 6-7. *See* Haverfield, 1999, 43 (describing *adat* in terms of history, myth, and institutional behavior); Lubis, 1999, 183 (human rights are defended not by words but by institutions—due process, freedom of association, separation of powers, and a judicial review and independence); Goodpaster, 1999, 21: “The choice of an institutional framework...has great impacts on personal incentives, the development of institutions intermediate between state and citizen, and an economy’s efficiency and growth.” *See also* Amsden, et al., 1994, 129: “Economic analysis...ultimately is out of its depth in dealing with profound institutional changes.”

6. Over 400 pieces of Dutch legislation remain in force, as does a continuance of coercive bureaucratic rule, Lindsay, 1999a, 1. *See* Budiardjo, 1997, 2, 4: “Much of Indonesian law is based on old, general and outdated Dutch law...essentially unchanged since the mid-19th century.” The foundations of the Indonesian State are *integralistic staatsidee* (organic state integrated with people), *beamtenstaat* (bureaucratic state), and patrimonialism, Lubis, 1999, __. Like most postcolonial legal orders, Indonesia’s distinguishes formal state and customary laws. The colonial concern with “capitalist law” extended only to export enclaves, and legal outcomes in rural areas were “disastrous,” Fitzpatrick, 1999, 74. Indonesian nationalists rejected dualism as discriminatory, but disagreed over its replacement. The “challenge of legal development” is still to overcome this dualism and its consequences, *id.* at 74-75. But the relationship between state law and local practices is so complex and intertwined that dualism is no longer an accurate description: *id.* at 76; *see* note 10 and accompanying text, *infra*.
7. Coase, 1960 (the “Coase Theorem”); *see* Brietzke & Kline, 2000; text accompanying note 26, *infra*. As in poker (or any complex variant of the economists’ game theory), players of Coasian games seek favorable legal/economic outcomes by bluffing and betting: engaging in the economists’ rent-seeking behavior, by staking something of value to the other players on the outcome (*id.*). Only some of these Coasian bribes amount to bribes as the law understands this offense: “the incentive to invest private resources to influence political decisions varies directly with the degree to which the resulting advantages can be privately appropriated”, Williamson, 1985, 338. The outcome from an indefinite number of such

rounds or auctions is unlikely to be determinate and/or an equilibrium, especially as the players behave opportunistically: seek to be Coase's "free riders" or "holdouts". The policy problem becomes "how to design institutions that will maximize the overall well-being of society" (Farber, 1997, 420-21) by, for example, minimizing opportunistic behavior. *See* North, 1990, 95-96 (transaction costs are high and determine institutional change when markets and information are incomplete, feedback channels are imperfect, and ideology is important).

8. *See* Carothers, 1998, 99-100 ("The Reform Menu"); Fitzpatrick, 1999, 93-94 ("anti-hegemonic pluralist approach" needed for Government acquisitions of rural lands in Indonesia); Haverfield, 1999, 67-68 (a new model of "critical pluralism" needed to deal with *adat*, through an accommodation rather than an obliteration of cultures); notes 16, 37 and accompanying text, *infra*. (The instability and economic dominance resulting from the power politics described in the text suggest that Indonesia has not yet reached the point where theoretical tradeoffs between growth and equality obviate policies which pursue both goals.) Outsiders force an institution's insiders to be efficient, "virtuous in spite of themselves", through "multiple centers of economic power": Cooter, 1997, 140. Several recent World Bank studies suggest "that Indonesia's rural areas may be better equipped to cope with the downturn, thanks to dollar-earning export commodities and dismantling of government monopolies on some agrarian industries." Wagstaff, 1999, 5. Wealthier rural people help the poorer ones, in a resurgence of the "moral economy" that echoes the 1930s. Also, many rural households have saved and thus prepared a buffer for the Crisis. Many people have returned to rural areas because they have lost their urban jobs, and land has become even more important as a source of social security. Sandee, 1999. In transition economies, some firms are too large; others are too small, Amsden, et al., 1994, 94. In the textile industry for example, some production segments are capital-intensive and have extensive economies of scale. Other segments are labor-intensive and small, and still others lie in between. Each has distinct managerial and financial needs, and a thriving industry requires an appropriate mix of all three sizes. Roy, 1999, 2564.
9. Here, we adopt George Stigler's approach to barriers to entry rather than Joe Bain's. Bain feels that any barrier to new entrants should be curbed, by applying a competition law. Stigler's currently more popular view is that only those barriers should be curbed which were not barriers formerly faced by firms already in the industry: barriers deliberately created by governments and companies already in the market. Thus, for example, economies of scale would be barriers to entry for Bain but not for Stigler. While a lack of capital, information, and perhaps entrepreneurship in cooperatives would not be Stigler's deliberately-created barriers to entry, this does not mean that nothing can and should be done about them: *see infra*. Similarly, the barriers to access to courts are "economic, psychological, informational, and physical", and should be fixed as such. Dakolias, 1995, 200; *see infra*.

At this stage of the transition, Indonesia still has many nonexistent or fragile markets. More commonly, however, Indonesian markets are "thin": While the number of potential Indonesian consumers is huge, income levels do not yet support large markets for higher-priced & quasi-luxury goods and services. Also, an island nation with inadequate transport and communications infrastructures will find that markets are often isolated from each other, fragmented. This

fragmentation is exacerbated by regional and inter-island barriers, created by governments and private companies. In competition policy terms, these deliberately created barriers to entry are much more dangerous in fragile, thin, fragmented, and/or regulated markets.

10. Fitzpatrick, 1999, 75-76, 82. Discussing rural land acquisitions under ostensibly “universalist” laws, he finds that the implementation of these laws creates intimidation and deceit, and/or a “legal vacuum, bureaucratic fiat or some sort of quasi-*adat*”, *id.*, at 80, 89. He discusses two cases where formal law gives way to a malleable *Pancasila*, “development” or “policy,” with regard to the formal legal requirements of discussion, deliberation, and compensation, and about whether implementations of Government policy are justiciable: *id.* at 82-86. Indonesian administrative bureaus and courts can currently function only as tools of power: Bouchier, 1999, 195. *See* Trebilcock, 1997, 19: Reforms must focus on creating efficient institutions, to maximize a social surplus, subject to such constraints as alleviating poverty and protecting the environment. The poor and powerless need “voice” and organization, ideally within a larger civil society: *see infra*. The enforcement of the new competition law could have anti-competitive effects if it is used to favor particular groups and institutions.
11. *See* Lindsey, 1999b, 16 (vague but protean elite policies, promoted through legal implementations under the New Order, tolerated only the limited dissent from the “national interest” that was required for policy legitimation); Mattei, 1997, 234-39 (discussing rigid economic structures that, as in the ghettos of American cities, segregate some people from a viable livelihood and perpetuate separate layers of law); Trebilcock, 1997, 23 (tendency in Japan, Taiwan, South Korea, and elsewhere in Asia, to an evolution of “authoritarian-pluralist regimes” with increasingly democratic features).
12. *See* Brennan, 1998, 256 (a “market failure” occurs “when market incentives fail to reflect adequately the interests of relevant others.”); Hardin, 1998, 128 (when an institutional failure cannot be regulated through a reassignment of responsibilities, misdesign rather than an internal irresponsibility is at fault); Offe, 1998, 215 (a “designer activism”--too much tinkering with institutions--undermines trust and creates the need for ever-hastier adjustments) *id.* at 215, 224 (describing failures of system and social integration as failures of validity and loyalty). Goodin, 1998, 111, describes intransitive voting patterns under Kenneth Arrow’s Theorem as leading to the democratic failure of a perpetual disequilibrium: *see* note 40 and accompanying text, *infra*.
13. Williamson, 1985. *See* Amsden, et al., 1994, 10, 16 (questions of deflated real wages and their effects on entrepreneurs, and of institutional size and type, cannot be safely left to spontaneous market forces); *id.* at 131 (organizational forms are driven by minimizing transaction costs and are a function of the limits of information—especially between principal and agent); Brietzke, 1994, 43 (such contractual behavior is both a cause and an effect of imperfect information and bargaining over unclear entitlements); Carlton and Perloff, 1994, 851-52 (“market inefficiencies” are monopoly power, externalities, uncertainties, and the opportunistic behaviors that are more likely when transactions are complex and/or outcomes are uncertain).

14. See Haverfield, 1999, 60 (the interposition of a village chief in *adat* land matters is thought to increase public participation, in what becomes a public-sector matter, but state law converts the chief into a mere witness of the transaction); Utumporn & Hilsenrath, 1999, (“it has been a lot easier to stabilize currencies than to clean up Asia’s messier corporate governance practices”, which could take years); Williamson, 1985, 338 (quoted in note 7, *supra*); “Rationality..”, 1999, 22 (quoting Sri Mulyani Indrawati) (“The ultimate question is whether the micro problem—banking recapitalization—will really work, so that it will not jeopardize macro stability again.); notes 26, 40, and accompanying text, *infra*.
15. The goals of coherence and consistency have been updated and are better conceptualized in civil law systems which are more modern than Indonesia’s, although transactions are still somewhat constrained—for reasons unrelated to state regulatory aims. Coherence and consistency are much less prized, and thus much less evident, in common law systems. This causes much distress to lawyers and non-lawyers alike, but it has the effect of leaving economic institutions more flexible while adopting and adapting to new economic opportunities. The U.S. offers the most extreme example of this pattern; while many non-legal factors are also clearly at work, law contributes to an efficient American economic flexibility, when compared to Germany, Japan or Indonesia. *But see also* Cooter, 1997, 117: State enforcement is more certain because it provides a canonical formulation which, ideally, is applied impartially by courts; citizen cooperation will increase the effectiveness and decrease the costs of enforcement.
16. See Cooter, 1997, 120-21 (civil law codes are the product of 18th Century rationalism—the popular will [*N.B.*] expressed by legislators and interpreted rather than created by judges); Haverfield, 1999, __ (Indonesian State officials’ belief that communal *adat* tenures are “inherently anti-developmental”, an example of “pigeon-holed thinking” that destroys a system which can otherwise be used to create developmental values); notes 8, 13, 15, and accompanying text, *supra*..
17. Trebilcock, 1997, 45 (quoting North). See de Soto (1994) (“That our legal institutions are in crisis is due partly to their gradual loss of social relevance in the face of the incursions of informality into all areas of everyday life”). *But see also* Cooter, 1997, 119, describing an approach identified with a British Judge, Lord Mansfield: if you don’t understand how new or unfamiliar organizations operate, don’t try to invent rules which are better than the best practices currently in effect). This precept can be applied to *adat* institutions, for example: see note 37 and accompanying text, *infra*.
18. Buscaglia, 1997, 6; Goodin, 1998a, 24-26, 34, 40-41; Offe, 1999, 200. See Amsden, et al., 1994, 134 (quoting Max Weber, the performance of an institution depends on how owners, bureaucrats, managers, and workers fit into the system); Buscaglia, 1997, 5-6 (citing Thomas Ulen, different legal systems may compute costs and benefits differently because resources and tastes differ); Cooter, 1997, 119 (discussed in note 17, *supra*); Goodin, 1998, 28 (institutions are often the byproducts of intentions or their interactions gone wrong); Hardin, 1998, 129 (Lon Fuller’s “internal morality of law” makes sense only as a functional fit within the law—between individual behavior and institutional purpose, which may itself be immoral). *But see also* Trebilcock, 1997, 46: Policymakers can also work in the interstices

of institutions and use an incremental strategy, without the need to promote change in the entire political regime.

19. Carlton & Perloff, 1994, 23; Goodin, 1998a, 7, 41-42; Pettit, 1998, 57, 62, 71-72, 75, 85. *See* Brennan, 1998, 260 (quoting Alexander Hamilton, Federalist No. 76—“the assumption of universal venality is little less an error in political reasoning than the assumption of universal rectitude.”); Brietzke, 1997, 119 (how different rules create behavioral incentives and disincentives, and institutional alternatives, a function of historical, cultural, and ideological contexts, the taste for particular rules being as diverse as the taste for anything else); Goodpaster, 1999, 30 (Indonesia lacks studies of the economic and social effects of existing decision-making, and its effects on incentive structures); Pettit, 1998, 82 (citing a commercial regulation study in the U.S. during World War II, 20% of the regulated complied unconditionally while 5% attempted evasion; the remaining 75% would comply if the 5% were credibly caught and punished); *id.* at 85 (criminal law sanctions do not support the moralistic deliberations that keep most of us decent).
20. Haverfield, 1999, 66; Offe, 1998, 199. *See* Carlton & Perloff, 1994, 25.
21. *See* Amsden, et al., 1994, 181 (people learn from their own history and the models it provides); Boon, 1999 (under “recent critiques of so-called Asian values”, “shenanigans ... owed more to Gordon Gecko than to Confucius.”); Lingle, 1999 (many foreigners bought into the “Asian model” as a “Third Way”, and failed to see “the rot below the surface arising from fatal contradictions with the demands of the global economy.”); Sen, 1999b (claim that Asians value discipline rather than freedom and democracy has little or no historical or intellectual basis, and dubious history doesn’t validate a dubious politics); Trebilcock, 1997, 46 (risk that “culture” becomes a “black box” into which things defying explanation get thrown). *But see* de Tray, 1999: We are taught to be sensitive to culture, and cultural differences will be part of the ultimate explanation of what happened in Asia. International donors “can’t impose their highly Western, conflictual program that requires people to admit their own errors and be very open and transparent.” *Id.*; *But see* Camdessus, 1999, quoted in note 22, *infra*.
22. Goodin, 1998a, 34; Trebilcock, 1997, 51. *See* Adams, 1989, 267 (discussing France, etc., “cultural traditions adjust to competitive pressures, and they can do so surprisingly quickly in countries that are already rich.”); Buscaglia, 1997, 5-6 (discussed in note 18, *supra*); Camdessus, 1999 (“There is a strong consensus for making transparency the ‘golden rule’ of the new international financial system.”); Goodin, 1998, 23 (like cultures, institutions are repetitive patterns that acquire value because they are stable and predictable); *id.* at 30 (criticism that institutional designers don’t recognize the extent to which materials are shaped and constrained by the past); Pettit, 1998, 55 (behavior is sensitive to opportunities and incentives available in society); Goodpaster, 1999, 23 (Indonesia’s “hierarchical relationships... allied with powerful cultural values of harmony, indirectness and hierarchical deference to authority” mean that subordinates do not evaluate the opaque behavior of superiors); Haverfield, 1999, 67 (Indonesian cultures can change, in contact with other cultures); Kennedy, 1994, 192 (cultural constraints and entrepreneurial potential largely irrelevant if state power wielded in an arbitrary and predatory fashion); Lindsey 1999b, 14

(Indonesian culture as law, a law without lawyers or a law without law); North, 1990, 73-104 (from an institutional economics perspective, change is a complex interaction of rules, methods and effectiveness of enforcement, and informal constraints such as culture); Sen, 1999a, (democracy gives citizens the opportunity to learn from each other, and to thus re-examine values and priorities).

23. Dakolias, 1995, 172; Garcia, 1998, at 112-13n; World Bank, 1998, 2, 4, 10, 18. *See* notes 3, 10 and accompanying text, *supra*. Judging is “the very basis of civilization”, and the transition from business with family and friends to impersonal transactions creates a huge increase in formal dispute resolutions, Dakolias, 1995, 167-69. Small claims courts are needed to level the playing field, especially in urban areas, *id.* at 210. Most studies “fail to identify the judiciary as an organizational structure operating under a complex institutional frame,” and fail to identify flaws in “judicial corporate governance”, Garcia, 1998, at 8n, 81n. A bureaucratic or judicial decision which fails openly to state the real reasons for it should be treated as illegitimate, since we cannot know the ultimate dangers of subterfuge. Luban, 1998, 159 (citing Calabresi). The “counter-reform attitudes prevailing among” judges in Latin America “would probably frustrate significant reform initiatives unless changes in the judiciaries’ governance structure and corporate culture would make them more responsive to the judicial needs of modern democratic societies.” Garcia, 1998, at 154n. Judicial reforms can be implemented in sequenced stages, based on the capacity and will to reform. Dakolias, 1995, 226; *see infra* on sequencing.

24 The first question is whether the Constitution could withstand the scrutiny of judicial review, or whether it should be amended prior to review. Among civil law systems, the German style of constitutional court arguably offers the most attractive model. Learned law professors could be appointed as judges, since the anticipated caseload would take only part of their time. This might anger members of the Supreme Court, who might be thought to lack the time and expertise to undertake judicial review. (The Supreme Court might use defensive techniques of a literal, abstract, and backward-looking statutory interpretation, to reach results regardless of social and ethical consequences.) There could be three bases for jurisdiction, as in Germany: abstract, or referral from the DPR or designated executive bureaus; concrete, or referral from a general court; and constitutional complaint, by a citizen claiming that her constitutional or human rights were violated. These rights are so important in a democracy, and many have been so recently ratified in treaties, that a separate ombudsman who reports to the DPR on rights matters should be considered. *See* Garcia, 1998, at 76-77n.; World Bank, 1998, 4.

25 Adams, 1989, 110; Amsden, et al., 1994, 49; Marks, 1999. *See* Goodin, 1998a, 9 (actual market functioning assumes prior institutional structure—for example, deferred performance is made possible by enforceable contracts); Goodpaster, 1999, 26; UNCTAD, 1997 (describing a world full of oligopoly, in contrast to the neoclassical and, frequently, IMF/World Bank view of frictionless, atomistic markets); note 9 and accompanying text, *supra*.

26. Dakolias, 1995, 167. *See* Brietzke, 1997, 118 (quoting A. Allan Schmid) (“How do the rules of property structure human relationships and affect participation in decisions where interests conflict or when shared objectives are to be implemented? How do the results

affect the performance of the economy?"); Cooter, 1997, 134-35 ("Democracy is a system of competition for control of the state, which has a monopoly on official use of force."); Haverfield, 1999, 68 (under *adat and*, I would add, other bodies of law, "social organization, political authority and property rights are closely related."); North, 1990, 54 ("Inability of societies to develop effective low cost enforcement of contracts is the most important source of both historical stagnation and contemporary underdevelopment in the Third World."); note 7, *supra* and notes 37, 40, and accompanying text, *infra* (property rights).

27. *See* Indonesian Competition Law, No. ___ of 1999, Elucidation, General, para. 5: "The emergence of conglomerates and a group of strong businessmen not supported by the spirit of real entrepreneurship has been one of the factors which caused the economic capacity to become extremely vulnerable and uncompetitive." *See also* Amsden, et al., 1994, 96 (large, diversified firms are characteristic of late industrializers, and this is countered by the downsizing, demonopolizing policies of transition economists); "Rationality...", 1999, 20 (quoting Sri Mulyani Indrawati, the new Competition Law is "one more layer added to a company's miscellaneous costs.").
28. Hardin, 1998, 135. *See* Carlton and Perloff, 1994, 28; Utumporn and Hilsenrath, 1999 (attaining sound corporate governance in Asia will take years, "before regulators, investors, directors, and the courts are working in a rhythm that provides the checks and balances"); "Asia Lacks...", 1999 (quoting the OECD's Joanna Shelton, "if companies wish to attract and keep investments from outside the companies, this model of a closed, insider system of managing companies is no longer sufficient"); "Few Companies...", 1999 (only 29 % of the 3,000 eligible Indonesian companies filed the annual financial statements required under a 1998 Regulation).
29. For example, the following documents must be obtained to start a construction company: Firm Establishment Act, Domicile Permit, Business Location Permit, Environmental Interference Regulation, Bank Reference, Trading Business License, Tax Registration Number, Firm Registration, Contractor Business License, Client Capabilities Registration, and Association Members Certificate. In Jakarta, obtaining the *main* permit took 13 months and 3 weeks and cost Rp. 10.4 million, plus Rp. 21.4 million in bribes. In Bandung, the corresponding figures are 7 ½ months, Rp. 8.2 million and Rp. 14.5 million. The licenses and figures for other businesses vary slightly. REDECON, 1998.
30. *See* Amsden, et al., 1994, 132 (while managers of publicly-listed companies have a strong incentive to control their operations, an incentive provided through the Stock Exchange, etc., the incentive for individual proprietors is stronger still); Brietzke, 1994, 49-50; Rodriguez & Choate, 1996, 346; Sianipar, 1999; Trebilcock, 1997, 40-41; text following note 38, *infra*.
31. *See* Salomon, 1999, 1 ("Some Indonesian legislators argue that efforts to strip bad loans out of banks and inject new funds means that the masses are paying for the errors of a few."); *id.* (efforts to restructure \$80 billion in Indonesian corporate debt are languishing and running into obstacles in the Commercial Court); "Macro Corner", 1999, 21 (foreign investors don't see Indonesian economy moving forward, due to problems concerning bank recapitalization and restructuring corporate debt); text following note 38, *infra*.

32. Adams, 1989, 44, 98; Budiardo, et al., 1997, 80, 82, 92; Carlton & Perloff, 1994, 850. *See* Haverfield, 1999, 58 (“Under the bureaucratic authoritarian system that prevails in Indonesia, bureaucrats see their role as ‘rent seekers.’”); Lindsey, 1999b, 18 (discussing Soepomo’s German- or Japanese-style kekeluargaan or ‘family-ness’—“the children, the rakyat or people, following the will of the father...and accepting punishment when their acts displease”); Trebilcock, 1997, 48 (administrative law reforms require more imagination about the relation between accountability and institutional autonomy, when “politics always returns with a vengeance.”); Widagdo, 1999 (Indonesian bureaucracy “disoriented” since Soeharto’s departure, without a vision of how this and the Crisis changes their roles); Indonesian Competition Law, No. __ of 1999, Elucidation, General, para. 3-4 (unfair business competition exacerbated by relations between bureaucrats and private businesspeople); “Rationality”, 1999, 20 (quoting Sri Mulyani Indrawati, without the right incentives, culture, and system, new regulations amount to little more than new transaction costs borne by business).
33. Cooter, 1997, 126-27, 132; Trebilcock, 1997, 23-25, 31. *See* “ADB Blames...,” 1999 (ADB blaming Asian crises on corruption in part & announcing a “zero tolerance” for corruption); *id.* (accountability, transparency, predictability, and participation are “universally applicable regardless of the economic orientation, strategic priorities, or policy choices of the government”); “RI Urged...”, 1999 (Indonesia ranks sixth among the world’s countries on Transparency International’s Corruption Index, as illustrated by the huge number of nonperforming loans).
34. *See* Amsden, et al., 1994, 52-54 (SOEs a “black box” complicating reorganization because its contents unknown to planners, and because of poor product quality and obsolete technology); *id.*, 142 (no “coherent, easily traceable path toward privatization” in any transition economy); *id.*, 210 (reinventing planning is the other side of privatization claims); “Government Calls...”, 1999(15 “world-class holding companies” being established to consolidate Indonesia’s 155 SOEs, to increase efficiency and “eliminate competing interests”); “Govt Postpones...”, 1999 (detailing postponements in Indonesia’s “privatization itinerary”); “Habibe...”, 1999 (aim of new SOE plans is to increase professionalism & managerial ability, to enable privatization once the capital market stabilizes); “Oil and Gas...”, 1999 (Draft Law for ending SOE monopoly draws mixed reactions); “Zain, 1999 (Indonesian populists reject sale of SOEs as unconstitutional, especially in vital industries).
35. *See* Cooter, 1997, 119 (discussed in note 17, *supra*); Moentadhim, 1999 (how small businesses have prospered recently, using as one example the export of frogs harvested from their natural habitat); Sianipar, 1999.
36. *See* Sianipar, 1999; Timberg, 199_ (for comparative analyses); Zain, 1999; “Government to Simplify...,” 1999 (new Forestry Regulations will force “investors to cooperate with cooperatives and local farmers in the ownership and operation of plantations”);
37. Indonesian food shortages have abated with the end of a two-year drought: Solomon, 1999, 2. The Asian Crisis shows that solid rural development is necessary to avoid instability,

although some rural people seem to have gained: Madeley, 1999; notes 8, 16 and accompanying text, *supra*. Soeharto “maintained rigid control over the fabric of rural life: Choosing the village headman, getting villagers to use cement rather than mud..., even what kind of rice to plant...” Now, this fabric of “an obedient community steeped in resentment” is “coming loose.” Wagstaff, 1999. While officials believe new policies will respect and take into account the interests of rural people, one such person says officials need to end the clearing of forests rather than build new houses. “Gap...”, 1999. The Agrarian Law of 1960 is an “ultimately unsuccessful” attempt to preserve *adat*: Lindsey, 1999a, 7; *see* Cooter, 1997, 119 (discussed in note 17, *supra*). *Adat* policies attempt a “unity in diversity”, but have been unjust, “juridically difficult and politically delicate”: Haverfield, 1999, 42. Rights to collect forest produce have been frozen in favor of Government concessions, despite generations of entitlement. Only 22% of Indonesia has been registered in an individual ownership, and the process would take about 100 years to complete. Residents on registered land risk losing it to transmigrants or developers. Regulation 24 of 1997 continues the non-registration of communal tenures, and refuses to exempt them from the definition of State land. Transfers must be done by notary’s deed, and the village chief’s function has been usurped and reduced to that of a witness. *Id.*, 56-59, 62. *See id* at 68 (quoted in note 26, *supra*); Cooter, 1997, 127 (customary law follows actual use and changes in response to the emergence of markets; using it forestalls the use of political connections to obtain rents); note 8 and accompanying text, *supra*.

38. Camdessus, 1999; Hasilbuan, 1999; Utumporn & Hilsenrath, 1999. *See* “Foreigners...”, 1999 (to facilitate debt-for-equity swaps as a means of corporate reorganization, foreigners can now establish holding companies in Indonesia); “Rationality...”, 1999, 22 (quoting Sri Mulyani Indrawati, “international banks have applied a credit ban on Indonesia, which is seen as being among the most high-risk countries in the world.”). *But see* Bello, 1999: discussing rival theories, of a greater liberalization and a “Back to Bretton Woods”—Malaysian-style capital controls, and advocating a limited “de-globalization” of domestic Asian economies.
39. *See* Buchari, 1999; Fitzpatrick, 1999, 91 (Robert & Ann Seidman recommend “institutions that guarantee competitive electoral democracy, bureaucratic accountability, popular participation in ongoing governmental decisions, and a civil society capable of acting as a countervailing power to the bureaucracy.”); Sen, 1999a (justice a central basis for deciding on democratic public policy objectives and instruments, including the uses to which markets are put); Solomon, 1999, 2 (In Indonesia, everyone wants a smooth election to legitimize their claim to power).
40. *See* Brietzke, 1994, 43 (creating enforceable property rights an often-productive but costly activity which does not, by itself, guarantee market access or the best incentives to produce); de Soto, 1997, xv (private property rights pivotal but often not enforced by a state which does not realize that this is a precondition to transforming informal assets into capital, and that this is the only way to counter vested interests and the slowness and excessive centralization of traditional systems); Goodin, 1998, 11 (for Kenneth Arrow, the equilibrium induced by political structures is an escape from “intransitive voting”).

41. Carlton & Perloff, 1994, 898; Trebilcock, 1997, 18. *See* Brietzke, 1997, 129 (neoclassical economists advice to politicians—“do nothing or you risk succumbing to your baser instincts”—is incomplete and unhelpful because citizens expect politicians to do something effective); Seidman & Seidman, 1997, 45 (competitive elections don’t prevent the executive from dominating the legislature, and are insufficient to inspire institutional transformations); Wade, 1998 (“While political leaders call for the Third Way, they covertly pursue the logic of My Way.”); World Bank, 1998a, 9 (“certain business and political interests reinforce one another and limit market and political opportunities for citizens who are not successful at lobbying authorities”, and this undermines confidence in the political process); “Govt Defends...”, 1999 (quoting former oil minister Subroto) (“The political decision-makers want to preserve the status quo through economic means.”).
42. “Go With...”, 1999. *See* Carothers, 1998, 95-97 (the rule of law advances both principles and profits, in a respect for the constitution and the sovereign authority of the people); *id.* (in contrast, reforms in Malaysia, South Korea, etc. don’t subordinate government’s power to law, and amount to a rule *by* law rather than a rule *of* law); Cooter, 1997, 101 (defining the rule of law as “many people obey just laws out of respect.”); Goodpaster, 1999, 22 (absent law, rule is usually personalistic and based on culture or an imported ideology); *id.* at 25 (the rule of law has few defenders because it is a commons or public good—available to all); Lindsey, 1999a, 8 (Soeharto’s New Order used a rule of law rhetoric but while continuing the Dutch legal and political model of a Guided Democracy); Lubis, 1999, 171-74 (a strong and effective MPR, and a judiciary controlled by public opinion, needed to create an Indonesian *Rechtsstaat*).

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