

# **The Case of Illegitimate Debt in Indonesia**

**A Case Study**



**African Forum and Network  
on Debt and Development**

Illegitimate Debt & Underdevelopment in the Philippines  
A Case Study

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# About AFRODAD

## **AFRODAD Vision**

AFRODAD aspires for an equitable and sustainable development process leading to a prosperous Africa.

## **AFRODAD Mission**

To secure policies that will redress the African debt crisis based on a human rights value system.

AFRODAD Objectives include the following:

- 1 To enhance efficient and effective management and use of resources by African governments;
- 2 To secure a paradigm shift in the international socio-economic and political world order to a development process that addresses the needs and aspirations of the majority of the people in the world.
- 3 To facilitate dialogue between civil society and governments on issues related to Debt and development in Africa and elsewhere.

From the vision and the mission statements and from our objectives, it is clear that the Debt crisis, apart from being a political, economic and structural issue, has an intrinsic link to human rights. This forms the guiding philosophy for our work on Debt and the need to have African external debts cancelled for poverty eradication and attainment of social and economic justice. Furthermore, the principle of equity must of necessity apply and in this regard, responsibility of creditors and debtors in the debt crisis should be acknowledged and assumed by the parties. When this is not done, it is a reflection of failure of governance mechanisms at the global level that protect the interests of the weaker nations. The Transparent Arbitration mechanism proposed by AFRODAD as one way of dealing with the debt crisis finds a fundamental basis in this respect.

AFRODAD aspires for an African and global society that is just (equal access to and fair distribution of resources), respects human rights and promotes popular participation as a fundamental right of citizens (Arusha Declaration of 1980). In this light, African society should have the space in the global development arena to generate its own solutions, uphold good values that ensure that its development process is owned and driven by its people and not dominated by markets/profits and international financial institutions.

AFRODAD is governed by a Board of seven people from the five regions of Africa, namely East, Central, West, Southern and the North. The Board meets twice a year. The Secretariat, based in Harare, Zimbabwe, has a staff complement of Seven programme and five support staff.

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## Preface

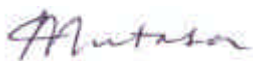
Debt servicing continues to happen at the cost of the exploitation of people, the denial of their basic rights to social and public services, the plunder of Southern agricultural, forest and mineral resources, and the destruction of sovereignty. The debt continues to be used to impose destructive and one-sided policies of neoliberal globalization.

In general, the term "illegitimate" means "against the law, illegal or not authorized by law; improper" or "wrongly inferred" and to some extent "illogical". Defined thus illegitimate debts include odious debts, loans secured through corruption, usurious loans, and certain debts incurred under inappropriate structural adjustment conditions. The notions of illegitimate debt aims to analyze and bring to book the question of how debt was accumulated and whether this process of incurring debt took place in accordance with certain ethical standards.

It is against this background, that Indonesia is currently struggling to overcome the repercussions of years of government abuse, corruption, and mismanagement. The Suharto regime's management of the economy between 1967 and 1998 serves as one of the examples of how illegitimate debts are accumulated and how they consequently paralyze the economy of a developing country. Suharto allowed massive state-ownership and unbelievable corruption to flourish thus preventing sound economic policies which would have favoured the common Indonesian people and encouraged further international investment in the economy. As Suharto's reign progressed, it became increasingly obvious that the economic advances mostly aided Suharto's family and friends while the public suffered the blows of natural disasters, fuel shortages, and economic mismanagement. Suharto's own family is said to have accumulated almost US\$40 billion by means of subsidies and monopolies. For years after Suharto's fall, civic protests continued against him and attempts to prosecute him for corruption and economic mismanagement seemed to be mounting even today.

The Suharto regime like other oppressive regimes such as that of Mobutu of Zaire enjoyed the support of the United States government as long as they served as frontiers to resist the advance of communism in their countries during the cold war era. Loans that did not benefit the Indonesia people were advanced to Suharto at the expense of national development. By the time Suharto left office, the Asian crisis had caught up with Indonesia and he had no option but to resign as public anger against him became unstoppable. This research publication done in collaboration with INFID (Indonesia) seeks to unpack the concept of illegitimate and odious debts in the context of Indonesia. It presents Indonesia as a case that requires fair and transparent arbitration in a neutral setting within the auspices of the United Nations. The illegitimate debts of Indonesia can definitely not be treated as a national issue without subjecting it to an international arbitration mechanism that ensures that justice prevails in the adjudication of the matter. For donors and financial institutions to demand that Indonesia pays for the Suharto regime's debts, failures and corruption is not fair and it's against the very basis of socio-economic justice.

There is a desire for fairness and an opposition to injustice that would support demands for debt arbitration and make recalcitrant governments change their preferences. The reactions of the public should not be discounted.



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Executive Director  
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# LIST OF ABBREVIATIONS

ADB	Asian Development Bank
BAPPENS	National Planning Board
BPS	National Bureau of Statistics
DM	Deutsche Mark
DMO	Debt Management Office
EURODAD	European Network on Debt and Development
GDP	Gross Domestic Product
JBIC	Japan Bank for International Cooperation
HIPC	Highly Indebted Poor Countries
IDA	International Development Association
IDB	Islamic Development Bank
ILC	International Law Commission
IMF	International Monetary Fund
MEFP	Memorandum of Economic and Financial Policies
NGO	Non-governmental organization
ODA	Official Development Assistance
OECD	Organization for Economic Cooperation and Development
PRSP	Poverty Reduction Strategy Paper
UN	United Nations
USA	United States of America

# EXECUTIVE SUMMARY

The history of foreign debts in Indonesia originates at the very beginning of the independence of the country, namely in 1946 when the new government of Indonesia issued a law on foreign debts to the Netherlands. By 1966 the foreign debts of Indonesia reached about 2.6 billion dollars. By December 2006, the total foreign debts of Indonesia were US\$ 61.7 billion or IDR 556.21 trillion, while the poverty level is 17.6% (if the standard is US\$ 1/day).

## Inventory of Indonesia's Debt Stock

The foreign debt stock of Indonesia, both private and public until 2003, was US\$ 134.85 billion. In the period of 1989 – 2003, the debt stock of Indonesia increased by US\$ 82.88 billion or 159.46%. The drastic increase in the foreign debts took place after the economic crisis in 1997. In the period of 2001 – 2003 the debt stock increased by US\$ 9.48 billion. Another thing is that in the period of 1995 – 1997 the private foreign debts increased drastically by 67%. In 1998 the private foreign debts reached a peak of US\$ 83.56 billion.

After the crisis the stock of private foreign debt decreased significantly. In 2003 the stock of private foreign debts was US\$ 54 billion. Theoretically the private foreign debts do not put burdens on the government's fiscus, but because the foreign creditors were backed up by the governments and the international organizations (IMF, World Bank and ADB) the private debts were converted to public debts. Most of the private foreign debts were paid by the government with the *bail-out* scheme as prescribed by the IMF, monitored by the World Bank on a daily basis. In only 10 years (1989 – 1999), the stock of foreign debts of Indonesia increased 10 times. This was the period when the stabilization and liberalization programs supported by IMF and World Bank were at a peak.

In 2005 Indonesia had to pay US\$ 8.3 billion for the foreign debts. The amount does not include the payment of the debts of the state owned companies and the private companies, that reached US\$ 6 billion. In total Indonesia had to pay more than US\$ 14 billion in 2005. This is almost equivalent to a quarter of the foreign exchange reserves of Indonesia.

Foreign debts have clearly put pressure on Indonesia's economy. The dependence on foreign debts have pushed the government of Indonesia to follow the rules and prescriptions of the creditors/donors whatever the risks for the livelihood of the people of Indonesia. The dependence on foreign debts has pushed the government to serve more the interests of the creditors rather than the interests of the citizens.

## Illegitimate Debt

The arguments for the illegitimacy of foreign debts in Indonesia are based on both international laws and domestic laws.

The 1969 and 1986 Vienna Conventions have clearly regulated the rules for countries and international organizations to make international agreements or treaties, including the agreements on loans. There are also international and national laws that guide the right and wrong approach in international interactions, such as the UN resolution on anti-corruption, European laws on anti-corruption and OECD convention on anti-bribery. These laws and conventions clearly stipulate the correct international interactions.

There are many cases of illegitimate debts in Indonesia. In this research there are five cases exposed as examples: the debts for the purchase of warships from Germany, the ADB loans for TCSSP, and three dam projects supported by loans from Japan.

## Loans from Germany

Germany sold half of the German Democratic Republic (GDR) fleet of ships to Indonesia. Firstly, all German loans to Indonesia after the war related to this sale, including the 'after sales' loans to enable the repair and maintenance of the used vessels. These clearly fulfill Sack's principles of odious debts. The loan was not employed for the needs and in the interests of the Indonesian State, which could be seen from the reluctance of the Indonesian Navy to buy those used ships and the courageous opposition of the Indonesian Minister of Finance, Mar'ie Muhammad. Then, although not stated explicitly, the loans were employed more for the interests of a major German company, Ferrostaal, the Indonesian state-owned shipyard, PT PAL.

Since the German Government committed a hostile act against the people and the State of Indonesia, all the loans related with the sale of those ships should be canceled by the current German Government and what ever part of the debt that has been paid by the Indonesian Government should be returned to the Indonesian state coffers. Secondly, this case study shows how odious debts have a double, contrasting, effect: these debts are subsidizing rich German and Indonesian officials, while further impoverishing the Indonesian people, who have to pay the debts incurred by the Indonesian government to their German counterpart.

From a legal point of view, the loans and loans agreements qualify the illegitimate debts. First, the loans agreements violated the 1969 Vienna Conventions on International Treaties namely the Article 48 on Error, Article 49 on Fraud, and Article 50 on Corruption. Both German public officials and the brokerage company (Ferorstaal), and Indonesian public officials knew that the ships could be used but then they also knew that the ships were proved to be useless. The parties in the agreement cheated the public of Indonesia by providing wrong information about the use and the conditions of the ships. Furthermore each party knew that the transaction involved bribery and corruption (mark-up of prices).

Secondly, the loan agreements also violate the international conventions on corruption. The loans clearly involved corruption and bribery on both side: German Company and officials and crony business groups in Indonesia. The UN Convention against Corruption, Article 34, states that corruption can become a legal factor to annul an agreement or contract. The 1969 Vienna Convention, Article 50, also mentions that if the representative of the state commits corruption the treaty or agreement is invalidated.

Third, the loans agreement violates the Indonesian constitution stipulating that the loan agreement should be approved as law by the Parliament. This loan agreement violates Chapter 11 of Indonesian 1945 Constitution, and Article 46 of 1969 Vienna Convention about the national procedures.

These loans for the German warships are not only illegitimate, but also criminal from the point of international conventions on corruption and anti-bribery. Therefore the people of Indonesia are not obliged to repay them, and even the agreements are subject to be brought to the criminal court on corruption. Both parties are involved in the wrongful acts. The German public officials and company (Ferostaal) have to be prosecuted under the European Law on anti-corruption and the OECD anti-bribery convention, and the UN Resolution on anti-corruption; while the Indonesian public officials and private companies involved in the abuse of functions and corruption have to be brought to criminal court on corruption.

The loans for the purchase of warships from Germany fulfill almost all substantial contents of 1969 Vienna Convention and the 1945 Constitution of Indonesia. The sale-purchase of the warships violates the Article 48 on Error, Article 49 on Fraud and Article 50 on Corruption of the 1969 Vienna Convention, and violates the Chapter 11 of 1945 Constitution of Indonesia. It is not only the debts that have to be cancelled, but the parties involved in the criminal transactions have to be brought to the court, for instance the European Commission for corruption and bribery.

### **Loans from Asian Development Bank**

In April 2007, more than 100 farmers from the Bengkulu province in Sumatra held a demonstration in front of the office of the Ministry of Finance in Jakarta. They demanded that the credit payment the farmers were forced to pay as part of the Tree Crop Small-holder Sector Project (TCSSP), be cancelled, because of its failure and it brought misery to the farmers.

The project mentioned came from a loan from the Asian Development Bank (ADB), which was approved in November 1992, amounting to US\$ 135 million. The objective of the project was to alleviate poverty by improving the income and employment prospects of rubber and tea smallholders and landless rubber tappers in the project area by increasing production through the introduction of improved crop varieties and cultivation practices. In other words, it intended to provide assistance to farmers to plant good quality rubber and tea trees. The project ended in 2001, and ADB had reported in its Project Completion Report for TCSSP (PCR: INO 22290) in July 2002, that the project was rated as successful.

However, contrary to what the ADB said, an NGO research in one of the project area, Bengkulu, from the testimony of the farmers effected, and even also from ADB's own assessment document, showed that the project had failed, because the funds was highly corrupted, the seedlings provided were bad seeds so they cannot make money from it, and until present,

the farmers cannot get back their land certificates which were kept by the authorities as collateral.

As stated above, at appraisal the project cost was \$ 225 million, with a 25 years maturity date and seven year grace period. The ADB loan was \$ 135 million, of which \$ 73 million was in foreign exchange, and \$ 63 million was in local currency. At completion, the total cost was \$ 182.2 million, which 106.4 million of it was financed by the ADB. An amount of \$28.6 million (21%) was cancelled from the loan during implementation.

The loans from ADB are included as illegitimate since it violates the 1986 Vienna Convention, particularly the Article 48 on Error and Article 50 on Corruption. Since the projects funded by the loans have been recognized as failure, the debts cannot be burdened to the people of Indonesia. Since the funds for the project were corrupted and it has been proved by the court decisions, and both ADB and the government of Indonesia recognized this corruption, then it is against the law and above international conventions if the people of Indonesia have to be burdened to repay the debts.

### **Loans from Japan**

The relations between Japan and Indonesia since Suharto era have been steadily close and intense. This is indicated from the fact that Indonesia is the biggest recipient of Japan ODA. During the transition period from President Sukarno to President Suharto, Japan was involved in facilitating the meetings of the developed countries who were interested to support Indonesia through Tokyo Meeting in 1966. Japan was an active member of the Intergovernmental Group on Indonesia (IGGI) and then the Consultative Group on Indonesia (CGI). The relations in fact benefit more for Japan rather than for Indonesia. Indonesia was treated as backyard of Japan, for dumping used technology and for upgrading skills of the young Japanese engineers by working in various construction projects in Indonesia.

Suharto's regime put emphasis on the infrastructure development that was mainly supported by Japan government through the Japan Bank for International Cooperation (JBIC). Until 1999 the Japanese ODA for infrastructure absorbed 32% of the total ODA to Indonesia that included electricity supply, dams, telecommunication facilities, railway, airports, seaports, undergrounds passes, highways (or toll roads), etc. The biggest portions of the Japanese ODA go to the construction of dams.

There are three dams that are included in this study: Bilibili Dam in South Sulawesi, Lau Renun Dam and Asahan Dam in North Sumatra. These dams were constructed to provide electricity for industries and mining operations. All three dams are supported by tied loans.

All three projects supported by Japan ODA (Bilibili Dam, Lau Renun Dam and Asahan Dam) are not only violating the basic principles of human security as the fundamental principle of Japan ODA, also violates the national Constitution of Indonesia. The dams fail to bring benefit to the people of Indonesia, but even threaten the livelihood of the local communities and contribute to the degradation of environment in the locations of the projects. Japan has to be also responsible for the wrongful acts, since the designs of the projects were made by Japanese experts, the construction works were conducted by Japanese companies, the main equipments are supplied from Japan and some of the utilization of the final products of the projects are for the Japan corporations.

Although the facts, data and incidences have been publicly exposed, the government has not been moved from its orientation to the policy prescriptions of the multilateral donors. The needs for more budgets allocated for health and education have been obvious, but the government still prioritized paying foreign debts rather than promoting education and health. Although the incidences of poverty as indicated by malnutrition, starvation and death because of starvation have been publicly exposed, the priority of the government in allocating state budget is still on the implementation of the policies imposed by the creditors. Foreign debts have made the government as the instrument for the creditors to serve their interests, and not the people's interests; while at the same time the World Bank and ADB continuously publish research and studies that justify the needs of the government for new loans and more policy reforms.

## 1.0 INTRODUCTION

The history of foreign debts in Indonesia originates at the very beginning of the independence of the country, even when the colonizer Netherlands had not recognized the independence, namely in 1946 when the new government of Indonesia issued a law on foreign debts to the Netherlands. In the period of 1946 – 1958 the foreign loans were mainly used for food support, and not yet integrated as a source of financing for development programs. The funds were mainly used for capacity building (education) and agricultural development.

Indonesia's relationship with the foreign donors is mainly determined by the orientation of its foreign policy. Although the country's foreign policy is based on the principle of "free and active" meaning that the country is freed to make relations with any country without aligning to any political and economic bloc, in reality Indonesia chose one of the two blocs during the Cold War era. During Sukarno era, Indonesia was one of the leaders of the Non-Alignment Movement, but in fact Indonesia tended to be closer to the Eastern Bloc. In early 1960's President Sukarno asked the donors, which are mainly from the Western Bloc, to go to hell with their aid.<sup>1</sup> Indonesia, however, received aid from both western donors and Eastern countries. The aid was not used in optimum ways for the welfare of the people. The Sukarno regime (before 1966) was called by the World Bank as having been in aid pathology<sup>2</sup>. The foreign aid was mainly used for unproductive activities and dissipated to political projects of mass mobilization. By 1966 the foreign debts of Indonesia reached about 2.6 billion dollars.

President Suharto welcomed foreign economic assistance. The Suharto regime of New Order firmly allied itself with the Western Bloc during the Cold War era. As a part of the containment policy of the Western Bloc, Indonesia was rewarded with a massive aid package. The design of the economic architecture of Indonesia was made collectively by the countries which then formed the *Inter Governmental Group on Indonesia* (IGGI). The relationship between Suharto's regime and the donors' community was so close that the state annual budget was decided after the IGGI meetings. President Suharto and his economic team had very close relationship with the donors, that the IMF and the World Bank could easily orchestrate the policy prescriptions and changes in Indonesia.

The relationship was based on mutualism. The donors were free and easy to determine what they wished, while Suharto and his cronies were free for corruption without any objection of the donors. The report from the World Bank in 1997 and the testimony of Prof. Jeffrey Winters in the US Senate exposed that up to more than 30% of the foreign aid, including the Bank's money, were misused by Suharto and Indonesian bureaucracy. The collapse of the economy of Indonesia in 1997/1998 was partially caused by the bad governance. Although the program loans were aimed to install better governance in the country, it turned out to be creating and maintaining bad governance.

Indonesia was the heaven for the donor agencies and their staff. BAPPENAS – the National Planning Board – was aware of this in later decade. On the side of the government of Indonesia, the ministries preferred foreign loans rather than using domestic sources since the loans will give higher budget to the ministries. The more the foreign aid, the higher the matching funds allocated to the ministries, and the more income they can earn. On the other hand the staffs of the donor agencies try to increase loans for Indonesia since they will get more overhead costs. The more the loans drawn by the government of Indonesia, the more secure will be their job and their life style in the poor country of Indonesia.<sup>3</sup>

The BAPPENAS study suspected that the foreign aid (loans, particularly) were used more for project seeking that tends to be rent-seeking of the government staff and the staff of the donor agencies rather than for promoting development in Indonesia. In other words, Indonesia was a victim of the unholy alliance of the Indonesian corrupt bureaucrats and the "self-seeking" staff of the donor agencies. The increasing numbers of poor people living in misery and destitution have to pay for the impacts of this alliance.

Up to December 2006 the total foreign debts of Indonesia is US\$ 61.7 billion or IDR 556.21 trillion, while the poverty level is 17.6% (if the standard is US\$ 1/day). Aid pathology that was attached to the Sukarno regime become worse since the multilateral agencies are involved in dictating economic policies in Indonesia.

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<sup>1</sup> Hal Hill, 1996, 79.

<sup>2</sup> Lester B. Pearson et al., *Partners in Development: Report of the Commission on International Development* (New York: Praeger Publications, 1969), p. 338 – 339.

<sup>3</sup> The Directorate of Monitoring and Evaluation of Development Funding, BAPPENAS, *The Study on the Strategy of Performance of Foreign Aid Implementation*, Jakarta, 2004. [www.bappenas.go.id](http://www.bappenas.go.id)

## **1.1 Research Objectives and Methodology**

This work proposes to build the case for the illegitimacy of Indonesia's external debt. After the institutions involved in loans contractions and the legal framework of Indonesia is taken into consideration, we identify the origin of Indonesia's external debts. There is an analysis and discussion of what makes the country's debts illegitimate. A chapter is devoted to providing information and statistics regarding Indonesia's debt profile. The paper concludes with an assessment of the socio-economic impact of the loans and what efforts have been undertaken to re-negotiate the debt.

## 2.0 THE CONCEPT OF ILLEGITIMATE DEBT

This is a much broader category than odious debt. It applies for example to ill-conceived development projects which should never have been financed in the first place. An example of this is the Bataan nuclear power station on the Bataan peninsula in the Philippines. It is the Philippines' largest single debt. Completed in 1984 at a cost of US\$ 2.3 billion, it was never used because the post-Marcos regimes in the Philippines do not want to take the risk, because the nuclear power plant was built on an earthquake fault at the foot of a volcano. It was financed by the US export credit agency, Ex-Im Bank, Union Bank of Switzerland (UBS), Bank of Tokyo and Mitsui & Co, all of whom are still being repaid (Eurodad 2006, 2007).

Another example of illegitimate debt is the US\$ 80 million worth of debt that has been cancelled on 2 October 2006 by the Norwegian Government. Between 1976 and 1980, Norway had a policy of supporting the export of chips to seven developing countries, namely Ecuador, Peru, Jamaica, Egypt, Sierra Leone, Sudan, and Burma. Norway had exported these chips mainly to secure employment for a ship-building industry in crisis in the creditor country rather than any objective analysis of the development needs of the countries purchasing the ships. This has been explicitly acknowledged by the Norwegian Government today which announced the historic step of taking co-responsibility for the debts which then followed (Eurodad 2006).

In a broader sense, Joseph Hanlon (2002) outlines illegitimate debt as debts which satisfy one or more of the following conditions, namely:

- (a) It is against the law or not sanctioned by law;
- (b) It is unfair, improper or objectionable, or
- (c) It infringes some public policy.

These two concepts – odious and illegitimate debts – have been adopted world wide by the ecumenical Jubilee movement and the global environmental movement by questioning the fairness of debts imposed upon the Third World nations. Since the 1980s, these global movements have been campaigning for the abolition of odious and illegitimate loans by creditor governments.

### 2.1 Invalid Debts Are Illegitimate Debts

While the research will utilize the conditions mentioned by Hanlon and Sack above to identify illegitimate debts, it will also focus on the legal conditions of the loans agreements, both from international law perspectives and national laws perspectives. As will be shown in chapter 2 of this research, debts are illegitimate because they are made against the laws or violate the laws, both national and international laws.

Debts are made based on the agreements between the creditors and the debtors, between one country and other country, and between one country and international organizations. The agreements between states and between states and international organizations are categorized as international treaties. The international treaties between states are regulated by the 1969 Vienna Convention, and the treaties between the states and the international organizations are regulated by 1986 Vienna Convention. The violation of these conventions can be categorized as illegal actions.

At national level these agreements are also subject to be bound to the national constitutions and laws. The failure to fulfill and respect the national legal stipulations, particularly the constitution, means that the agreements are invalid.

If the loans agreements violate the international conventions and the national constitution and laws, the agreements are invalid and hence the debts created by the agreements are also invalid. The invalid debts are illegitimate debts, and therefore cannot be maintained in the state accounts and the people of the country are not bound to repay the debts.

The analysis of the legal aspects of Indonesian loans will show that most of the loans agreements in the period of President Suharto and after are illegitimate.

## 2.2 Corruption Makes Debts Illegitimate

Corruption hurts the poor disproportionately by diverting funds intended for development, undermining a government's ability to provide basic services, feeding inequality and injustice, and discouraging foreign investment and aid. **Kofi Annan, United Nations Secretary-General** in his statement on the adoption by the General Assembly of the United Nations Convention against Corruption

The UN members have adopted the UN Convention against corruption. This convention is included in the UN Convention against Transnational Organized Crimes. Any loan that involves corruption in its broader sense, whether by one party or all parties in the treaties or agreements concerning the loans, is illegal. The people of the country are not bound to the stipulations in the treaties. The implementation of the treaties or agreements is then categorized as transnational organized crime and has to be stopped and eliminated.

There have been many other conventions adopted by groups of countries, such as OECD Convention on Anti-Bribery and European Union Law on Anti-Corruption, and US Law on Transnational Organized Crime and others. These laws and conventions outline the criminal acts in international economic transactions. Foreign loans or foreign debts are parts of international economic transactions that are also subject to the anti-corruption or anti-bribery conventions and laws. Though the conventions and laws do not clearly state that international or foreign loans are included, but the nature of international or foreign loans shows that they are parts of international economic transactions and are susceptible to bribery and corruption. The loans that involve corruption or bribery are by nature illegitimate, and the people of the countries are not obliged to repay them or the loans have to be cancelled for the sake of justice as stipulated in the anti-corruption and anti-bribery conventions and laws.

## 2.3 Odious Debts

Concern about the never-ending indebtedness of many Third World nations have driven governments and non-governmental organizations — including religious, environmental and anti-globalization groups — to weed out debts which have not been useful – or even harmful — to the peoples of the debtor countries. Out of this concern grew several concepts of unfair debts, which payment should not be burdened upon the shoulders of the people of the countries, whose governments incurred those debts in the first place. Of those concepts, “illegitimate debt” (Hanlon 2002; Eurodad 2006, 2007) and “odious debt” (Adams 2004) are the two most popular ones.

The Doctrine of Odious Debt has a long history, since its principles were already well known to France, Russia, Germany, and the United States of America at the turn of the 19-20th century. After the Spanish-American War in 1898, the United States repudiated Cuba's Spanish debts. Saying they were “imposed upon the people of Cuba without their consent and by force of arms,” the US commissioners to the peace negotiations argued that much of the borrowing was designed to crush attempts by the Cuban population to revolt against Spanish domination, and was spent in a manner contrary to the people's interest. “They are debts created by the Government of Spain, for its own purposes and through its own agents, in whose creation Cuba had no voice”<sup>4</sup>.

Therefore, so the US negotiators argued, these debts could not be considered local Cuban debts, nor could they be binding on a successor state. As for the lenders, the US negotiators argued: “[T]he creditors, from the beginning, took the chances of the investment. The very pledge of the national credit, while it demonstrates on the one hand the national character of the debt, on the other hand proclaims the notorious risk that attended the debt in its origin, and has attended it ever since”<sup>5</sup>.

As Patricia Adams points out, the dispute over the “Cuban debts” became one of the most contentious cases of debt repudiation – repudiation caused not because the debt imposed an excessive burden on the successor, but because illegitimate parties contracted them for illegitimate purposes. Such debts became known in law as “odious debts”.

Only a quarter of a century later was the legal *Doctrine of Odious Debt* given shape by Alexander Nahum Sack, a professor of law in Paris and former Minister in the Tsarist government in Russia.

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<sup>4</sup> Patricia Adams, *Odious Debt*, 2-3.

<sup>5</sup> *Ibid.*, pg. 3.

With colonial territories becoming independent nations and colonies changing hands, with monarchies replaced by republics and military rule by civilians, with constantly changing borders through out the world, and with the ascendant new ideologies of socialism, communism, and fascism overthrowing old orders, Sack developed a theory of debt which dealt with the practical problems created by such transformations of the state. He believed that liability for public debts should remain intact, for the sake of international commerce. Without strong rules on state obligations to pay those public debts, he believed, chaos would reign in relations between nations and international trade and finance would break down<sup>6</sup>.

Debts not created in the interests of "the state", however, should not be bound to that general rule. As Sack stated:

If a despotic power incurs a debt not for the needs or in the interests of the State, but to strengthen its despotic regime, to repress the population that fight against it, etc., this debt is odious for the population of all the State.

This debt is not an obligation for the nation; it is a regime's debt, a personal debt of the power that has incurred it, consequently it falls with the fall of this power.

The reason these "odious" debts cannot be considered to encumber the territory of the State, is that such debts do not fulfill one of the conditions that determine the legality of the debts of the State, that is: *the debts of the State must be incurred and the funds from it employed for the needs and in the interests of the State.*

"Odious" debts, incurred and used for the ends which, *to the knowledge of the creditors*, are contrary to the interests of the nation, do not compromise the later – in the case that the nation succeeds in getting rid of the government which incurs them – except to the extent that real advantage were obtained from these debts. The creditors have committed a hostile act with regard to the people; they can't therefore expect that a nation freed from a despotic power assume the "odious" debts, which are personal debts of that power.

Even when a despotic power is replaced by another, no less despotic or any more responsive to the will of the people, the "odious" debts of the eliminated power are not any less their personal debts and are not obligations for the new power. One could also include in the category of debts the loans incurred by members of the government or by persons or groups associated with the government to serve manifestly personal interests that are unrelated to the interests of the State.<sup>7</sup>

In other words, Sack's concept of odious debt can be summarized into the following four principles<sup>8</sup>:

- (a) A condition of legality of a loan is that it is "employed for the needs and in the interests of the State";
- (b) Odious debts fall with the regime and are not owed by the successor;
- (c) Debts are considered odious if they are used for personal rather than State purposes; and
- (d) Creditors commit a hostile act when they make an odious loan.

Typically, as noted by the Brussels-based *European Network on Debt and Development*, (EURODAD), odious loans are associated with dictatorial regimes such as that of Mobutu Sese Seko in the Democratic Republic of Congo, Ferdinand Marcos of the Philippines, General Suharto of Indonesia, the apartheid regime of South Africa and Saddam Hussein of Iraq. These regimes racked up huge debts with bilateral creditors, such as the USA, UK, France and Germany, as well as with multilateral agencies, such as the World Bank and the IMF. Eurodad believes that many of those loans were extended for purely geopolitical strategic purposes. Therefore, many non-governmental organizations (NGOs) argue that it is not fair that the populations of debtor countries bear these huge debts alone and that creditors should bear co-responsibility for negligent, politically motivated lending<sup>9</sup>.

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<sup>6</sup> *Ibid*

<sup>7</sup> Cited in Adams, *ibid*. p. 3-4.

<sup>8</sup> Hanlon, 2006, p.8.

<sup>9</sup> EURODAD, 2006.

## 3.0 LEGAL & INSTITUTIONAL BASES OF ILLEGITIMATE DEBTS

What is the legal status of the loans agreements that create the bilateral and multilateral debts? What if the loans agreements are invalid from domestic laws and international laws perspectives? Should the people of a country be burdened to repay the debts when the debts are illegitimate? What are the responsibilities of the creditors?

The foreign aid is based on agreements or treaties between a country and another country or other countries, and between a country and international organizations. The arguments for the illegitimacy of foreign debts in Indonesia are based on both international laws and domestic laws. Therefore before we put certain foreign debts into the category of illegitimate debts, we have to explore the legal basis of the foreign debts both in the international laws and domestic laws of Indonesia.

### 3.1 Loans Agreements as International Treaties

Foreign debts are made based on the loans agreements between the debtor country and the creditor country or between the debtor country and the international organizations. The loans agreements are parts of international treaties since they are made between the legal persons of international laws.

The loans agreements, to be binding, are also parts of the national laws. National laws are the laws that are applied within a territory of a country to regulate the domestic affairs, while international law regulates the affairs of the state in its relations with other states and international organizations.

The international law that regulates the international treaties (including agreements) is the *Vienna Convention on the Law of Treaties* that was signed on 23 May 1969 and entered into force since 27 January 1980. The convention is briefly called the *1969 Vienna Convention*. The international law that regulates the treaties (including agreements) between state and international organizations is the *Vienna Convention on the Law of Treaties between State and International Organization or between International Organizations*, which was signed on 21 March 1986, and is called the *1986 Vienna Convention*.

Loan agreements between individuals or between individual bodies (such as private companies) or between an individual and legal bodies are included in the private laws. Loan agreements in which one of the parties is the government, the agreements are included in the public laws, since it affects the legal rights and legal obligations stipulated in public laws. The loans agreements emphasized in this research are those between Indonesian government and other countries and international organizations.

A treaty comes into force based on the agreements among the parties signing the treaty. Chapter 2 of 1969 Vienna Convention stipulates that a treaty comes into force according to the procedures and dates decided in the treaty. A treaty can be enacted partially or the whole for temporary period since the treaty is signed while waiting for the moment or the requirements for validity, if in the treaty it is stated so. The temporary enactment is based on the Article 25 of 1969 Vienna Convention. The international treaty is regulated in that way to fulfill the constitutional requirements of each state.

The cancellation of an international treaty is caused by the invalidity of the treaty. The invalidity of treaties is determined by two aspects: (1) formal irregularities and (2) substantial irregularities.

Formal irregularities refer to a treaty that is invalid if the treaty is not made in the right procedures; that is:

- It violates the procedures of national laws
- Approved under violent repression

Substantial Irregularities refer to a treaty that is invalid if:

- Substantially contrary with the Constitution
- Contains an error
- If the state or the international organization as the party in the treaty cheats during the negotiation process.

## 3.2 Developments in International Law

International laws are discussed in the International Law Commission (ILC) and decided in the General Assembly of the United Nations. There are some important developments concerning the implementation of the international conventions on treaties (the 1969 Vienna Convention and 1986 Vienna Convention) that have become topics of discussions in the ILC meetings that came out with UN resolutions such as: *Unilateral Act Of States*, *Responsibility of international Organizations*, *International Liability in Case of Loss From Transboundary Harm Arising Out of Hazardous Activities*, *Responsibility of States for Internationally Wrongful Act*.

In the debate about the Responsibility of International Organizations that was started in 2000 until 2005, ILC discussed about the treaties and rules that are invalid or that are violations according to international law. The discussions indicate that international organizations (such as World Bank, IMF, ADB, etc.) cannot freely conduct their actions without considering international regulations and law.

The Responsibility of States For internationally Wrongful Act has been discussed and adopted as the UN Resolution No. 56/83 in December 2001. The Resolution outlines the rules about international responsibilities of a state to the actions that are internationally invalid.

The developments in the UN concerning the international treaties show that each international treaty and international relations has to comply with the international law, that can be monitored, and each party can be asked to be responsible and even can be brought to international courts. No state and no international organization have the right to abuse power and violate international law against other states.

## 3.3 Foreign Loans in Indonesian National Law

The national laws about international treaties have been regulated clearly in the 1945 Constitution of Indonesia and some operational laws. The loans agreements are included as international treaties.

### 3.3.1 1945 Constitution

The procedures for making international treaties by Indonesian government has been regulated in the 1945 Constitution and other laws that become guidelines for making international treaty.

#### a. 1945 Constitution before the Amendment:

##### Ø Article 11:

This article emphasizes that all treaties (including loans agreements) have to be approved by the Parliament.

#### b. 1945 Constitution after the Amendment:

##### Ø Article 11:

- 1) *The President, with the approval of the Parliament, declares war, makes peace and treaties with other states.*
- 2) *The President, in making other international treaties that cause broad and substantial impacts to the life of the people that concerns with the burdens of state finance, and/or requires the change of laws, the treaties should be made as laws that should be approved by the Parliament.*
- 3) *The further stipulations about international treaties are regulated by laws.*

### 3.3.2 The President's Letter No. 2826/HK/60, dated August, 22, 1960 about the treaties with other states

In the implementation of the 1945 Constitution, before and after the amendment, the government of Indonesia uses the Letter of the President No. 2826/HK/60, dated August, 22, 1960, that was made by President Soekarno as the guidelines for making international treaties. The President's Letter actually cannot be included as part of the national legal system of Indonesia, as stipulated in the regulations on the structure of the laws. In reality the Letter was used as the guidelines for making and validating international treaties by the government of Indonesia, and is always quoted as consideration in making related laws.

The President's Letter stipulates that according to the government's "interpretation" the Article 11 of 1945 Constitution "does not include all treaties with other states", but covers only "important" ones. What the government means by "the important ones" is, according to President Soekarno, the treaties that "relates to political affairs".

There are three criteria to include an international treaty as "important" treaty, namely:

- a. The treaty that brings implications to the "orientation of foreign policies" of Indonesia such as the friendship treaty with other states, the formation of alliance and the decision on and change of the borders;
- b. The treaties that might influence "the orientation of foreign policy" of Indonesia, such as the agreements on economic cooperation, technical cooperation, and the foreign borrowings;
- c. Affairs that according to the Constitution and the laws have to be regulated by laws, such as citizenship, judiciary, extradition, etc.
- d. According to the Presidential Letter of Soekarno, treaties with other states, other than those mentioned in the above three criteria, do not need to get consent or approval from the Parliament. The agreements are made by the President and afterwards the Parliament is reported only for "information".

The President's Letter No. 2826/HK/60 was then strengthened by the Letter of the State Secretariat Minister No. 202/M.M.Sekneg/8/1975 that was issued in the era of President Suharto. Both the President's Letter and the Letter of the State Secretariat Minister are substantially against the stipulations in the Constitution. The interpretations of the article in the Constitution are mainly influenced by the characteristics and interests of the regimes, and do not reflect the national interests; and therefore cannot be used as guidelines for making international treaties for foreign aid.

These regulations were, however, implemented by almost all Presidents since President Soekarno, Suharto, Habibie, Abdurahman Wahid, Megawati and the present Susilo Bambang Yudoyono. Before the issuance of the Letter of President Sukarno, namely from 1950 to 1958, the loans agreements by the government of Indonesia with other states and other international organizations were discussed and made as laws by the Parliament.

### **3.3.3 The Decision of MPR RI No. IV/MPR/1999 about the General State Guidelines for 1999 – 2004.**

In the Chapter IV about the **Orientation on the Policies for Law**, section 4, it is stipulated that "To continue the ratification of international conventions, particularly those related to human rights based on the national interests and needs in the form of legislations". In the section about international relations it is stipulated that "international treaties and cooperations that are related to the national interest and the life of the people have to be approved by the Parliament". Foreign aid (loans and grants) is related to the interest and life of the people, and therefore have to be approved and made as laws by the Parliament.

### **3.3.4 The Law No. 37/1999 about Foreign Relations**

The law incorporates the international laws and norms into Indonesian national laws. Explicitly it is stipulated in the chapter 5 of the law. The law stipulates that the power to implement foreign relations is in the hand of the President, except in declaring war, making peace and international treaties (chapter 6).

### **3.3.5 The Law No. 24/2000 about International Treaties**

#### ***(1) The power of the Ministry of Foreign Affairs***

The law gives power and authority to the Minister, who is responsible for international relations and foreign policy, to provide political considerations and take necessary measures in making and ratifying international treaties (chapter 2). This means that any international treaty has to pass through the ministry of foreign affairs to get political considerations and to take any measure in making international treaties.

In reality, most of the loans agreements do not involve discussions with the ministry of foreign affairs, so that they are free from strategy and foreign policies of Indonesia; while most countries use loans and grants as parts of their foreign policies.

## **(2) The Acceptance and Ratification**

International treaties can be ratified by Laws or Presidential Decision (Article 9). In the article 10, it is stipulated that foreign loans and/or grants are included as objects of international treaties that have to be ratified as laws. This means that loans and/or grants agreements have to be approved and made as laws by the Parliament. In reality some foreign loans are made as Law, some are made by Presidential Decisions, and even some have no national legal format.

## **(3) The termination of a treaty**

An international treaty or agreement is terminates (article 18) if:

- There is an agreement among the parties using the procedures as stipulated in the treaty;
- The goal and objectives of the treaty have been achieved;
- There are substantial or fundamental changes that influence the implementation of the treaty;
- One of the parties does not implement or violate the stipulations in the treaty;
- A new treaty is made to replace the old one;
- There are new norms in international laws;
- The objects of the treaty are lost;
- There are stipulations that bring loss to the national interests.

The Article 18 of the Law No. 24/2000 is in line with the stipulations in Articles 60 and 61 of 1969 Vienna Convention.

### **3.3.6 The Law No. 17/2003 about State Finance**

#### **(1) The Management of State Finance**

The law regulates that the President as the Head of the Government holds the authority to manage the state finance as part of the government's authorities (article 6 (1)). In actuating the authority the President gives power to the ministers to act on behalf of the President, as regulated in Article 6 (2), namely:

- a. To the Minister of Finance as the authority holder of fiscal management and as the representative of the government in controlling and managing the state assets;
- b. To the Ministers/heads of government agencies as the users of budget/the users of the goods in their ministries/ state agencies;
- c. To the governor/mayors/heads of districts as the heads of provincial and district governments to manage provincial/ district/municipality finance and represent the regional governments in controlling the assets of the regions;
- d. Not included the monetary authority, which includes printing and distributing money that is regulated by law.

#### **(2) Debts Management**

According to Article 23 (1) of the Law No. 17/2003 that is based on the Article 11 (2) of 1945 Constitution, the Central Government can give grants/loans to or accept grants/loans from foreign states/organizations with the approval of the parliament Furthermore the loans and/or grants received by the Central Government can be lent on to the regional governments/State companies/regional companies (Article 23 (2)).

### **3.3.7 The Law No. 1/2004 about State Treasury**

#### **(1) The State treasurer and its authority**

Article 7 of the Law No. 1/2004 states that the State Treasurer is the Minister of Finance. Including in the authority of the State Treasurer are (a) to make loans and provide guarantees on behalf of the government; (b) to give loans on behalf of the government; and (c) to manage the debts and assets of the state.

## (2) Debts Management

The article 38 of the Law No. 1/2004 stipulates that (a) the Minister of Finance can appoint a state official with an authority from the Minister of Finance to make loans or accept grants from foreign states or from domestic sources based on the stipulations in the Law about State Budget; (b) Loans/grants as stipulated in the Section (1) can be lent on to the regional governments/state companies and regional government companies; (c) the costs for the making loans or grants as stipulated in the section (2) will be borne upon the State Budget; (d) the procedures for making loans/grants both foreign and domestic sources and the lending or granting on to the regional governments/state companies/regional government companies are regulated by **government regulations**.

The stipulations in the Article 38 of the Law No. 1/2004 are **in itself dangerous** and **legally invalid**. The danger is that there is no clear limitation concerning with:

- 1) The maximum limit of loans made by the Minister of Finance;
- 2) The limit of guarantee that is allowed in the loans agreements;
- 3) The definition of the waiver of sovereignty that is allowed in the agreement, such as: the choice of law in settling disputes in international treaties, the obligation to change, terminate and or make laws, etc.

The granting of great authority to the Minister of Finance is susceptible to the abuse of power that might create loss to the state, both in terms of financial losses and the degradation of sovereignty.

The stipulations about the debts management in the Law No.1/2004 is legally invalid and against the 1945 Constitution, particularly Article 11 (2) of the Constitution that requires the approval of the Parliament for all international treaties that are related to state finance. This is different from the Law No. 17/2003 about State Finance that requires the Parliamentary Approval for making international agreements on loans, as stipulated in the Article 23 (1) of the Law.

In the consideration of the Law No. 1/2004 there is no mention of the Article 11 (2) of the 1945 Constitution; and this is different from the Law No 17/2003 that quotes the Article 11 (2) of 1945 Constitution in its consideration.

According to the MPR Decision No. III/MPR/2000 about the Sources of Laws and the Structure of Laws, the Law No.1/ 2004, particularly about the debts management, has to be legally cancelled, since it is against the 1945 Constitution. Instead the debts management has to be based on the stipulations in the Law no. 17/2003 about State Finance.

### 3.3.8 Government Regulation No 2/2006 about the Procedures for Loans and/or Grants

The regulation was made as the implementation of the Article 38 (4) of the Law No 1/2004 about the State Treasury. The Chapter II, Article 2 of the Regulation stated that the government is authorized to make foreign loans (Article 2 (1)). The authority is held by the Minister of Finance (Article 2 (2)). The regulation also prohibits other ministries, government agencies, and regional governments to make agreements that implicates to the foreign loans.

This regulation has weaknesses and might threaten the state finance, because of the broad authority of the Minister of Finance, such as:

- a) Article 13 of the Regulation states that for program loans, the Minister of Finance can propose foreign loans to the potential foreign donors as stipulated in the List of the Priority Plan for Foreign Loans and/or Grants. The broad authority of the Finance Minister can create potentials for lobby by other ministries, state agencies and state companies to the Minister of Finance for programs that can be supported by foreign loans. This can trigger the abuse of power and collusion, corruption and nepotism.
- b) The article 14 (2) states that the negotiations for the foreign loans agreements are conducted by the Minister of Finance or state officials appointed by the Finance Minister by involving the elements of the Ministry of Finance, the Ministry of National Planning and the Ministry of Foreign Affairs, accompanied by legal experts. In the Article 14 (3) it is stated that the scope of negotiations include the financial aspects and the legal aspects. In the Article 14 (4) it is stated that the results of the negotiations should be reported to the Minister of Finance to get the approval and to be made as the Loans or Grants Agreements.

This shows the domination of the Ministry of Finance in the foreign loans and grants agreements. The past experiences show that the negotiations for foreign loans and grants that were dominated by the Ministry of Finance and National Planning were very weak, particularly in accepting the conditionalities. As a consequence, there are loans agreements that have brought losses to Indonesia. The losses, particularly from legal aspects, caused the degradation of state sovereignty, such as:

- i. the making or the changes of laws and regulations;
- ii. the choice of legal dispute settlement do not bring advantage to Indonesia;
- iii. The tax evasion in the purchase of goods and services for the project and program implementation;
- iv. The stipulations about guarantees and collaterals that bring losses;
- v. The stipulations about the payment of commitment fees;
- vi. The fulfillment of other requirements in the loans agreements.

These were signed by the Minister of Finance and become tied to the government, the Parliament and the people.

It should be recognized that foreign loans and grants are parts of foreign policies of each county. Therefore all those related to the legal aspects and international procedures as well as the national strategies in international relations should be under the authority of the Ministry of Foreign Affairs. The role of the Ministry of Foreign Affairs is often marginalized. In a discussion about the role of the Ministry of Foreign Affairs in the foreign loans agreements, the Ministry of Foreign Affairs is seen as inhibiting the success of the foreign loans agreements.<sup>10</sup>

- c. The Article 16 of the Government Regulation states that the Foreign Loans or Grants Agreements and other international agreements in finance are made by the Minister of Finance, and apply since the enactment of the Regulation except if it is mentioned in other ways in the documents.

This stipulation is against the Article 11 (2) of the 1945 Constitution that requires all the approval of the Parliament, and the Law on International Treaties that requires all international loans agreements in the form of laws. Therefore the Article 16 of the Government Regulation No 2/2006 has to be cancelled on behalf of the law.

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<sup>10</sup> Seminar on the Equality in the negotiations of Foreign Loans Agreements, BAPPENAS, Jakarta 10 May 2007

## 4.0 THE INDONESIAN CASES OF ILLEGITIMATE DEBT

### 4.1 Selling Wrecks for a Fortune: The Debts for German Warships

The collapse of the Berlin Wall, which paved the way for Germany's unification, has ironically left a big hole in Indonesia's state coffers. This big hole was created due to the purchase of 39 used former GDR Navy ships by the Indonesian Government, which was not handled by the Indonesian Navy but by the then Indonesian State Minister for Research and Technology, Dr. B.J. ("Rudy") Habibie, with the direct approval of the then Indonesian President, Ret. General Suharto, but with bitter opposition from the Indonesian Minister for Finance, Mar'ie Muhammad.

After a lot of haggling between the two ministers, the price of the 39 used GDR Navy ships – consisting sixteen *Parchim* corvettes, fourteen *Frosch* troop landing ship tanks (LSTs), and nine *Condor* mine sweepers – was set at US\$ 442.8 million, more than US\$ 100 million higher than what the Finance Minister was willing to approve. This sale was supported by a US\$ 200 million loan from the German Government's credit agency, *Kreditanstalt fuer Wiederaufbau*, or KfW, brokered by the German firm, Ferrostaal. In addition, the deal was insured for a total of DM 700 million or US\$ 466 million by Hermes AG, the German Export Credit Agency (Gaban & Muryadi 1999: 9-10; Kaiser & Kowsky 2007: 5).

Since the unified Germany was only allowed to have one fleet, the former GDR fleet had been lying idle for nearly three years at the Peneemunde Wolgast shipyard. The condition of those old Navy ships was very deplorable, according to Indonesian Navy commander, Admiral Tanto Koeswanto who came to inspect the ships before Dr. Habibie's deal with the German government had been set. The Indonesian Navy commanders were not interested to buy those ships. Apart from their old age, the ships' technical specifications did not fit the Indonesian maritime situation. In contrast to the tropical warm sea water in the Indonesian archipelago, the German ships were designed to deal with the cold Baltic waters. In addition, the ships were designed to split the waves for only three to five days, again, since they were designed for the Baltic sea, not for an archipelago of 17 thousand islands (Gaban & Muryadi 1999: 11-12).

The sale of the ships triggered further loans from the German Government to the Indonesian Government, to cover the repair and maintenance costs of the ships. On 17 October 2000, the two governments signed a loan agreement of Euro 28,142,222.00, and on 18 January 2001, two additional loan agreements of Euro 12,319,712 and Euro 980, 414, 43 were signed by the two governments. In 2001 and 2003, Hermes AG granted further cover in connection with the sale of the vessels. In reply to a parliamentary question from the Socialist Party Bench in the *Bundestag*, the German government stated that "the overhaul of eight corvettes came with two export guarantees (Herman-guarantees) of Euro 24.2 million in total" (Kaiser & Kowsky 2007).

#### 4.1.1 Enriching FERROSTAAL and its Indonesian Cronies:

Ferrostaal, meanwhile, also enjoyed high level contacts in the German Government, with the then Chancellor Helmut Kohl sitting on its Board. Kohl, in turn, kept a very close friendship with then Indonesian President, Suharto, and often attended inaugurations of German joint ventures with the Suharto family companies in Germany and in Indonesia. For instance, Kohl visited Jakarta during the public announcement of the Jakarta Mass Rapid Transit (MRT) Project at the end of October 1996 (Aditjondro 2006: 168).

Ferrostaal, which is now a subsidiary of the German large engineering company, MAN, had played an important role in the purchase of the 39 former German Navy ships, by brokering the KfW's credit for the deal. In return, the large German steel and shipping company obtained two major bonuses: it was trusted to coordinate the repair of all the 39 ships, and also managed the training of 1,660 Indonesian Navy personnel in Germany (Gaban & Muryadi 1999: 10).

Ferrostaal's success in brokering KfW's credit for the deal, however, could not be separated from Dr Habibie's role in promoting German business interests in Indonesia, through his youngest sister, Yayuk Habibie, and through Habibie's close links with the Suharto family. For instance, Ferrostaal became an influential shareholder in two companies owned by Suharto's very business-oriented middle son, Bambang Trihatmodjo, namely in PT Samudra Petrindo Asia, a tanker company, and PT Samudra Ferro Engineering.

The first one is an LNG tanker company, which formed a deal with the Indonesian state oil & gas mining company, Pertamina, to ship LNG from Bontang (East Kalimantan) and Lhokseumawe (Aceh) to East Asia, and the second one serves mining operations in South Sumatera (PDBI 1997, Vol. III, pp. A-1120, A-1126, A-1132; Aditjondro 2006: 299, 320).

A much forgotten fact is that before the sale of the former GDR Navy ship took place, Yayuk Habibie had also brokered the sale of 32 Boeing 737-200 from Lufthansa to the Indonesian Government. These old airplanes had already been used by Lufthansa for twenty years. Under pressure from Dr. Habibie and his crony, Transportation Minister Haryanto Dhanutirto, Indonesian state-owned airlines, Garuda and Merpati, agreed to buy seven and three of those used Lufthansa airplanes each. This occurred after Wage Mulyono, then president director of Garuda, was sacked by President Suharto, after he refused to buy the old airplanes (Aditjondro 2006: 299, 321-2).

What is not much exposed is that Dr. Habibie, who at the time of the sale of the former GDR Navy ships was also the Director of the state-owned shipyard, PT PAL, may have pushed for the purchase of the used ships to prevent the shipyard from bankruptcy. During the previous year, in 1993, a controversy had erupted among members of the then opposition party, PDI, concerning excessive expenditure by the company, which failed to pay IDR 300 billion tax it owed to the state. Part of those excessive expenditure consisted of airplane tickets for Markus Wauran, a PDI member of the parliament, and his wife, to Washington, Virginia, Boston, Washington, London, Hamburg, Paris, and back to Jakarta, leaving Jakarta on 20 May 1993 (Aditjondro 1998: 116).

Further research into the round-the-world trip of Markus Wauran, shows the reason for PT PAL's – or, to be more accurate, Dr Habibie's – underwriting of the trip. In addition to strongly opposing his parliamentary commission's investigation of PT PAL's financial mismanagement, Wauran also strongly supported Dr Habibie's nuclear energy ambitions. Under his influence, the entire Tenth Commission of the parliament supported the government's plan to start building nuclear power plants, which was opposed by environmentalists and Abdurrahman Wahid, the leader of the 40-million strong Islamic organization, *Nahdlatul Ulama* (Aditjondro 2003: 165-6).

#### **4.1.2 Membramo Mega-Project<sup>11</sup> and *der Spiegel* Allegations:**

The commercial loans for the purchase of the wrecks by Indonesia is only a dot in the ocean of dirty business and political relations between the German business groups and the German public officials on one hand and the crony business groups and the Indonesian public officials on the other hand. Following is the much bigger context of the dirty business and political relations that came out with the burdens to the poor people of Indonesia.

Due to its closeness to Habibie and indirectly to Suharto, Ferrostaal had tried 'to sell' another white elephant to the Indonesian Government. This was the huge Mamberamo hydropower scheme in the Northern swamps of West Papua, which was to involve Ferrostaal and two other German giants, Siemens and Hochtief. In April 1997 an official seminar and workshop on the mega-project was attended by private companies from Germany, the Netherlands, France and Japan as well as Indonesia. In February 1998, a former governor of Irian Jaya, Barnabas Suebu, who has been re-elected recently, announced that Germany, Japan and Australia had agreed to invest in the project.

No official announcements on foreign participation were ever been made. Watch Indonesia, the NGO that tracks German involvement, believes that bilateral discussions on the project were deliberately kept low-key. A December 1997 meeting of the German Indonesian Forum (GIF), a group representing business interests in both countries, included an unpublicized workshop on proposed industrial development in the Mamberamo region, on the northern swampy lowlands of West Papua. The participants included representatives from the companies Ferrostaal and Siemens. The terms of reference show that German, and to a lesser extent, Australian funding will be used in conjunction with Indonesian state funds for many of the feasibility studies. The basic preliminary studies were estimated to cost around 13 million DM. Three German companies had already invested about 100,000 DM each in these studies. Their activities were likely to be in the fields of hydro-electric (Siemens/ Hochtief), heavy industry (Ferrostaal) and infrastructure (Hochtief).

Mamberamo is also being promoted as a future food supply centre of national importance, with possibility of a million hectares set aside for rice cultivation to be irrigated from the dam scheme. Like a previous disastrous mega-project in Central Kalimantan, this mega-project was packaged as part of the strategy to salvage the country's self-sufficiency in rice.

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<sup>11</sup>) The section on Mamberamo is based on reports by a pro-indigenous group, *Do or Die* (Issue No. 8), Watch Indonesia (May 1998), a Berlin-based human rights group focusing on Indonesia, and the author's recollections from his field work in the Mamberamo River Basin in the early 1980s (see Aditjondro 1983a, 1984b).

There were plans to move about 300,000 people from the western parts of Indonesia to the area to provide the workforce for the agricultural projects. The village of Kasonaweja, capital of Central Mamberamo sub-district, was going to be the site of the shipping terminal, warehouses, offices and a trade centre.

The Mamberamo development plan was part of the rush to develop the Eastern part of Indonesia and populate them with hundreds of thousands of Indonesians from the more densely-populated island of Java, to make it harder to justify the claims of the Papuans for independence. The Indonesian state needs to be able to turn the natural wealth of the area into power to keep itself propped up over the coming years. Thirty four potential sites for damming the river were identified on the Mamberamo and its tributaries. Two of these, both on the Mamberamo itself, were identified for further studies. They were called Mamberamo I (estimated to produce around 5.700 MW) and Mamberamo II (933 MW). The subdistrict capital of Central Mamberamo is the village of Kasonaweja, 135 km from the mouth of the Mamberamo River. There were plans to build a shipping terminal, along with warehouses, offices and a trade centre here. The mountainous region is believed to be rich in minerals, including gold, copper, bauxite and nickel. The development of hydro-power for smelting could make the mining of nickel in other areas feasible.

Reports from the region stated that the process of land appropriation had already begun in early 1998, with the invaders using bribery, threats and trickery against the local people. Then President Habibie was due to announce this project in August 1998. The whole project was shrouded in secrecy. Information about who was involved was extremely hard to come by, though a *Do or Die* contact person visited the region almost a year earlier and said that some construction had already started, ahead of any permissions or approvals.

In 1997, the governor of West Papua said his office would mobilize local people's support for the project. However, the majority of the people had not been informed, let alone be consulted about the mega-project plans. A representative of the people there went to the UN Indigenous People's Conference in Geneva in July 1998, but was not permitted to speak by the people running the conference.

Six thousand people living near the river were to be moved from their forest home to a new town, with the descent into squalor, alcoholism and prostitution that inevitably accompanies such forced relocations. In the soon-to-be-industrial zone, the seeds of a new shanty town were being sown; accommodation for around 3,000 people was already under construction near the mouth of the Mamberamo River.

According to Indonesian official figures, some 7,381 people were living in the area in 1998. They lived a semi-nomadic life by hunting, fishing, horticulture and harvesting sago palms. The peoples of the area include the Namunaweja, Bauzi, Dani, Manau, Kawera and Anggreso tribal groups. There was little circulation of cash in the area and few schools. The lack of money circulation made it difficult for the inhabitants to go to the towns Sarmi or Jayapura for higher education. A crocodile trade existed between the local people and soldiers or traders from other islands. The indigenous Indonesian Protestant Church (GKI di Tanah Papua) and the foreign missionary association, RBMU (*Regions Beyond Missionary Union*) were active in some of the sub-districts of the area. Fishing boats from other parts of Indonesia exploited the fishing grounds, harmed the ecosystem and thereby threatened the resource base of the local peoples.

However, when B.J. Habibie was replaced by Abdurrahman Wahid as Indonesian President, the mega-project was shelved. No significant national or international news have filtered out of this region. What have filtered out, this time from the German news weekly magazine, *Der Spiegel*, were allegations of Ferrostaal's bribery to Habibie, during his Presidency. In its 41 edition in 1999, the German business weekly magazine exposed allegations of bribery by Ferrostaal, amounting to DM 200,000, to Dr B.J. Habibie. According to documents obtained by *Der Spiegel*, the funds were deposited through the tax haven of Lichtenstein at Habibie's bank account in the Hamburg branch of Deutsche Bank. In addition, also Rahadi Ramelan, who had been appointed as Minister of Trade and Industry during Habibie's Presidency, also has had DM 200,000 deposited in his bank account by Ferrostaal's CEO, Klaus von Menges.

The bribes to Habibie and Rahadi Ramelan were meant to ensure that the Indonesian Government would continue ordering Ferrostaal and other German companies, to handle the expansion of the state's steel factory, PT Krakatau Steel, which had been handled earlier by Ferrostaal, Klockner and Siemens. During the time of the bribery, Habibie was holding the portfolio of State Minister for Research and Technology, and Rahadi Ramelan was his good friend.

Delving through a stack of documents, *Der Spiegel* found out that on 20 March 1991, Ferrostaal sent DM 900,000 to Grammont, a Lichtenstein-based institute, which functions as a money laundering vehicle, with a special order to transfer the funds to other accounts. On 10 February 1993, Dr. Menges ordered the institute to transfer DM 200,000 to B. Habibie's account No. 12 04 700 at the Hamburg branch of Deutsche Bank. Other documents showed that Menges also ordered the transfer of DM 200,000 to Rahadi Ramelan's account No. 25 90 693-4 at Deutshen Bank Asia in Singapore, on 23 January 1991.

#### 4.1.3 Enriching the Rich, and further impoverishing the Poor:

Now let us go back to the 39 former GDR Navy ships: what is the current status of these very expensive war ships? Certainly, not all of them are currently in sailing condition. The sixteen Parchim corvettes, which have had their German names changed into the names of Indonesian heroes, were incorporated into the Indonesian Navy's Eastern and Western Fleets. These corvettes are mainly used to combat illegal fishery as well as piracy in Indonesian waters, while the ex East German LSTs are only used to transport transmigrants and rice. Some of them are docked, since their engines have been dismantled and brought to Ukraina, Rusia, for major overhaul services. Meanwhile, a significant part of servicing those ships is still handled by Dr. Habibie's family businesses, involving Yayuk Habibie and Fanny Habibie, under the banner of Ferrostaal (Gaban & Muryadi 1999: 4-5, 15; Thoha 2007: 411-2).

Certainly, the usefulness of the former GDR Navy ships is much below the value of their purchase. According to INFID's investigation, only fourteen of the ships are still listed as Main Weapons on the list of Indonesian Security System, while the rest – 25 ships – could be declared as scrap iron. Nevertheless, contrary to a private agreement between the German and Indonesian Defense Ministries, that "the buyer" (the Indonesian Government) would use the ships "solely for coastal protection, the safeguarding of the sea route and to combat smuggling", the former GDR vessels have been used to repress internal opposition to the Indonesian government, on the following occasions:

- (1) In the summer of 1999, former GDR landing craft were used in the massacre in Timor Leste by Indonesian Army supported militia;
- (2) In January 2000, four former GDR vessels took part in the sea blockade of the Maluku islands. Parts of the Indonesian Army worked closely together with militants from both sides and the Indonesian Navy blockade allowed hundreds of thousands of people to be driven from their villages;
- (3) In March 2000, a former GDR landing craft brought soldiers from the Kostrad<sup>12</sup> infantry battalions 515 and the *Kopassus (Special Forces)* to the offshore island of Biak in West Papua. The same vessel had already brought troops to the island in July 1998 who, on 6 July 1998, killed at least eight and injured 37 people in a bloody suppression of a demonstration by unarmed civilians;
- (4) In May 2003, another former GDR vessel landed troops and tanks in the vicinity of the port of Lhokseumawe in the province of Aceh. In a raid, the troops killed ten villagers, including a twelve year old boy (Kaiser & Kowsky 2007).

#### 4.1.4 Conclusion

Two major conclusions can be drawn from this case study of the sale of half of the GDR fleet to Indonesia. Firstly, all German loans to Indonesia, related this sale, including the 'after sales' loans to enable the repair and maintenance of the used vessels, clearly fulfill Sack's principles of odious debts. The loan was not employed for the needs and in the interests the Indonesian State, which could be seen from the reluctance of the Indonesian Navy to buy those used ships and the courageous opposition of the Indonesian Minister of Finance, Mar'ie Muhammad. Then, although not stated explicitly, the loans were employed more for the interests of a major German company, Ferrostaal, the Indonesian state-owned shipyard, PT PAL, and businesses owned by relatives of then Minister of State for Research and Technology, Dr. B .J. Habibie, who used PT PAL and other state companies under Dr Habibie's mandate as milking cows. Habibie family businesses involved in the maintenance and repair of the German vessels are operating under the banner of Ferrostaal. Consequently, the fact that news weeklies which exposed the opposition of the Minister of Finance to the deal, namely *Tempo*, *Editor* and *Detik*, were banned by the Minister of Information, at the request of the President, further shows that the deal was for personal rather than for State purposes, with Habibie's personal interests covered up by the President.

<sup>12</sup> Kostrad is the Special Strategic Command of the Army.

Therefore, since the German Government committed a hostile act against the people and the State of Indonesia, all the loans related with the sale of those ships should be canceled by the current German Government and what ever part of the debt that has been paid by the Indonesian Government should be returned to the Indonesian state coffers.

Secondly, this case study shows how odious debts have a double, contrasting, effect: these debts subsidizing rich German and Indonesian officials, while further impoverishing the Indonesian people, who have to pay the debts incurred by the Indonesian government to their German counterpart.

In this deplorable case, the German Government has used the close friendship of then Chancellor Helmut Kohl with then Indonesian President Soeharto, as well as the close links of then Indonesian Minister for Research and Technology, Dr. Habibie, with the German transnational corporation, Ferrostaal, to dump used former GDR Navy ships on the shoulders the Indonesian Government. Neither the Indonesian Navy nor the Indonesian people have benefited from this deal, although all Indonesians are still burdened with the loans and associated interest. The only parties which have benefited from this deal are Ferrostaal and Dr. Habibie's family business.

From legal points of view, the loans and loans agreements qualify the illegitimate debts. First, the loans agreements violated the 1969 Vienna conventions on international treaties namely the Article 48 on Error, Article 49 on Fraud, and Article 50 on Corruption. Both German public officials and the brokerage company (Ferrostaal), and Indonesian public officials knew that the ships could be used but then they also knew that the ships were proved to be useless. The parties in the agreement cheated the public of Indonesia by providing wrong information about the use and the conditions of the ships. Furthermore each party knew that the transaction involved bribery and corruption (mark-up of prices).

Second, the loans agreement also violates the international conventions on corruption. The loans clearly involved corruption and bribery on both side: German Company and officials and crony business groups in Indonesia. The UN Convention against Corruption, Article 34, states that corruption can become a legal factor to annul an agreement or contract. The 1969 Vienna Convention, Article 50, also mentions that if the representative of the state commits corruption the treaty or agreement is invalidated.

Third, the loans agreement violates the Indonesian constitution stipulating that the loan agreement should be approved as law by the Parliament. This loan agreement violates the Chapter 11 of Indonesian 1945 Constitution, and the Article 46 of 1969 Vienna Convention about the national procedures.

These loans for the German warships are not only illegitimate, but also criminal from the point of international conventions on corruption and anti-bribery. Therefore the people of Indonesia are not obliged to repay them, and even the agreements are subject to be brought to the criminal court on corruption. Both parties are involved in the wrongful acts. The German public officials and company (Ferrostaal) have to be processed under the European Law on anti-corruption and the OECD anti-bribery convention, and the UN Resolution on anti-corruption; while the Indonesian public officials and private companies involved in the abuse of functions and corruption have to be brought to criminal court on corruption.

## **4.2 ADB Loan for Tree Crops Brings Misery to Farmers**

### **4.2.1 Background and Summary**

In April 2007, more than 100 farmers from the Bengkulu province in Sumatra held a demonstration in front of the office of the Ministry of Finance in Jakarta. They demanded that the credit payment the farmers was forced to pay as part of the Tree Crop Small-holder Sector Project (TCSSP), be cancelled, because of its failure and it brought misery to the farmers.

The project mentioned came from an ADB loan, which was approved in November 1992, amounted to US\$ 135 million. The objective of the project was to alleviate poverty by improving the income and employment prospects of rubber and tea smallholders and landless rubber tappers in the project area by increasing production through the introduction of improved crop varieties and cultivation practices. In other words, it intended to provide assistance to farmers to plant good quality rubber and tea trees. The project ended in 2001, and ADB had reported in its Project Completion Report for TCSSP (PCR: INO 22290) in July 2002, that the project was rated as successful.

However, contrary to what the ADB said, an NGO research in one of the project area, Bengkulu, from the testimony of the farmers effected, and even also from ADB's own assessment document, showed that the project had failed, because the funds was highly corrupted, the seedlings provided were bad seeds so they cannot make money from it, and until present, the farmers cannot get back their land certificates which were kept by the authorities as collateral.

#### 4.2.2 Project Overview

The Tree Crop Smallholder Sector Project (TCSSP) began in 1992/1993 and ended in March 2001. The total planned budget fro the project was US\$ 225 million, comprising \$ 135 million from ADB loan, and the remainder, \$ 90 million, from the Government of Indonesia. The primary output of the project was to establish and maintain (1) about 75,000 hectares (ha) of rubber plantations in South, East, and Central Kalimantan, Aceh and Bengkulu; and (2) about 20,000 of tea plantations in West Java. A total of 23 subprojects were to be developed, each covering an area up to 5,000 ha. It also included two pilot projects, one to establish 10 small rubber tree nurseries in Aceh, Bengkulu, South Kalimantan, East Kalimantan and Central Kalimantan, and the other to establish about 2,000 ha of drought-resistant tree crops in the relatively dry provinces of West Nusa Tenggara (NTB) and East Nusa Tenggara (NTT) provinces. The executing Agency for the project was the Ministry of Agriculture (MOA).

#### The Project had three components:

(i) **Part A: Rubber and Tea Plantations.** This part involved (a) land development, replanting and new planting of rubber and tea; (b) construction of roads and bridges, and upgrading/construction of office buildings for certain project management units (PMUs); (c) provision of agrochemicals and field maintenance costs to participant farmers through suitable credit arrangements; and (d) provision of planting materials to the participant farmers.

(ii) **Part B: Pilot Project.** This part involved (a) land clearing and construction of access roads and internal roads; (b) perimeter surveys of the land to be used; (c) provision of planting materials and agrochemicals; and (d) provision of extension, field maintenance, and project management services.

(iii) **Part C: Support Services.** This part involved provision of (a) local training and extension services to the participating farmers and staff of the Directorate General of Estates (DGE) and other agencies of the Government responsible for carrying out the Project; (b) support for project administration and management; (c) vehicles and equipment; (d) inspection services and monitoring and evaluation; and (e) consulting services.

To implement the project, the farmers were required to have at least 1 ha of land. The assistance was in the form of 500 seedlings, land preparation cost, land certification, and a loan for fertilizer and production facilities. The credit was to be paid back in the fifth year. For five years, the farmers were to be reimbursed for the cost of maintaining their trees. This loan and credit scheme was administered by the respective Project Management Units (PMU). Collateral was not required, although farmers with land certificates (primarily those in the transmigration areas) were required to give these land certificates to the PMU. In the Loan Agreement, the interest rate on the credit to farmers was intended to be less than the average Indonesian Central Bank rate, which was 16%. But in practice the interest rate was fixed at 16%.

#### 4.2.3 Debt and Repayment

As stated above, at appraisal the project cost was \$ 225 million, with a 25 years maturity date and 7 years grace period. The ADB loan was \$ 135 million, of which \$ 73 million was in foreign exchange, and \$ 63 million was in local currency. At completion, the total cost was \$ 182.2 million, which 106.4 million of it was financed by the ADB. An amount of \$28.6 million (21%) was cancelled from the loan during implementation.

The actual project cost was lower than at appraisal in dollar equivalent terms primarily because of the local cost savings from the depreciation of the Rupiah against the dollar. At appraisal, the exchange rate was Rp 2,000 to \$1.00 and during implementation the exchange rate rose to over Rp12, 000 to the dollar. Also, the unit costs for civil works were lower than at appraisal; replanting of existing rubber and tea plantations did not take place, as MOA preferred to open up new areas which were cheaper to prepare as only grasses and scrub trees had to be cleared. Low cost were also the result of lower wages paid to farm laborers.

#### 4.2.4 Project gone bad: Reason for illegitimacy

The project completion report (PCR) for TCSSP reported that the project achieved all of its development objectives and met all of its physical targets, which was to alleviate poverty by assisting farmers to plant good quality rubber and tea trees. However, a study that was done in one of the project area, in the province of Bengkulu, Sumatra, has indicated otherwise, that poverty in that area has not been alleviated and that the project had failed. Another study of another project site in Kalimantan in one of ADB's own document also showed that the project as successful as the PCR claimed.

In Bengkulu, the initial target was to plant 5,000 Ha of rubber in South Bengkulu. But then it expanded to 12,850 Ha in North Bengkulu to compensate for area reduction in South Kalimantan. At the beginning of the project, the farmers were enthusiastic to participate in the project with the hope of getting better income. Many farmers in Bengkulu enrolled for the project. But to the farmers' disappointment, ten years later at the time of harvest, the trees could only produce very little rubber. According to the farmers, it was because of bad seedlings. They could only harvest 50 kg (total) of rubber maximum per week, which they sold for Rp 2,000 to Rp 2,400 per kg (US\$ 1 = Rp 9,000 approximately). Subsequently, most the farmers cannot pay their debt. Only very little of the debt was collected (see Table 2).

**Table 4.1 Farmers credit payment collected in Bengkulu**

			Debt*) (Rp 000)	Credit payment		Remaider	
	Ha	Farmers		(Rp 000)	%	(Rp 000)	%
North Bengkulu	2,270	2,587	3,379,341	486,679	14	2,892,661	86
South Bengkulu	2,082	2,216	3,364,896	153,473	6	3,231,423	95

Source: P2BPR Bengkulu 2002

\*) Excluding 16% interest

While a case study on the project in East Kalimantan also found a problem with seedlings, and therefore rubber production was not satisfactory. After looking at the land quality, planting season, and maintenance activities, project officers concluded that the problem might be the seedlings. It was also found that the seedling contractor was using a grafting technique instead of the correct method of inoculation.

The study report then concluded that the TCSSP was designed and implemented in the conventional top-down manner. The people were unable to participate in planning or monitoring, a lack of trust prevailed, and there was no effort to control dishonest business practices. The farmers were simply technology users; there was no systematic improvement in their knowledge of plantations.

As a result, the PCR reported that debt collections were very low in all of the project area. The approximate monthly payments for each farmer are Rp 60, 000 - Rp80, 000 for rubber, and Rp 40, 000 – Rp 50, 000 for tea. These compare to appraisal estimates of monthly payments of about Rp 111, 200 for rubber and Rp 39, 250 for tea. Table 2.2 shows the total debt (interests plus principal) due and the amount collected.

**Table 4.2 Debt payment due and collected (Rp million) – as of Dec 31, 2001**

Item	Due	Collected	% Collected
Rubber	77,895	2,381	3.1
Tea	20,165	740	3.7
Cashew	73	22	30.1
Total	98,131	3,143	3.2

Source: ADB PCR: INO 22290

Because of the debt burden they carried, and other implications that went along with it, in December 2001, the farmers in Bengkulu filed a complaint to the Government of Indonesia (Plantation Service), asking the government and the ADB to conduct a field investigation and help solve the problem. Both parties obliged and sent their team to do a review and survey on the area. The reclassification team that was formed by the Governor of Bengkulu on March 12, 2003, concluded that 80% of the seedlings did not match the standard seeds as stated in the agreement. The review was then reported in ADB document "Aide Memoire of ADB Follow-up Review Mission for Loan 1118-INO: Tree Crop Smallholders Sector Project".

However until now, the farmers haven't received any kind of compensation from the reclassification that was promised to them. Many of the farmers, particularly those who are in transmigration areas, cannot have back their land certificates, which they have given to the PMUs as collateral. Consequently, more than 90% farmers became labors in the private rubber Plantations Companies (PT Air Muring, PT. Agrisinal, PT Agromuko etc).

Moreover, the complaint the farmers filed to the court of first instance in Bengkulu had proved that a number of the project fund was corrupted by the authorities. The court's verdict declared that the corruption from the TCSSP had inflicted a loss to the country from funds for drainage and road building that was corrupted, and also had caused deficit to 3,470 farmers by corruption of seedlings procurement, reducing fertilizers, purchasing equipment that is below standard, and for withholding land certificates of TCSSP participants.

The project basically failed, and has brought misery to the farmers, who have relied their future livelihood from the plantation. The project failed because of corruption of the Indonesian government officials and the sub-contractors. Although it has been proved in the court that there was corruption in the project, the project was continued, and even the ADB report noted it as successful. This is against the article 50 of 1986 Vienna Convention on corruption and Article 48 of 1986 Vienna Convention the error in the documents of agreements. The parties in the agreement knew that the project was not successful, but it was reported successful. Both parties ignored the facts that the project has made people live in deep destitution.

### **4.3 Bilibili, Lau Renun and Asahan Dams: Japan's Problems in Indonesia**

The relations between Japan and Indonesia since Suharto era have been steadily close and intense. This is indicated from the fact that Indonesia is the biggest recipient of Japan ODA. During the transition period from President Sukarno to President Suharto, Japan was involved in facilitating the meetings of the developed countries who were interested to support Indonesia through Tokyo Meeting in 1966. Japan was an active member of the Intergovernmental Group on Indonesia (IGGI) and then the Consultative Group on Indonesia (CGI). The relations in fact benefit more for Japan rather than for Indonesia. Indonesia was treated as backyard of Japan, for dumping used technology and for upgrading skills of the young Japanese engineers by working in various construction projects in Indonesia. The intensive relations between Indonesia and Japan through construction projects can be seen clearly from the presence of the Japanese consultants who occupy almost all floors in the office of the Ministry of Public Works. The office of the Ministry of Public Works in Jakarta has long become the base for the Japanese consultants, so obvious that someone cannot distinguish whether this Ministry belongs to the government of Indonesia or the government of Japan.

Suharto's regime put emphasis on the infrastructure development that was mainly supported by Japan government through the Japan Bank for International Cooperation (JBIC). There are six main sectors that are the key priorities of Japanese ODA: *agriculture, public health and medical services, education, energy, transportation, and water supply*.<sup>13</sup> Until 1999 the Japanese ODA for infrastructure absorbed 32% of the total ODA to Indonesia that included electricity supply, dams, telecommunication facilities, railway, airports, seaports, undergrounds passes, highways (or toll roads), etc. The biggest portions of the Japanese ODA go to the construction of dams.

There are three dams that are included in this study: Bilibili Dam in South Sulawesi, Lau Renun Dam and Asahan Dam in North Sumatra. These dams were constructed to provide electricity for industries and mining operations. All three dams are supported by tied loans.

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<sup>13</sup> Japan's ODA 1990 Annual Report, Ministry of Foreign Affairs, March 1991

### 4.3.1 Bilibili Dam

In 1976 Makassar City, the capital city of the Province of South Sulawesi, was flooded. In 1977 the International Engineering Consultants Agency (IECA) with the support of JICA conducted a preliminary survey in Jenebrang River, and concluded that there is a need for the construction of a multipurpose Bilibili Dam. The Ministry of Public Works implements the project called The Main Project of Jenebrang River Area Development and the Development of Multipurpose Bilibili Dam. The funding of the project consists of:

- a) The construction of Bilibili Dam: IDR 5,381 billion (from JICA);
- b) Conservation of water sources of Jenebrang Project: IDR 2,805 billion (from JBIC);
- c) The project for standard water supply in South Sulawesi: IDR 16,622 billion (from JICA)
- d) Costs for other components of the projects: IDR 1,599 billion (from JICA);
- e) The development of Hydropower Electricity: IDR 23, 3 billion (from JBIC).

Since 1979 up to 1989 the government and JBIC/JICA conducted several steps of project preparation and implementation: feasibility study and the study of flood control, the design of the dam construction and the design for flood control, and the environmental impact assessment study. In this process the local communities were not informed. The people knew about this mega project from rumors when a construction company (PT Krisna Karya) constructed the Makassar – Jeneponto Road. The rumor said that the dam would be constructed and the village of Bontoparang would be flooded.

Though the people protested, the construction of the Hydropower Electricity of Bilibili Dam continued. In the preparation phase of the project, the people were relocated. The land cleared for the Bilibili Dam construction was 2,553 hectares including residential areas. There were 1,879 households to be relocated. According to the Decision of the Governor of South Sulawesi No. 611.11/ 4269/1991, the total population relocated was 7.846 people (around 1,879 households). The relocation processes took two methods: local transmigration that was supported by the government, or self-choice program. For the first method, the government provided the new locations, while for the second method, the people chose their own new locations and the government compensated the properties (including lands) in their original places. There were 1,238 households took the second option, while only 740 households took the first option. From the first group, there were 540 households who were transmigrated to Mamuju District and there were 200 households transmigrated to Luwu District. Those who chose the second option only moved to the locations around the Dam areas, to higher places by purchasing new lands or using the lands they inherited from their ancestors<sup>14</sup>.

The people were not given more choices and had weak bargaining position in negotiating the compensations. This is common in the dam projects, where people who resist to their demands for compensation would face the fact of being flooded by the dam water. The process in Bilibili dam was quite different from other dams in Indonesia where military repressions were used. There was minimum military and police intimidation and repression; but the people have been divided using the feudalistic-bureaucratic lines.

#### The Impacts of Bilibili Dam

In July 2001, the Center for Quality Control of Construction (PPMK) of the Ministry of Public Works conducted an assessment of the quality and benefit of Bilibili Dam. PPMK made assessment of the Bilibili Dam, the Karet Dam and the installation of water purification of Samba Opu. The assessment was aimed to answer the question: has the benefit of the asset for the promotion of the social welfare of the local communities optimally been achieved?

The assessment report consisted of: the multipurpose dam with the capacity of 375 million m<sup>3</sup>; the clean water piping of 16.7 km with the capacity of 3.3 m<sup>3</sup>/second; the installation of water piping of Samba Opu with the capacity of 1 m<sup>3</sup>/second; the flood control of Jenebrang River for 30 km; the urban drainage channel of 15 km; the Karet Dam of 205 m for controlling sea water intrusion; 8 Sabo Dam and Sand Pocket. The on-going actions to produce the optimal benefits included: the construction of irrigation infrastructures for 24,600 hectares by developing 2 new dams and rehabilitating the existing dams (up to 2003); the hydro-power electricity of 16.3 MW (up to 2004); the revegetation of green belt areas of 7,900 hectares in the watershed area; and the plan for establishing a Management Body for Water Resources to manage the use of water in optimum ways.

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<sup>14</sup> The people in Bontoparang told that up to 1993 there were still people living in the would-be-flooded areas until 1995 when the area was totally flooded.

Bilibili dam officially started operating in 1999. The operation of the whole project raised expectations from the local communities, and the potential business people in the area. The Bilibili Dam was intended to (a) reduce the flood, stabilize the supply of drinking water, the supply of water for industries and irrigation; (b) to stabilize the supply of water sources by the water supply installation from Bilibili Dam to the water processing site of Somba Opu to respond to the increasing demand of clean water of the Makassar City.

The development of Bilibili Dam that consisted of three phases delayed. The following table reveals it:

**Table 4.3**

Phase	Planning	Actual
<b>Phase I</b>		
L/A Conclusion	Oct 1990	Dec 1990
Consultant Selection	May 1990 – May 1991	May 1990 – May 1991
Consulting Services	May 1991 – Dec 1998	Jun. 1991 – Dec 1999
Work	Aug. 1992 – Aug 1995	May 1992 – Nov 1999
<b>Phase II</b>		
L/A Conclusion	Oct 1992	Oct 1992
Consulting Selection		
Consulting Services	Aug 1993 – Dec 2000	Jul. 1993 – Dec 2001
Civil Engineering Works (Add )	Sept 1994 – Dec 1998	Jan 1994 – Dec 1999
Equipment Works	Apr 1997 – Dec 1998	Aug 1997 – Dec 1999
<b>Phase III</b>		
L/A Conclusion	Oct 1994	Nov 1994
Consultant Selection	Jul 1994 – Jun 1995	Dec 1994 – Sept 1995
Tender/Contracts	Oct 1995 – Dec 1996	Jun 1995 – Jan 1996
Procurement & Installation	Jan 1997 – Jan 1999	Feb 1996 – Jan 1999
Land Acquisitions (Phase I-III)	1990 – 1995	1990 – 1997

**Source: JBIC Evaluation**

In the official evaluation by JBIC, it was stated that the project has brought positive impacts such as: (a) preventing flood and the damages caused by the flood.; (b) the economic growth is steady as the result of the environmental improvements; (c) the reforestation around the project location that has sacrificed 9,650 hectares of forest cut and 1,850 hectares of forest flooded by dam water; (d) social impacts that include the improvement in the quality of drinking water, the good relocation of the local communities etc.

There are 2,085 households that were relocated because of the project (1990 – 1997). The local government has socialized about the project since 1984 and offered the local communities two schemes of relocation: (a) Local transmigration, and (b) self choice program – SCP). The land and other properties compensation are based on the market prices. The total compensation was 4, 5 billion Yen. From 2,085 households, 618 households were relocated to Mamuju districts (5 locations) and to Luwu district (1 location). Majority of the population (1,467 households) chose to move to higher places or to the locations around the area on their own choice.

In reality, negative impacts came along with the development of the dam. The main impact is that the local people have to change their professions for their livelihood. Before the construction of the dam, most of the people depended on plantation, farming and forestry. After the construction of the dam most of them lost their job and have to find alternatives to survive. The dam has contributed to the degradation of human security of the local communities, particularly the livelihood security of the local communities.

This also happens to the households who were transmigrated to other districts, in Mamuju and Luwu districts. The migrants who were rice farmers have to convert their skills to becoming cacao and palm farmers in the new location since the lands in the new locations suit only for cacao and palm plantation. The transmigrants also had to face social conflicts with the local communities. According to the study of JARI Celebes Raya, 40% of the local transmigrants moved back to their original locations and had to find other alternative sources of income.

The people who took the *Self Choice Program* faced the same problem. They have to become fishers in the dam water with the boat and fishing facilities provided by the government as part of the program. This is new way of life for them and most of them failed because they have not been used to fishing culture.

One of the villages that is directly and badly impacted by the development of Bilibili Dam is Bontoparang Village, in the Sub-District of Parang Loe. It is located straight at the banks of Bilibili Dam. The size of the village is 1,954 hectares with the number of population of 2,572 people (1995). 45% of the area consists of hills and mountains, 35% has become the flooded area of the Dam, and 20% is low lands where the local communities live. The people are working as farmers, freshwater fishers, petty traders, government officials, workers in private companies, contracted workers, etc. The direct impact of the Dam to the people in Bontoparang village is obvious from the fact that the harvest time for the local people degraded. A local citizen (Abdul Malik, 43 years) interviewed during the research expressed that,

“ before the development of Bilibili Dam the local people harvested the rice fields twice a year at minimum; after the development of the Dam, the people have increasing difficulties in cultivating their lands because of shortage of water since Bilibili Dam has been full of mud”.

The local communities expressed that they lost some parts of their rice fields which were flooded by the construction of sand pockets and the mud flowing down from the upstream during and after the construction of the dam.

The situation in Bontoparang reflects the direct impacts of the Bilibili Dam, both for the people who chose Self Choice Program and for the people who moved back from the transmigration areas. The people who chose SCP had to face the fact that they lost their farming lands, and now they have to depend on the fish catch from the dam, opening small food stuffs and move to urban areas to work as pedicap drivers or construction workers in Makassar and Gowa. The people expressed that the development of Bilibili Dam has totally destroyed their livelihood and their social and cultural entities.

Conflicts over the control and management of natural resources along the river between the local communities and the implementer of the project and the government have been taking place. The access of the local communities to the resources is limited while the natural resources have become parts of the cultural and economic activities of the local communities where they rely their livelihood on. The local communities are not involved in the controlling, monitoring and evaluating of the benefits of the project, as has been mentioned in the original plans.

The feasibility of the Bilibili Dam is questionable. Instead of bringing betterment to the local communities, the project triggered accumulated debts to Japan. Before the project finished there were other projects funded by new loans that came up to overcome the impacts coming out from the previous project phases. The Sabo Dam and Sand Pocket for blockading the flow of landslide materials from Bawakaraeng Mountain were not in the initial design of the Project. The new project added 3.8 billion Yen to the original loans, and another 20 billion Yen for developing piping system for water purification. But these two project did not bring any success.

### **Economic impacts**

The compensation process was not finalized. The price of land was decided single-handedly by the government with the price of IDR 900 – 2500/meter, and the compensation procedure was so bureaucratic that prevented the people to continue asking for the compensation. The demand of the local communities for fair compensation was started in 1999 until 2002, but the efforts failed to influence the government and the project implementers.

### **Social Impact**

The relocation of the local households was not well prepared. The new place in Mamuju was a nearly Savannah, where rice could not grow, the water was dirty and the security for the relocated people was not guaranteed. In the new location they had to face the local communities who did not allow the transmigrants to take their lands. Since the intimidation involved the potentials of physical violence, the relocated people had to move back. There were 300 households who moved back to the locations around Bilibili, and only 25 households were left in the new place until now.

## Ecological Impacts

Flood and water crisis continues. In dry season the water in Bilibili Dam becomes shallow and hence the Dam cannot provide enough water supply. In rainy season the mud flow reached up to 29,000 – 152,700 more than 600 NTU limit, due to the erosions from Bawakaraeng Mountain, so that the Dam cannot produce clean water as needed. Makassar and surrounding areas are still flooded since then, and even the ricefields around Bilibili Dam were also flooded that threatens the production of the ricefields.

The erosion materials from Bawakaraeng Mountain cannot be blocked by the Sabo Dam and the Sand Pockets. The materials covered 200 hectares of ricefields in the Lonjoboko village that make it impossible for the local communities to cultivate the ricefields.

The sediments in the Bilibili Dam has built up exceeding the allowable limit. A senior official of JBIC even commented that "It's abnormal that dam lakes are filled with sediments less than 20 years after the completion. Initial design must have been faulty".<sup>15</sup> When the design, that was made by Japanese consultancy firm funded by Japan loans, was faulty that results in the failure of the project and in the accumulation of more debts, who is to be blamed? Or who is responsible for the faulty design? Should the poor Indonesian pay the debts for the projects that were designed by the creditor?

The Hydroelectricity Power of Bilibili started operating in February 2006. Until October 2006, the Hydroelectricity power was only able to produce 20% of its planned capacity due to water shortage stored in the dam. The Hydroelectricity power was planned to produce 20 MW, but in fact it only produced 4 MW at night time and 3 MW at daytime.<sup>16</sup> The national news center *Antara* reported that due to dry season, the water inflow from Jeneberang River declined down to 5 m<sup>3</sup>/second, from the assessed 11 to 12 m<sup>3</sup>/second.

In February 2007 the heavy flow of mud flowing down from the Bawakaraeng Mountain to the Bilibili Dam reached up to 20 million m<sup>3</sup>. The Dam authority said that it was still safe for the dam, while the same authority said that the carrying capacity of the dam is 29 million m<sup>3</sup> of mud. If the mud stored reaches 29 million m<sup>3</sup>, then the dam will no longer function.<sup>17</sup>

### 4.3.2 LAU RENUN DAM

The Lau Renun Dam or *Renun Hydroelectricity Power and Associated Transmission Line Project* was started in 1983 when the feasibility study, project design, project blue print, environmental impact assessment and the areas for relocation of local communities were prepared. In 1986 the study was completed by the Japan Nippon Koei Co in cooperation with the University of North Sumatra to make detailed design for flood control (1984) and the detailed design of the construction of the dam (1986). The Environmental management plan and the Environmental Monitoring Plan of the Hydroelectricity Power of Renun were completed in 1988 by the University of North Sumatra, and the Environmental Impact Assessment was finished in 1991. In the initial plan the physical construction of the project was started in 1993 and finished in 1999, and would start operating in 2000.

The dam uses water from 11 small rivers<sup>18</sup> and is expected to produce 82 MW of electricity power. There are two turbines each producing 41 MW of electricity. It was expected that the hydroelectricity power of Lau Renun would solve the problem of supply deficit of electricity in North Sumatra at peak voltage of 100 – 150 MW. The development of the dam was supported by a loan from Japan OECF (now JBIC), amounted to IDR 532,6 billion that was divided into three loans agreements: 1991, 1993, 1994.

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<sup>15</sup> "Mud Clogging ODA-built dams/Sediment in Indonesian reservoirs building up need for more yen loans", *The Yumiuri Shimbun*, May 14, 2007.

<sup>16</sup> "The Production Capacity of PLTA Bilibili Declines", *SINDO Newspaper*, 2 October, 2006.

<sup>17</sup> "20 million cubic meter of mud flows down to Bilibili Dam", *Tribun Makassar Daily*, Wednesday, 21 February, 2007.

<sup>18</sup> Mbara River in the Parbuluan V Village with the construction of Intake 1, Mbotar River in Parbuluan VI Village dor the construction of Intake 2, Sibira in Parbuluan VI for Intake 3, Simartaban-taban in Pegagan Julu V for Intake 4, Lembara Besar in Pegagan Julu V for Intake 5, Sipatonga in Pegagan Julu V for Intake 6, Sigilang in Pegagan Julu V for Intake 7, Sipatuak in Pegagan Julu IV for Intake 8, Sipaha in Pegagan Julu IV for Intake 9, Pinagar in Pegagan Julu IV for Intake 10, Manasal in Pegagan Julu II for Intake 11 and Renun in Parbuluan V as the Main Intake.

**Table 4.5 Loan Disbursement for Lau Renun Hydroelectricity Power Development**

Items	Phase I	Phase II	Phase III
LA Date	25 September 1991	4 Nov 1993	29 Nov 1994
LA Amount	5,460 Million Yen	15,668 Million Yen	5,479 Million Yen
Interest Rate	2,6 %	2,6 %	2,6 %
Repayment Period	30 Years	30 Years	30 Years
Grace Period	10 Years	10 Years	10 Years

Source: [www.jbic.or.id](http://www.jbic.or.id)

The Lau Renun Dam needs a block of land of 245, 66 hectares that would be used for:

- a) Road access: 34,52 hectares,
- b) Project Construction: 92,62 hectares,
- c) Permanent structure: 109, 52 hectares.
- d) Watershed area: 31,300 hectares.

The lands belong to the local communities. The construction started in 1993 and up to now it has not finished yet.<sup>19</sup>

### The impacts of the Dam

Until now, it is impossible to make benefit analysis of the project and the asset since it is not operating yet. This means that the project delays up to seven years from the time planned.

The development of Lau Renun Dam and the Hydroelectricity Power of Lau Reun was expected to provide the increasing demands of electricity in North Sumatra. Until 2007, the electricity plant has not been operating because of technical problems of the electricity engines<sup>20</sup>.

Since the beginning PLTA Lau Renun has created problems. The first problem is the compensation of the lands and other properties of the local communities. The land take-over process was done under intimidation by the military, the forestry officials and police. Without being informed about the project development, the local communities were forced to sell out their lands with the price of IDR 2,500/meter (20 cent US dollar per meter).

In the meeting with the people in the village of Pegagan Julu IV, during this research, the people expressed that,

“Since the initial process of the development, the local people gave up because of intimidation. The people were invited in the meetings but only as listeners, while the government officials talked and the military equipped with ready weapons accompanied them. In fact the planning of the project did not involve the local communities who are directly affected by the project. The indigenous customary councils and leaders were not also involved. The customary leaders protested during the land clearing using explosives, but their protests were ignored by the national electricity company and the government”.

*The second problem*<sup>21</sup> is that the Lau Renun project directly impacts on the water system in the area. All water flows are channeled to the dam and this has caused the shortage of water for 1,715 hectares of rice fields around the area that depend on the water from the Lau Renun River. Until July 2006 most of the rice fields became dry fields, and contributed to the reduction of rice production in the area.

*Three*, the local customary leaders and councils are not respected while the roles of these local informal leaders are determinant in managing the sources of sustainable livelihood of the local communities. *Raja bondar* (the chairman of the indigenous water management system) has the authority for guaranteeing the sufficient water supply for the rice fields and other farming fields were not consulted by the project implementers. The indigenous water managers were invited by the national Electricity Company and were promised to pay attention to the water supply to the rice fields and farms, and they signed an agreement on 12 June 2003.

<sup>19</sup> Information from the people living around the area of 20 KM water tunnel construction that was developed by Japanese experts and now constructed by Korean experts (Hyundai Corporation). It is suspected that the technological factors inhibit the completion of the project as planned.

<sup>20</sup> *Kompas Daily*, Jakarta, October 2006.

<sup>21</sup> Documentary film of KSPPM about the declining volume of water and the drying of rice fields.

But the agreement was not respected by the project implementers, and the local communities are now facing the fact that the water supply is declining and drought becomes real threat for the local farming, and it impacts to the livelihood of the local communities.

From the present condition, the feasibility study of the dam was not properly conducted. The project did not consider the regional development planning of the Dairi District. The regional planning has identified one problem related to the destruction of the watershed areas of Lau Renun River that will influence the water supply to PLTA Lau Renun. The upstream areas of Lau Renun River have been in critical conditions. The head of the District of Dairi recently expressed that 60% of the forest in the watershed area of Lau Renun River has been damaged. Even since 1982 the forest in the watershed area was only 60% because of forest cutting.

This will threaten the supply of water to the PLTA Lau Renun; while PLTA Renun needs water at minimum of 20 m<sup>3</sup>/second (one turbine needs minimum of 10 m<sup>3</sup>/second). There is a strong possibility that the availability of water supply will not be able to fulfill the needs of water for the PLTA (Hydroelectricity Power Plant).

The conditions of the watershed will also influence the irrigation, the safety for South East Aceh that has been susceptible to landslides and floods, and the security of water supply to Toba Lake. Toba Lake itself is of strategic importance for the Province of North Sumatra for tourism and for the PLTA Sigura-gura that supplied electricity for Aluminum Smelting Factory.

The direct impact of the PLTA Renun has been felt by the local communities, particularly because of the decrease in water supply for their rice fields, as expressed by the people in Pegagan Julu IV Village:

***“In the past we worked and relied on wet rice fields, and now we cultivate dry land farms. In the past we planted and harvested rice, now we planted coffee. The outcome is that our income decrease and we had to work harder than before to earn the same amount of income. This development does not bring betterment for us but worsens our livelihood. We are concerned with our next generation”.***

In other words, Pistar Matanari and Markus Matanari from Pegagan Julu IV village expressed that:

***“We do not have the right to refuse development, even we dream of it as the expression of attention of the government to the people. But we do not want that the coming of PLTA Renun disturbs our livelihood and the security in the communities. You can go on with the development, but do not disturb the security of our water supply”.***

The development of this project has also triggered conflicts among the local indigenous communities. In the compensation process of the lands, certain clans claimed certain lands while other clans claimed that the lands belong to their clans. This had happened between the Pak-Pak indigenous communities and the Batak Toba indigenous communities. Both claimed the same lands that would be used for the dam. The project implementer, instead of solving the agrarian conflicts, even made use of the situation for taking over the lands with low compensation. This conflict will continue and in turn will influence the security conditions in the area.

Lau Renun Dam is a case of a project funded by loans that does not consider the livelihood of the local communities. This is in itself against the basic principles of JBIC itself that used human security as the guidelines of its foreign aid. The Lau Renun Dam shows that the JBIC does not implement its own statutory mandate of human security. The livelihood of the local communities is threatened, while the outcome of the project might be the same like other dams constructed by Japan in Indonesia.

Furthermore the Lau Renun Dam also will contribute to the degradation of the quality of environment around the area. The water from 12 rivers that are channeled to one dam will impact on the water supply that is needed by the surrounding areas. The construction of the dam also did not consider the declining conditions of the watershed areas due to the forest cutting.

As the Bilibili Dam that came out with low production of electricity because of faulty design, the Lau Renun Dam will also face the same vain. If the project fails the people of Indonesia will still pay to Japan, although the failure is also caused by the fault of the Japanese consultants and experts who have been highly paid by Indonesian debts.

The local communities do not receive benefits of the project and the Indonesian poor will also not benefit from the project, but all these poor Indonesian will repay the debts that predominantly consumed by the Japanese experts and supplier industries.

### 4.3.3 ASAHAN DAM

When this report was being written there were two cases that related to Asahan Dam. The first case was the shortage of electricity supply in North Sumatra Province due to technical failure in the electricity supply plants. There was no back up for securing the electricity supply in this third big industrial area in Indonesia. The request to Asahan to divert parts of its electricity supply for public needs was initially rejected, but due to political pressure stating that the contract for PT Inalum would not be extended, the request was fulfilled by PT Inalum.

The second case was the corruption case regarding the Asahan Authority Body. The former Minister of Public Works who was also the former chairman of the Asahan Authority Body was reported to the Corruption Eradication Commission. This was the first corruption case related to Asahan Dam project that is opened to public.

These are only small cases regarding the complicated development process of Asahan Dam project. The project itself can be categorized as highly political, with less economic value for the country.

The development of Asahan Dam is one of the controversial ODA projects in Indonesia. Started with the visit of the Prime Minister Tanaka in January 1974 to Indonesia with a special mission of "diplomacy for securing natural resources supply". Since 1974 Japan prioritized its loans and investments in Indonesia in the sectors of natural resources and infrastructures. It was in this context and framework, the agreement to develop Asahan Dam was made. The Tanaka visit itself was responded by a huge students' demonstration in Jakarta and other big cities in Indonesia, which still monumental in Indonesian political history. The demonstration was targeted against the Japan hegemony in Indonesia. The movement against Japan is called Malari (or translated as *the 15 January Calamity*).

Asahan Dam was one of the results of Tanaka visit to Indonesia. In its initial design, Asahan Project was an integrated project that consists of:

- i. Aluminum smelting factory with the capacity of 225.000 ton/year;
- ii. The hydroelectricity power plant located in Asahan river with the capacity of 600 MW;
- iii. Special seaport with three bridges, consisting of two bridges with the capacity of 16.000 deadweight and one bridge with the capacity of 1,000 Dwt.
- iv. New residential area located at Tanjung Gading to accommodate 2.100 workers of the Aluminum Factory;
- v. Other infrastructure facilities such as roads, bridges etc.

Asahan Project was a mega project that was supported by a package of foreign private investment. The project is owned and operated by PT Indonesia Asahan Aluminum (PT Inalum), a joint venture between the government of Indonesia with 25% of the shares, and Nippon Asahan Aluminum Co.

50 % of the shares of the Nippon Asahan Aluminum are owned by Japan's Overseas Economic Cooperation Fund (OECF) and the rests are by 12 aluminum smelting companies and trading companies from Japan such as Sumitomo Aluminum Smelting Co, Mitsubishi Corp, Marubeni Corp, Mitsui Aluminum Co etc. Japan has the license for 30 years to operate the production since 1983, and after 30 years the Asahan Project will be given to the government of Indonesia.

The total cost of the project when it was accomplished in 1982 was US\$ 2 billion, more than double of the initial plan of US\$ 834 millions when the Master Agreement was signed in 1975. The main reason was inflation.

Although the project scheme was in the form of private foreign investment, in reality Japan provided loans to Indonesia to support the project. The information from JBIC shows that the loans from the Japan government for Asahan Project consist of (see Table below):

**Table 4.6 Loan Disbursement for Asahan Project**

No	Year	Project Name	Amount	Category
1	1970	Asahan Hydroelectricity Power Plant	2,88	Energy
2	1976	Asahan Development Loan (I)	262,5	Public works and Utilities
3	1976	Asahan Hydroelectricity Power Plant	2,202	Energy (PT Inalum)
4	1976	Asahan Hydroelectricity Power Plant	3,401	Energy (PT Inalum)
5	1978	Asahan Hydroelectricity Power Plant	13,700	PT Inalum
6	1978	Asahan Hydroelectricity Power Plant	3,000	PT Inalum
7	1978	Asahan Development Loan (II)	353	Public Works and Utilities
8	1978	Asahan Hydroelectricity Power Plant	2,149	PT Inalum
9	1979	Asahan Hydroelectricity Power Plant	6,200	PT Inalum
10	1980	Asahan Hydroelectricity Power Plant	12,800	PT Inalum
11	1980	Asahan Hydroelectricity Power Plant	1,785	PT Inalum
12	1981	Asahan Hydroelectricity Power Plant	12,100	PT Inalum
13	1981	Asahan Development Project	5,340	PT Inalum
14	1982	Asahan Hydroelectricity Power Plant	4,200	PT Inalum
15	1982	Engineering Services for Asahan Hydroelectricity Power Plant Project	19,84	Energy
16	1983	Engineering Services for Asahan Hydroelectricity Power Plant Project	1,936	Energy
171	1986	Engineering Services for Lower Asahan River Flood Control Project	6,28	Public Works and Utilities
18	2006	Asahan Hydroelectricity Power Plant	27,642	Energy

Source: ODA Statistical Data (in 100 million yen), and the Report of the Registration of Loans and Grants, Ministry of Finance, March 2007.

Asahan project was designed as an integrated project consisting of: the dam for controlling water from Siruar River, the dam for storing water for PLTA Sigura-gura, Tangga Dam for PLTA Tangga, and the repair of Asahan River flows between Porsea and Siruar, and the development of transmission pylons.

According to A.R. Soehoed<sup>22</sup>, there were also other components of the project such as the constructions of supporting facilities along the area between Porsea and the Tangga Falls, the housing complex for the workers at Kuala Tanjung, and the development of the center for telecommunication at Tanjung Gading.

The construction period was planned to be for six years from the preparation up to the production of the aluminum. After the first production, there was a need for two years period for full production capacity of 225,000 ton/year. The development of PLTA Sigura-gura needed five and a half years and PLTA Tangga needed six and a half years for their accomplishment.

To manage the project based on the Master Agreement, President Suharto issued a decree No 5/1976 for the establishment of Asahan Authority Body. The Body was established to support the community development, to oversee the development of PLTA and the aluminum smelting processes.

The local communities do not receive the benefits of the project. According to the chief of Tangga village, Binsar Panjaitan, during the development process, the participation of the local communities was limited to becoming construction workers and security guards. When the development finished the local communities were no longer needed.

“At the time I asked the company to use the local people to take care of the security. But after the project accomplished, nobody is working in the project anymore. The promises of the Asahan Authority Body that the local people would be recruited as permanent workers in the company were only lip services”.

The Asahan Authority Body also promised to support community development, and that PT Inalum would support for the community development were never actualized.

<sup>22</sup> A.R. Soehoed, *Asahan: Impian yang Jadi Kenyataan* (1983).

In 1998 there were some changes, after the people of Tangga village conducted a demonstration to PT Inalum. At the time PT Inalum provided support for schools, the construction of village roads and support for the Independence Day ceremonies. But the demands by the local people to be recruited as permanent workers are until now not fulfilled.

In 2004, according to Binsar Panjaitan, the Asahan Authority Body provided RP 40 million credit for the local community with interest rate of 9%/year for seed capital, and should be paid back by monthly installments to the Body. The community groups used the money as seed capital for small and medium enterprises. Binsar Panjaitan stated that the project in general does not bring benefit to the local communities. There is no farmer group that is supported by the Project, and so are the small and medium enterprises.

“This is what happens with big investment in North Sumatra. It does not bring benefit at all for the local communities. We are still dreaming of the fulfillment of the promises”.

The Asahan Dam Project is controversial since the project as a whole was intended to support private business of Japanese corporations. The electricity produced from the dams is totally for the utilization of PT Inalum (a company which major share holders are the Japanese companies).

In the government loans and grants registration, the beneficiary of the loans is PT Inalum.

The loans are mainly for the interests of Japan government and the Japanese corporations. The contractors of the project developments were from Japan and the equipments were also purchased from Japan. More than 75% of the components of the project were supplied from Japan, and the final use of the project is for Japan's companies. The people of Indonesia have to pay debts that were not used for Indonesian interests, but predominantly for the interests of Japan. These loans are included as illegitimate because of several reasons: (1) it violates the Vienna Convention on International treaties, particularly the Article 48 of 1969 Vienna Convention on corruption; (2) it violates the international conventions on corruption; (3) it violates the national constitution, since the project did not bring benefit to the Indonesian people.

#### **4.4 Conclusion**

There have been legal instruments – both national and international – that can be used as guidance for parties in making international treaties. The international conventions clearly what is right and what is wrong in the international interactions. Regarding the treaties or agreements on loans that involve governments of countries and international organizations, there have been international conventions, laws and UN resolutions. The violations of these conventions and laws can make certain international treaties or agreements invalid or illegitimate.

The 1969 Vienna Convention and 1986 Vienna Convention have clearly regulated the rules for countries and international organizations to make international agreements or treaties, including the agreements on loans. There are also international and national laws that guidelines the right and wrong acts in international interactions, such as the UN resolution on anti-corruption, European laws on anti-corruption and OECD convention on anti-bribery. These laws and conventions clearly stipulates about the right international interactions.

The national laws and constitutions and the statutory acts of the international organizations are also the sources of legal guidelines for each country and international organization in making agreements or treaties with other countries or international organizations. There are many cases of illegitimate debts in Indonesia. In this research there are five cases exposed as examples: the debts for the purchase of warships from Germany, the ADB loans for TCSSP, and three dam projects supported by loans from Japan.

The loans for the purchase of warships from Germany fulfill almost all substantial contents of 1969 Vienna Convention and the 1945 Constitution of Indonesia. The sale-purchase of the warships violates the Article 48 on Error, Article 49 on Fraud and Article 50 on Corruption of the 1969 Vienna Convention, and violates the Chapter 11 of 1945 Constitution of Indonesia. It is not only the debts that have to be cancelled, but the parties involved in the criminal transactions have to be brought to the court, for instance the European Commission for corruption and bribery.

The loans from ADB are included as illegitimate since it violates the 1986 Vienna Convention, particularly the Article 48 on Error and Article 50 on Corruption. Since the projects funded by the loans have been recognized as failure, the debts cannot be burdened to the people of Indonesia. Since the funds for the project were corrupted and it has been proved by the court decisions, and both ADB and the government of Indonesia recognized this corruption, then it is against the law and above international conventions if the people of Indonesia have to be burdened to repay the debts.

All three projects supported by Japan ODA (Bilibili Dam, Lau Renun Dam and Asahan Dam) are not only violating the basic principles of human security as the fundamental principle of Japan ODA, also violates the national Constitution of Indonesia. The dams fail to bring benefit to the people of Indonesia, but even threaten the livelihood of the local communities and contribute to the degradation of environment in the locations of the projects. Japan has to be also responsible for the wrongful acts, since the designs of the projects were made by Japanese experts, the construction works were conducted by Japanese companies, the main equipments are supplied from Japan and some of the utilization of the final products of the projects are for the Japan corporations.

## 5.0 SOCIO-ECONOMIC IMPACT OF FOREIGN DEBTS

The direct impacts of the projects funded by loans to the local communities are obviously clear. The local communities are displaced, they lost their sources of livelihood, the collapse of cultural identities, conflicts among the members of the communities, the loss of collective history and they have to spend more time and energy to start their new life from scratch. The impacts of the two Dams (Bili-bili and Lau Renun) supported by JBIC have been clear for the local communities. Although in the initial plan and in the feasibility studies it was clearly stated that one of the objectives of the dams is to promote the welfare of the local communities, what happened is that the local communities who are displaced lost their very substantial human security; the projects undermined the economic, social and cultural rights of the local communities.

The development of Asahan Dam where the electricity produced is mainly used by the Japan company (PT Inalum) is another case where the people of Indonesia paid the loans (for the development of the dam, for the electricity machineries, for the construction of the electricity installations, the consultancy firms, and the replacements of the electricity engines), but the benefits are enjoyed mainly by Japan's companies. The Indonesians pay for nothing they received. This raised the issue of justice and fairness in the foreign loans transactions.

There were also foreign loans that were supposed to promote people's economy or to support poverty alleviation, but in reality the projects even impoverish the people. The case of ADB's project for supporting small plantations in several regions in Indonesia is one of the cases. To show to the people that foreign loans are used for the fulfilling the needs of the people, some small portions of the debts are used directly with the involvement of the people, such as the *Kecamatan Development Program* (KDP), supported by the World Bank. In reality the project is only to cover the huge grand design by the donor to trap the poor to repay the debts, and to cover the huge programs for controlling the governments (through legal reforms, privatization and liberalization programs).

Other loans (mostly commercial loans) that were used for purchasing weapons were also among the categories of loans that can be included as illegitimate. The people paid for the loans but the commodities purchased by foreign debts are used to harm or to kill the people who paid them or whose children and grand children will pay for the debts. The loans were indirectly used for paralyzing the rights of the people and even eliminate the rights to life of the people.

Physical projects in fact can easily show whether the foreign debts are useful for the people of Indonesia or not. For program loans, it is difficult to evaluate whether they are harmful and make the poor poorer. Therefore it is necessary here to pay special attention to the impacts of the program loans to the economy and social life of the people.

### 5.1 IMF and the World Bank and the Impoverishment Process

During the last 10 years (1997 – 2007) the economic development and the poverty alleviation programs do not show positive support for the people's livelihood; the poverty situation is worsened. One of the low performances of economic development in Indonesia is the decision of the government to receive loans of US\$ 7.3 billion from IMF together with its strong and burdensome conditionalities. Since the signing of the Letter of Intent (LoI) and the Memorandum of Economic and Financial Policies (MEFP) with the IMF, Indonesia has hardly picked up back its economic growth. For 7 years (1997 – 2004) Indonesia signed 20 LoIs with all heavy conditionalities for Indonesia. The result is obvious: the increased poverty, the death toll caused by malnutrition and hunger, and conflicts for appropriating resources.

The LoI and MEFP pushed the government of Indonesia to implement the policy prescriptions from IMF and World Bank that directly affect the condition of the people's livelihood. The conditionalities include, among others:

1. The government is not allowed to control the price and distribution of rice.
2. The government has to cut subsidy to rice price up to zero.
3. The elimination of the prohibition and limitation on the import of rice.
4. The cut of subsidy to agricultural sector up to zero.
5. The privatization of the Logistics Bureau.
6. The elimination of the credit for farmers; the credit should become the business of the commercial banks.

These conditionalities attacked directly to the heart of the livelihood of the majority of the people of Indonesia. Indonesia has been trapped in policy frameworks that result in the impoverishment of the people. The policies include the tight fiscal policies, tight monetary policies, the dependency to external debts, the re-structurization of financial sectors, structural adjustment programs, liberalization of investment and trade, and the privatization of the public services that are substantially fundamental for supporting the fulfillment of the rights of the citizens to food. The closure of 16 Banks, the conditionalities for increasing the prices of 9 basic consumption goods, the massive lay-off of labour in industries have systematically put pressure on the livelihood of the people in rural and urban areas.

The privatization of health services such as the elimination of the cheap services in the Public Health Centers, the increase in the prices of medicines, the elimination of the budget for village midwives result in difficulties for women to and children to access to health services. The health of women and children degraded; the mortality rate at birth and children under five increases. This is worsened by the shortages of appropriate and nutritious food for women and children.

IMF also pushed the policy on food. The government of Indonesia was pushed to increase the prices of rice, soy beans, sugar and flour and adjust them to the competitive global market prices, and open the domestic market to free import of all agricultural products. The control of prices and distribution of agricultural products had to be lifted, and the limitation of import had to be eliminated. The monopoly of import by BULOG (the national logistics bureau) has to be eliminated and the Bureau has to be privatized to become a private company that has to compete with other companies in importing, distributing and collecting agricultural products.

The Memorandum of Economic and Financial Policies (MEFP) that was integrated part of the Letter of Intent (LoI) between the government of Indonesia and IMF on October 31<sup>st</sup>, 1997, were the response to the imposition by IMF. Initially the part of the Structural Reform and Privatization in the MEFP (paragraph 41), the government of Indonesia agreed to lift the control only on the rice of other agricultural commodities except rice, sugar and tobacco, and these would be done after three years. But the pressure from the IMF was so strong that the government of Indonesia had to increase the prices of rice, sugar and soy beans on January 1<sup>st</sup>, 1998.

In the LoI and MEFP signed on January 15 1998 by the government of Indonesia and IMF, the monopoly of BULOG on agricultural products, except on rice, was lifted. Since then the government of Indonesia also eliminated the limitation to the import of agricultural products. As a result, the people had to purchase the basic needs of food in competitive market prices, which are above their purchasing capacities.

The foreign debt stock of Indonesia, both private and public until 2003, was US\$ 134.85 billion. In the period of 1989 – 2003, the debt stock of Indonesia increased by US\$ 82.88 billion or 159.46%. The drastic increase in the foreign debts took place after the economic crisis in 1997. In the period of 2001 – 2003 the debt stock increased by US\$ 9.48 billion. Another thing is that in the period of 1995 – 1997 the private foreign debts increased drastically by 67%. In 1998 the private foreign debts reached the peak of US\$ 83.56 billion. After the crisis the stock of private foreign debt decreased significantly. In 2003 the stock of private foreign debts was US\$ 54 billion. Theoretically the private foreign debts do not put burdens on the government's fiscal, but because the foreign creditors were backed up by the governments and the international organizations (IMF, World Bank and ADB) the private debts were converted to public debts.

Most of the private foreign debts were paid by the government with the *bail-out* scheme as prescribed by the IMF, monitored by the World Bank on daily basis. In only ten years (1989 – 1999), the stock of foreign debts of Indonesia increased by ten times. This was the period when the stabilization and liberalization programs supported by IMF and World Bank were at the peak. This still continues up to present.

In 2005 Indonesia had to pay US\$ 8.3 billion for the foreign debts. The amount does not include the payment of the debts of the state owned companies and the private companies, that reached US\$ 6 billion. In total Indonesia has to pay more than US\$ 14 billion in 2005. This is almost equivalent to the one fourth of the foreign exchange reserves of Indonesia. The payment of the foreign debts absorbed great percentage of annual state budget. In 1997/1998 the payment of the foreign debts was 9.9% of the annual state budget. Afterwards the ratio increased; in 2001 and 2002 the percentage was 25.51% and 26.49% respectively. Although in 2003 the percentage decreased, it still high compared to the allocation of the budget for other sectors that are vital for saving the economy and for promoting economic growth.

**Table 5.1 Public Debt Ratio to State Budget (IDR trillion)**

Details	1997/98	1998/99	1999/00	2000	2001	2002	2003
1. Debts :	10,817	32,864	42,735	50,068	87,142	91,538	81,975
a. Foreign	10,817	24,479	20,505	18,830	28,945	28,325	26,795
b. Domestic	-	8,385	22,230	31,236	58,197	63,213	55,180
2. State Budget Expenditure	109,301	172,669	231,879	221,47	341,56	345,60	364,97
<b>Ratio (% of 1 to 2)</b>	9,90	19,03	18,43	22,61	25,51	26,49	22,46

Source: *State Budget and the Statistics of Economy and Finance of Indonesia*.

The stock of foreign debts of Indonesia for the period of 1969 – 2006 is about US\$ 62,159,086,761. The foreign debts have put pressure on the fiscal deficit, the disparity in the allocation of state budget to social distribution and the pressure on the foreign exchange reserves. Every year the debts that come to maturity reach between US\$ 4 billion to US\$ 5 billion. Up to December 2006, the outstanding foreign debts reached IDR 559,431,780,850,715 or US\$ 62,159. This is excluding the interests.

## 5.2 Debt Payment Ratio

So far the government of Indonesia is trying to reduce the debt stock, by limiting the fiscal deficit, reducing new loans, negotiating rescheduling and negotiating debt swap. This is a standard as recommended by the World Bank and IMF, although this mechanism does not consider justice for the people. From the standard macroeconomy used by international investors, Indonesia's foreign debts actually have reached the secure limit. This is clearly indicated from the ratio of debts to GDP. Theoretically there is no standard for debt to GDP ratio, but investors agree that the safe limit of the debt to GDP ratio is between 30% - 40%. This is still, however, considered high since in Latin America the countries have been struck by debt crisis although the debt to GDP ratio was 34%. Other indicators that can be used to see the safe limit of debt burdens are: the ratio between the debt payment and the borrowing, the ratio between the foreign debt payment and the domestic revenue and export. The following data will show that Indonesia's debt burden is on the limit of the debt sustainability.

Since 1980 the Indonesia's foreign debt payment tends to be higher than the new borrowing, moving away higher than 1. The ratio of payment and new borrowing in 2003 was 2.23 and in 2004 it was 2.43. It has been worse than the ratio during the peak of the crisis in 1997/1998 which was 2.05. The debt payment and borrowing ratio in 2004 was the worst since the period 1969/1970. In 1995/1996 the worst record was 2.27.

The ratio between the debt payment and the withdrawing of new loans or net transfer is one of the determinant indicators of how much is the inflow compared to outflows from the country. The ratio above 1 indicates that the payments of the principal and the interests of the debts have been higher than the withdrawal of the new loans.

The payment of the principal and interests of the foreign debt in the period of 1969 – 2003 was US\$ 56.52 billion, while the borrowing in the same period of 1969 – 2003 was US\$ 37.68 billion. The difference between the payment of the debts and the new loans in the period of 1969 – 2003 was US\$ 18.84 billion or IDR 170 trillion. In nominal terms the difference between the payments and the new loans tends to increase. In the period of 2001 – 2003 the difference reached the peak of IDR 18 trillion to IDR 22 trillion, and in 2004 increased up to IDR 40.5 trillion. The high difference in 2001 – 2004 never happened in the history of foreign debt of Indonesia since 1969/1970. The previous record was in 1997/1998 during the peak of the crisis, which was IDR 15.1 trillion.

## 5.3 Foreign Debts Absorbing Domestic Revenues

The payment of foreign debts has absorbed a big portion of the domestic revenues. Since 1986/1987 – 1998, 30% of the domestic revenues were used for the payment of the foreign debts. In 1998/1999 almost half of the domestic revenues (46.8%) were used for the payment of foreign debts. As a comparison with the previous decade, the portion of the domestic revenues that were used for the payment of the debts was below 15%.

As a consequence the proportion of the state revenues for the payment of salaries of state apparatuses, subsidy for poor people (including the oil subsidy), and the costs for social welfare projects (education, health and environment) decline by years. The debts burdens have reduced the fiscal capacities of the government to pay the development programs and support the poor population. This is the *social opportunity costs* of the foreign debts. After the economic crisis 1997 – 1999, the ratio of debt payment and the domestic revenues seems to decrease. Since 2000 the ratio was below 15 %. This means that the tax revenue has increased. But in 2004 the ratio increased again up to 19.6%, and it was predicted that it would decrease again below 10% as what happened in 1970 – 1980s.

With the increased proportion of domestic revenues used for the debts payments, in the future the capacities of the government to repay the debts will decrease. The government will become more dependent to the debts rescheduling through mechanisms similar to Paris Club and the new loans. The debts rescheduling does not mean much to reduce the debts burdens, it only moves the burdens from the present period to future periods with higher interests.

In 2003 the government had to pay the foreign and domestic debts up to IDR 116.3 trillion. This was equivalent to the 56.2% of the state revenues from income tax and value added tax. These payments have included the results of London Club, Paris Club 1 – 3, and the reprofiling of the recapitulated obligations. It is predicted that without the reduction in the debt stocks and the cancellation by the creditors, Indonesia will be burdened more by the foreign and domestic debt repayments.

#### **5.4 Debt to GDP Ratio**

The debt to GDP ratio indicates the economic capacity of a country to repay its debts in the long term (the solvability). The orthodox assumption says that the safe limit of the debt to GDP ratio is between 30% - 40%. This limit will determine the fiscal sustainability of the country, which means that the country is still able to repay the debts without additional debts or without efforts to reduce the portions of state budgets in the other sectors. Before the crisis the foreign debt to GDP ratio of Indonesia was below 40%, even in 1996 the ratio was 24.7%. In the period of 1990 – 1996 the debt to GDP ratio was in a safe zone according to World Bank's criteria.

Although the ratio of public foreign debts to GDP in 1990 – 1996 tended to decline the private debts tended to increase. This was critical since the private loans were commercial and with short-term maturity period. This in turn became vulnerable for the depreciation of domestic exchange to foreign exchange. This happened after 1997 when the debt to GDP ratio increased drastically. The economic crisis has brought the increase in the debt to GDP ratio. The peak was in 2000 when the ratio was 56.8%, the highest in the period of 30 years. Since 2001 the ratio tended to decrease due to the improvement in economic performance of Indonesia. In the period of 2000 – 2003 the ratio decreased from 56.8% to 39.1%. But this position is worse than the worst condition in the pre-crisis period, namely 24.7% (1996).

#### **5.5 Debt Service Ratio**

The Debt Service Ratio (DSR) is a ratio between the payment of foreign debts and the export capacity of the country. The DSR indicator reflects the capacity of a country to repay its short-term debts, or indicates the liquidity of its economy.

The debt service ratio to export in the period of 1990 to 1999 is high. This reflects the use up of foreign exchange reserves in the period that brought the economy in critical situation. The debt service ratio to export after 1999 tended to decline, but still high enough according to the standard of the World Bank. The ratio indicates the volume and value of exports reserved for the repayment of foreign debts. Until 2003 the DSR to export of Indonesia was around 33.80%. This level is above the standard level of the World Bank, which is 20%. For Indonesia, DSR to export is still in critical situation, if there is no systematic effort to reduce the debts burdens or to improve export capacities.

#### **5.6 Poverty Profiles in Indonesia**

The recent data (2007) shows that more than one million children under five or 26% of the total children under five are living with malnutrition. 64% of the total population in Indonesia consumes insufficient calorie. Only 18% of the total population of Indonesia who have access to clean water and 48% of the population have no access to clean water at all. The World Bank reports that 110 million of the populations (50%) have income below US \$ 2 per day. The unemployment rate reaches up to 10.9 million people or 10.3% of the total labour force.

**Table 5.2 The Real Problems faced by the people of Indonesia, 2007**

No	Problems	% of the total population	Remarks
1	Malnutrition	26%	From the total population; majority is from the Eastern parts of Indonesia.
2	Insufficiency in calorie intake	64%	From the total population of Indonesia.
3	Access to clean water in urban areas	52%	Only 18% of the total population of Indonesia who have access to clean water.
4.	Without appropriate sanitation facilities	44%	

*Source: National Planning Ministry, May 30<sup>th</sup>, 2007*

The increase of fuel price has domino effects to prices of all products that need external inputs, including agricultural products that need external inputs in the production processes. While the prices of the inputs increased, the costs for transporting and storing also increased. The external inputs include fertilizers, pesticides and seeds. People could not cultivate their agricultural lands and produce in maximum capacity since they are lacking in cash for purchasing the external inputs.

The World Bank came in with soft loans for safety net programs for purchasing cheap rice for the poorest. There were 7.5 million people of the poorest category who received the package of "rice for the poorest" and IDR 300,000 per month for unconditional cash transfer for the poorest. The World Bank disseminates enthusiastically the success of the Community Driven Development Project or well-known as *Kecamatan Development Project* (KDP), but even in the district where this project is being implemented the cases of malnutrition and starvation incidence are appalling. KDP is only an image making project to show to the people of Indonesia that the World Bank is not the same like IMF, while in fact it is the World Bank that managing the implementation of conditionalities imposed by the IMF after the crisis. All these actions and project seem to be in vain; even it raises another burden of debts repayment for the future generations who have the fortune to survive.

Poverty has been endemic Indonesia even since before the economic crises in 1997/98. But after the crises the condition became worse. Before 1997 the poverty level tended to decrease. The government at the time launched a poverty alleviation program, which targeted the rural and urban communities through various projects such as rural infrastructure development, microfinance, family welfare programs through the Family Planning Coordinating Body, etc. The government mobilized funds from the state-owned companies and the conglomerates to support the poverty alleviation program. The program to certain extent was successful, but at the same time also strengthened and widened the spans of corruption among the bureaucrats from lower level to the highest level.

The poverty indicator used by the BPS (National Bureau of Statistics) is based on the household spending, and the poverty line indicates the minimum spending by an individual to fulfill his/her needs of food and non-food per capita per month, namely the cost for the consumption of 2,100 calorie of food per day/capita, the fulfillment of non-food items such as cloth, housing, health, education, services, fuel, etc.

The economic crisis of 1997/98 and up until now worsened the poverty conditioned. From 2002 to 2005 the poverty figures tended to decline, but in 2006 due to the increase of price of oil for more than 120% (to follow the prescriptions from the IMF and the World Bank), the poverty figures increased again. In 2005 percentage of people living in poverty was 15.97% or 35.10 million people, but in 2006 the number of people living below poverty line increased to 17.8% or 39.05 million people. The poverty figures in rural areas are higher than in urban areas, where in 2006 the people living in poverty reached 24.76 million people in rural areas, and 14.29 million people in urban areas. This situation is worsened because of the increasing numbers of unemployment. According to the National Bureau of Statistics, in 2006 the unemployment reached up to 10.93 million people or 10.28% of the total labor force. This is far above the normal manageable figures of 5%.

According to the prediction by the Center for Social and Economic Studies, The Institute of Sciences of Indonesia, the poverty figure in 2007 would increase due to the increase in the numbers of unemployment by 1.6 million people. Added with the unemployment from 2005 that has not been absorbed, the total unemployment in 2007 would reach 12.7 million people. The unemployment condition would add to the poverty figure that might increase up to 45.7 million people.<sup>23</sup>

In 2006 the government finalized the strategy with budget plan for a poverty alleviation program that would start in 2007. The Poverty alleviation program, however, is supported mainly by new loans from the World Bank and Asian Development Bank. The government's guidance of "no free lunch" is also applied to the poor, although the poor becomes poor not because they are born to be poor but because they are made poor since the government has to serve the interests of the foreign capital.<sup>24</sup> The poor people will have to pay the debts in the future by their next generation.

### 5.5.1 Foreign Debts Payment Compared to the Budget for Health and Education

While the needs for improving education and health sector are demanding, the budget allocated for these two sectors is still below the budget allocated for the debts repayment. In 2004 the total payment for the foreign debts was IDR 110,972 trillion, while the budget for health was only IDR 7,038 trillion, and for education was only IDR 25,987 trillion. In 2007 the budget allocated for health and education sectors were slightly increased, but it was only IDR 17,467 trillion for health sector and IDR 44,058 trillion for education sector. Although the budget for these two sectors are combined, the amount is still far below the amount of budget allocated for the payment for foreign debts, which in 2007 was IDR 139,916 trillion. The following table shows the comparison from 2004 to 2007.

The allocation of the budget for education is still far below the amount required by the 1945 Constitution and by the Law No. 20/2003 on Education. The Constitution (the fourth Amendment), Article 31 (4) and the Law No. 20/2003, Article 49 (1) stipulate that the government has to allocate 20% of the annual budget for education. Until now the government is unable to fulfill its obligation for education. This is because the state budget has to be allocated more on the payment of the foreign debts.

## 5.7 Conclusion

Foreign debts have clearly put pressure on Indonesia's economy. The dependence to foreign debts have pushed the government of Indonesia to follow the rules and prescriptions of the creditors/donors whatever the risks for the livelihood of the people of Indonesia. The dependence on foreign debts has pushed the government to serve more the interests of the creditors rather than the interests of the citizens. The conditionalities imposed by the creditors, particularly by IMF, World Bank and Asian Development have pushed the government to implement policies that make the poor people poorer. The policies imposed by IMF, World Bank and ADB as detailed in the letter of intents between the government and the IMF, have been proved to make the crises deepened. In turn the people's economy that was hit by the crises in 1997/1998 became worse because of the implementation of the policies that favor only the global capital actors rather than the people of Indonesia.

Although the facts, data and incidences have been publicly exposed, the government has not been moved from its orientation to the policy prescriptions of the multilateral donors. The needs for more budgets allocated for health and education have been obvious, but the government still prioritized paying foreign debts rather than promoting education and health. Although the incidences of poverty as indicated by malnutrition, starvation and death because of starvation have been publicly exposed, the priority of the government in allocating state budget is still on the implementation of the policies imposed by the creditors. Foreign debts have made the government as the instrument for the creditors to serve their interests, and not the people's interests; while at the same time the World Bank and ADB continuously publish research and studies that justify the needs of the government for new loans and more policy reforms.

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<sup>23</sup> [www.detik.com](http://www.detik.com), Wednesday, 27/12/2006; 14.35

<sup>24</sup> Compared to Prof. Mubyarto's analysis on the transfer from the local communities to the national capital and from the national capital to the centers of the global capital, in *The Development Manifesto*, Yogyakarta, 2005.

## 6.0 RENEGOTIATION OF THE DEBT

The government of Indonesia is very confident with its capacity to repay the debts, despite the fact that the numbers of people living in poverty are still worrisome. The government of Indonesia has decided not to cancel or repudiate the debts, whether they were odious or illegitimate or not. The main argument is that the debt cancellation and debt repudiation might reduce the confidence of foreign investors to Indonesia.

There is another fact that Indonesia is not able to cancel the debts, whether there is good and strong reason to do it that is that the creditors have put conditionalities to Indonesia that Indonesia has to be tied to IMF and the World Bank. The IMF and World Bank argued that Indonesia's foreign debts are technically sustainable, and these two institutions are against debt cancellation in any scheme.

The main efforts taken by the government of Indonesia are debt rescheduling and debt relief in terms of debt swaps. The terms of "illegitimate debts" and "odious debts" have not been accepted by the government, although the legal documents made since the step down of President Suharto have been made that certain extent condemn the authoritarian and dictatorship regime of Suharto. Most of the laws that supported the strong dictatorship of President Suharto have been eliminated or changed, and the corruption conducted by his families and crony businesses were also brought to the court. The policies and actions concerning with the foreign debts have not been taken as legal cases.

The actions by the democratic regimes after the New Order era (since 1998) were actually undermined by the actions taken by the creditors directed by IMF and the World Bank. When the legislative bodies were trying to make stronger laws on the management of foreign economic cooperation, including foreign debts, the economic teams of the government continued policies prescribed and dictated by the IMF and the World Bank. The legislative commissions in the Parliament were ignored at least until 2006 when the Consultative Group on Indonesia still continued discussing and evaluating economic policies and legal reforms of Indonesia, without acknowledging that there have been existing legislative bodies, elected through democratic processes, that are the authoritative bodies for making the laws, overseeing the implementation of the government's policies and being accountable to the whole country. Instead of being responsible to the Parliament, the Executive preferred to be responsible to the IMF, the World Bank and the donors' consortium.

Although the government has recognized that the prescriptions from the IMF were wrong, the government still implements the policies. The most strategic action taken by the creditor countries/institutions was the centralization of all economic policy making in one Ministry, the Ministry of Finance. This is strategic for the creditors, since once they put their personnel in the Ministry, there is no longer need for lobbying other institutions in the government and Parliament, even there is no need for lobbying the President. The authority for managing foreign borrowing and the economic policies is now in the hand of the Ministry of Finance. In the past the creditors have to spread their personnels in several agencies: Ministry of National Planning, Ministry of Finance, Ministry of Trade and Industry and the Coordinating Ministry for Economic and Finance Affairs, and the Ministry of Public Works. At present the creditors need only one person chairing the Ministry of Finance, and their interests will be totally accommodated. The laws made in the last two years affirm the strong authority of the Minister of Finance: as the treasurer of the government, the sole authority for foreign borrowing, the last authority for making decisions on sectors to be privatized, the main authority for the sale of natural resources (including gas and oil), the main authority for making international economic cooperation, the authority for making state budget and for approving the budgets of the provincial and district governments.

Ministry of Finance is the only ministry that is free from political interference; democracy is not viable in the Ministry. Once the ministry is ruled by the neoliberal economists, it is impossible for the people to expect that the state will fulfill its obligation for public and social services, since the government's economic policies (that are made by the Ministry of Finance) will not allow welfarist approaches. The fulfillment and the implementation of the prescriptions of Washington Consensus is the priority, rather than actualizing the mandates of the Constitution. This is different from other Ministries, where politicians from the Parliament are competing to chair the ministries; Ministry of Finance is the sole domain of the technocrats inherited from the New Order Regime. In such atmosphere of economic regime, where the economic policy frameworks are in line with those of the Washington Institutions (IMF and the World Bank), it is difficult to expect that there is creative breakthrough in the negotiations for foreign debts.

Even in solving domestic public debts inherited from the crises because of the conversion of private debts to public debts, the government has no initiative since the conversion of the private debts was one of the conditionalities imposed by IMF and other creditors to bail out their own interests during the crises.

## 6.1 Debt Rescheduling

Since 1967 when Indonesia was in economic and political crises up to the other economic and political crises in late 1990s and up to present, the government of Indonesia has not taken significant measures for debt cancellation such as debt moratorium, request for forgiveness or other debt cancellation measures. Even in a situation where there is a need for full attention from the government to concentrate its resources to solve domestic acute problems, such as natural disaster, poverty, malnutrition, starvation, etc., the government is still firm with its position for not proposing debts relief or debt moratorium or debt write-offs.

The only brave efforts of the government, even in deep crisis situation, is debt rescheduling. In late 1960s, coordinated by the creditor countries and institutions, the new government of Suharto conducted several negotiations for debt rescheduling. In a situation when Indonesia was almost bankrupt, Indonesian government did not propose debt moratorium or debt write-offs or debt relief. The government only requested debt rescheduling. Although the benefit of the debt rescheduling was minimum, Indonesia had to repay more than the debts repayment. Indonesia had to give up all the strategic energy resources (gold, copper, oil and nickel minings) to the companies from the creditors, and the ministries with strategic positions in economic policy making become the domains of the multilateral agencies (World Bank and IMF). The foreign economic teams were freely moving in the offices of the ministries in the central government. It was the time when Indonesia gave up all the authorities of making policies to foreign consultants and economists.

During the crises in late 1990s the same story repeated. The government only negotiated rescheduling and invited the intervention of the IMF. On 4 June 1998, Indonesia met the creditors in Frankfurt, Germany. The negotiations came out with the *Frankfurt Agreement*. The *Frankfurt Agreement* was mainly for the private debt rescheduling and the debt-to-equity swap schemes for the private companies. The schemes were implemented by two agencies: Indonesian Debt Restructuring Agency (INDRA) and the Jakarta Initiative Task Force (JITF).

For the public debts, the Government of Indonesia had tried to negotiate with the creditors through London Club and Paris Club. The results of the negotiations are debts rescheduling with the period of 17.5 years (London Club) and 20 years (Paris Club). London Club was conducted on 29 March 1999, 28 September 2000, and 6 September 2002. Paris Club was held on 25 September 1998, 13 April 2000 and 12 April 2002.

The main problem with these debts negotiations is that the debtor (Indonesia) has to be tied to the evaluation and monitoring by IMF. Indonesia has to be tied to IMF although the schemes are different from IMF's, and the loans from IMF have been totally repaid. The debt rescheduling is not enough to solve the debts burdens of Indonesia. The rescheduling is only removing the same problem from the present time to the future. Until now the government of Indonesia does not try to reduce the debt stock. Indonesia still follows the classic debt management of IMF and World Bank that has been proved to be ineffective in managing debt sustainability in Indonesia.

## 6.2 Reducing Debt Stock

Although according to the World Bank that Indonesia's debt is still in the level of technically sustainable, that gives credit to the present government, the payment of foreign debts (added with the domestic debts) still absorbs significant proportion of the annual state budget, even more than those allocated for education, health, and other social services (don't mention the budget for anticipating natural disasters). Therefore there is still urgent need for a comprehensive strategy for reducing debt stocks. J. Mohan Rao criticizes the orthodox approach that is based on top-down neoliberalism and globalization. According to Rao the macroeconomic regime has to be shifted to a pro-growth and pro-equity approach where growth is triggered by public investments. This will create multiplier effects that attract private investment flows and pull back the capital that moved out of the country during crises. The public investments can be obtained from the additional funding mobilizations.

To guarantee the stability of exchange rate, there is a need for partial control of the capital flows. All have to be integrated in a pro-equity policy to solve poverty problems. The shift has to be accompanied by the cancellation of debts, particularly the odious and criminal debts inherited from the irresponsible regime.

The other approach is the technical approach of Nancy Birdsall and Brian Deese that promotes *Enhanced HIPC (Highly Indebted Poor Countries) Initiative*<sup>25</sup>. HIPC initiative has failed to guarantee sustainable growth in the debtor countries. They proposed nine concrete measures. *First*, the increased amount in the debt reduction so that the debt burdens of the poor countries would not be more than 2% of GDP, so that the governments are able to provide better social basic needs for the people. *Second*, the enhancement of the scope of HIPC initiative, where non-HIPC countries are also provided with the HIPC facilities. *Third*, to protect the poor countries from external shocks such as the change in commodity prices that influence their income.

To support the third measure, Rao suggests the fourth to sixth measures as follows: the utilization of IMF's golds, the increase in official aid and the multilateral supports. Cross-subsidy, where the multilateral banks put higher interest rate to the middle income countries and the profits will be used for reducing the debts of the poor countries.

For the long run, Birdsall and Deese recommend the improvement of efficiency and selectivity of aid. This can be done by the elimination of tied aid, the implementation of quasi-market for development programs and the grants and loans through *International Development Association*. Furthermore there is a need for the increase of the responsibility of the creditors and the simplification of HIPC procedures.

The third approach is suggested by Francis Lemoine who provides concrete recommendations for Indonesia. Lemoine questions the IMF and World Bank's analysis saying that the Indonesia's debts are *technically sustainable* in the long run, that reduces the debts problems of Indonesia to only liquidity problem in the state budgets. He recommends a partial solution based on *Paris Club*.

*Paris Club*, however, does not significantly reduce the *present value* of Indonesia's debts. Although the liquidity problem is solved for short-term period due to the debt rescheduling, the debt stock of Indonesia is still high. Lemoine says that debt stock of a country influences the confidence of investors to the country. Lemoine recommends that rather than rescheduling, it would be preferable for Indonesia to reduce the *net present value* of Indonesia's foreign debt stock up to the level of sustainability. Then utilizing Napoli scheme, the rest of the reduction of debts stock can be paid by the multilateral creditors.

The other approach is suggested by Pedro Morazan and Irene Knoke. They argue that to achieve a comprehensive solution to foreign debts that benefits more for the poor debtors, there is a need for fundamental change in the international mechanisms for solving debts problems.

They argue that the mechanisms used by the IMF, Bank Dunia, Paris Club, and London Club are only tools made by the creditors to protect their own interests, and not to recover the financial positions of the indebted countries through debt cancellations. Therefore Morazan and Knoke suggest that there is a need for arbitrage institution where creditors and debtors are represented in equal levels, added with one person appointed by both parties. The solutions to debts problems have to also accommodate the elements and principles promoted by *the International Jubilee Movement*.

### 6.3 The Limits of Debts Repayment

Based on the approaches discussed above, this research recommends the following alternative strategies for Indonesia to reduce its debts burdens.

*First*, the government should make a maximum limit for paying the foreign debts in order that the available resources and funds for the national economy are bigger enough. The management of the finance has to be in maximum transparency and is monitored by multi-stakeholders forum that involves as broad public as possible. The funds can be part of the state budget or pooled in a Trust Fund that may not be used in stock market and financial markets. The funds have to be allocated only for certain priorities, such as: (1) labor intensive works in rural areas; (2) credit subsidy program for the recovery of real sectors and other priority sectors such as small and medium enterprises (SMEs); (3) the financing of social sectors such as education and health.

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<sup>25</sup> Birdsall, N dan Deese, Brian (2003) "Perluasan peringanan utang sebagai landasan tatanan global baru" dalam *Abritrasi utang penyelesaian menyeluruh masalah utang luar negeri Indonesia*, INFID : Jakarta.

This recommendation is in line with that of Birdsall and Deese<sup>26</sup> (2003) in order that the *Enhanced HIPC Initiatives* use the ratio of debts to poverty. The use of *debt service to tax ratio* is better than the *debt service to export ratio*.

The maximum limit has to be regulated by a law so that the government can use it as the legal basis and instrument for negotiating with the creditors. The regulation should include: (1) the maximum limit of repayment from the annual budget, such as 10% from the state revenues from tax and non-tax; (2) the regulation of terms used by the government in negotiations with the creditors; (3) the regulation of the finance management that is used for foreign debts repayment, either from annual state budget or from the Trust Fund, where maximum transparency and public participation is included.

It is also necessary to regulate the priorities for the use of the funds. The government also should limit the new debts, and if possible *zero debt* for foreign debts of the government. The government also has to make regulation of the maximum rate of tax increase and the decrease in subsidy so that the state revenues can be calculated in reasonable ways. This will reduce the opportunities for the IMF and World Bank to put pressure on the government to increase the amount of debts repayment by increasing the targets of state revenues.

*Second*, the reduction of the principal of the debts. There are some measures that can be taken:

- a. The debt reduction by a combination of financial engineering and the commercial renegotiation with the creditors. One of the ways that can be used is through *debt-to-equity swap*. For example, a foreign company is investing in the amount of US\$ 70 million. Through commercial negotiations, the governments debts can be traded in the secondary market with discount (say 30%). The broker of the foreign company can buy the government debts in the amount of US\$ 100 million. The government agrees to pay in Rupiah (Indonesian currency) in the equivalent amount of US\$ 80 million. The government can also pay in Rupiah in the amount of US\$ 70 million to the company but with the compensation of tax facilities. The result is that the government debt in the amount of US\$ 100 is paid, the foreign direct investment (FDI) in the amount of US\$ 70 – 80 million is available, and the government's debt is reduced by 20% to 30%. There is a risk of this method, namely inflationary risks if the government prints new money. But this can be anticipated if the Central Bank (Bank Indonesia) is independent, free from political interference of the government.
- b. The reduction of *debt stock* through international arbitrage. The main rationale is that the multilateral and bilateral creditors are also responsible for the failure in guaranteeing the good governance in the debtor countries in managing the debts. The presence of odious and illegitimate debts is also the mistakes made by both the creditors and the debtors. Therefore the creditors should also be responsible to provide facilities and hair cut for compensating the odious and illegitimate debts.
- c. The negotiations of foreign debts using the geopolitical and strategic levels. Indonesia is not included in HIPC from income criteria and from debt ratio to exports. The government and the World Bank also claim that Indonesia has received better terms in Paris Club 3 compared to Paris Club 1. The maturity period, for example, has been extended from 11 years to 18 years for non-ODA debts; the grace period is extended from 5 years to 10 years for ODA, and there is also rescheduling for interests payments. But according to the report of the *European Network on Debt and Development (EURODAD)*, terms received by Indonesia are worse than those for other countries. Indonesia is only given the *Houston Terms*. In this scheme Indonesia receives only facilities for the rescheduling of interests for 20 years with progressive payments of 10 years. While for non-ODA debts the rescheduling is made based on market rate more than 15 years with progressive payment for 2 – 3 years per year (Lemoine, 2003).

If the government uses the *Naples Terms*, Indonesia will get the debt reduction up to 67% of the total non-ODA debts. For ODA debts the government can even get grace period of 15 years, with the discount for interest for 40 years. Pakistan and Bulgaria received the cut of 30% and 66.7% of the *Net Present Value (NPV)* for ODA and non-ODA debts, and rescheduling the rests of ODA debts for 38 years with the grace period of 15 years. Indonesia was trapped in economic and technical arguments, while Pakistan and Yugoslav used the geopolitical and strategic arguments. HIPC scheme itself has consumed US\$ 29.3 billion. The costs are paid by creditor countries, commercial creditors (US\$ 15.1 billion), World Bank (US\$ 6.2 billion), IMF (US\$ 2.3 billion), and other creditors.<sup>27</sup>

<sup>26</sup> Birdsall, N and Deese, Brian (2003) "Perluasan peringanan utang sebagai landasan tatanan global baru" dalam *Abritrasi utang penyelesaian menyeluruh masalah utang luar negeri Indonesia*, INFID : Jakarta.

<sup>27</sup> Harinowo, C. (2002) *Utang pemerintah perkembangan, prospek dan pengelolannya*, Gramedia: Jakarta

This scheme actually can be used by Indonesia since the creditors also have to be responsible for the unsustainable debts of Indonesia.

According to Nancy Birdsall and Brian Deese, Indonesia's debts have reached a level that inhibits the economic growth. But according to Lemoine from EURODAD, there are also strategic reasons that make Indonesia not eligible for HIPC criteria, namely that the debt stock of Indonesia is higher than those in other low income countries. The reduction of debt stock for Indonesia will be significant costs for the creditors. The creditors are worried of moral hazard if Indonesia is included in HIPC. Besides the creditors still believe that Indonesia's debt burdens are only short-term liquidity problem. Therefore Lemoine suggests that one of the alternatives is to reschedule the debts payments for longer terms and with lower interest rates and longer grace periods, if the problem is liquidity. This was taken in the transition period from President Soekarno to President Suharto in 1966 – 1968.

The second alternative is to reduce the *net present value* (NPV) of the stock of Indonesia's foreign debts to the level of sustainability. This means that 50% of the total debt stock has to be cut.

- d. Bilateral renegotiations, particularly with Japan. Almost one third of the Indonesia's *debt outstanding* is to Japan. Japan's strategic interest to Indonesia is to contain Chinese geopolitical ambitions in East and South East Asia region, can be used as a strategic point for negotiations. Japan potentially functions as the US to Mexico if the Brady Bonds scheme is used to Indonesia. Indonesia has to be able to design a scheme for bilateral debts negotiations to Japan using investment and market for Japan multinational corporations relative to China.

*Third*, there should be additional indicators. The classic debt management usually uses the ratio of debt outstanding to GDP or debt ratio becomes the main indicator. This applies to short-term loans, middle-term loans, and long-term loans, domestic and foreign loans. For the variable of "the capacity to repay debts" the approach uses *debt service ratio* that compares the obligations to repay debts, the principal and the interests, and the revenues from exports. This approach ignores the facts that the repayment of government debts has consequences to social justice, both for a generation in a country and for the next generation.

Each Rupiah or dollar spent for repaying the debts has social opportunity costs. This is because the opportunities for the poor and the people in need lost their opportunities to get rid of poverty, misery and destitution. The trade off or the distribution effects of the debt payment is ignored in the government's economic policies concerning foreign debts.

Therefore there should be another indicator, namely the ratio of the debt payment to the tax revenues in the State Budget. This may be called the *debt service ratio to fiscal revenues* (DSRFR). If this ratio is compared to the proportion of revenues from other revenue sectors and the expenditure for other sectors, it will show clearly how social justice is accommodated in the debts management.

For Indonesia the ratio will show that there is a need for reorientation of debt management of the government, namely to refocus on the reduction of debt stock, not to transfer the debts to the next generation, or to add more new debts. The consequence is that if there are still new loans, the loans should be allocated to development projects that have direct impacts to economic growth and to the improvement of welfare of the people. The new loans should be allocated to projects that produce its own income to repay the debts, meaning the project itself will repay the debts, and not the whole country pays the debts.

One more important measure concerning the indicators is the ratio of debt to more specific human needs of the country. The Human Development Report of UNDP every year identifies the basic needs of the people that are very important to ensure their humanity. These fundamental needs include: education, health, food and physical security. The funding needs of each sector have also been calculated in the annual HD Report, so that it is easier to calculate the ratio of debt payment to the cost for financing the fulfillment of the basic human needs. The following table shows the picture of the debts payment in 2002, which actually can be allocated to support the additional budget for human development up to 91.4%.

**Table 6.1 Foreign Debts Payment to the fulfillment of human basic rights, 2000 (in trillion Rupiah)**

Budget lines	2002
A. Interests of foreign debts	29,0
B. Principal of foreign debts (Net)	16,7
C. Total A+B	45,7
D. The finance for human development	53,7
E. Additional needed funds for human development	50.0
F. The necessary costs for human development	103.7
G. Ratio C/D (%)	85.1
F. Ratio C/E (%)	91.4
G. Ratio C/F (%)	44.1

Source: Bank Indonesia and UNDP

*Fourth*, the role of the *Debt Management Office* should be expanded, to include the debt reduction negotiations. The present Debt Management Office (DMO) is more on administrative matters such as documenting loans agreements and documenting debts, and more focused on domestic debts rather than foreign debts. The function is not yet optimal in making analysis of debt sustainability, risks analysis and the repayment rate of debts, etc. The DMO has to be more creative in developing alternative initiatives, and not only focused on the conventional methods of debts management. Rescheduling and re-profiling are still needed, but may not be used as the main strategy in debt management.

The DMO should develop alternative measures and non-conventional methods that need negotiations techniques and financial engineering such as hair cut, write-off, debt-to-bonds conversion, debt-to-equity swap, and other types of conversions and swaps (debt for nature swap, and debt for MDGs swap, etc.).

*Fifth*, Indonesia has become a polite and humble client of the creditors in the last forty years. This has to be counted by the creditors by rewarding bonus to Indonesia. On the other hand Indonesia has also taken the initiative for developing country strategy paper for poverty reduction (PRSP), although it was not obligatory for Indonesia. The PRSP shows the strong intention of the government of Indonesia to reduce poverty. The main problem with the implementation of the PRSP is that the funds allocated for the program is not sufficient enough since the bigger percentage of the state budget is allocated for paying foreign debts. PRSP and the facts that more than 50% of Indonesian population (using the standard of US\$ 2 of the World Bank) show that Indonesia has strong and systematic intention to end the poverty for the people.

More than that in certain regions in Indonesia, people become poor because of the implementation of the projects funded by foreign loans, such as indicated by the case studies of the dam projects from JBIC and the small plantations from ADB as mentioned above. The cancellation of the debts or the write-off of some of the debts will be valuable for recover the livelihood of the people who have been affected by the projects.

## **6.4 Problems and the Solution to Foreign debts**

In the future all foreign loans are submitted and passed through one door, namely the Ministry of Finance. This is to ensure that all loans are registered in order that the debts burdens can be easily calculated.

To actualize this, the government has issued a law on foreign borrowing as the replacement of all regulations about foreign borrowing issued in the past. The discipline of foreign borrowing is one problem. The main problem is the dependency of the government to foreign debts. The government has been addicted to the foreign loans, or as the consultant of the JBIC said, the government of Indonesia has been spoiled by the foreign debts that reduce the initiatives for alternative sources of revenues for development. In the past, receiving new loans was perceived as achievement by the government arguing that new loans means that Indonesia is still trusted by the creditors.

New loans mean that Indonesia will be deeply sinking in the debt flows. This is made difficult when the government shifted the dictum of foreign borrowing from complementary to becoming the main pillar for covering the state budget deficits.

More and more people claim that most of the foreign debts are “odious debts” because the debts do not create productivity, do not promote domestic capital accumulation and the debts were used to make pressure on the citizens and some of the loans were corrupted or used for fulfilling the greed of dictators and their cronies.

Therefore the review of the way of thinking about foreign loans is not only demanding but also necessary, supported by a strong and determined legal framework.

There are some important issues that should be taken into account for making the new law.

*First*, so far there is no quantitative limit and details of the foreign borrowing of the government. The government draws foreign borrowing almost without limit. The conventional limit such as the ratio of debt to GDP is almost ignored. The implication is that, not only the increasing foreign debts, but also the allocation of the foreign loans was not well managed.

It is not surprising that certain sectors are heavily funded by foreign loans, while other sectors were not. Even in the micro sector such as the banking, there is *maximum lending limit*. The government almost did not comply with the *risk management* mechanisms.

*Second*, the use of the foreign loans was not efficient. Professor Sumitro Djojohadikusumo, the mentor of Indonesia’s technocrats, since long had reminded about the mismanagement of Indonesia’s ICOR that was also interpreted as the leakage in the foreign debts up to 30% of the total of each loans. The World Bank Report in 1997 also had revealed that the foreign loans-funded projects were siphoned for individual pockets for more than 30%, including the projects funded by the World Bank.

*Third*, there is *miss-match* in the use of the foreign loans. The short-term loans were used for long-term investment, and there are also projects funded by loans that do not produce foreign exchange, and even did not take *hedging* so that the loans become open to the risk of exchange rate volatility.

The government of Indonesia has established a special directorate general in the Ministry of Finance that is specifically assigned as the Debt Management Office. This is regulated by the Decision of the Ministry of Finance in 2006. The DMO is expected to function as the main office for managing the foreign debts including:

- Maintain the sustainability of debt stock.
- To eliminate leakage or corruption in the use of foreign debts;
- To conduct negotiations with the creditors concerning with the new borrowing;
- To improve the management system of foreign debts from the planning, negotiations, utilization, monitoring and the repayment.

The renegotiation of debts or the cancellation of debts is not included in the tasks of the DMO, since the government has determinedly express that Indonesia will not repudiate foreign debts, will not ask for cancellations, and will repay all the foreign debts. The parliament of Indonesia can take up a role for evaluating the past foreign loans whether from legal aspects of the loans agreements or from the benefits of the projects-funded by the foreign loans. The Parliament, using legal perspective, can decide whether the debts are legitimate or illegitimate. If the debts are illegitimate, the parliament can ask the government to negotiate the cancellations with the creditors. There has been enough room for the Parliament to play this role.

The proposals for debt relief have been promoted by several groups in Indonesia. There are many reasons to take the action.

First, Indonesia has been since long compliant and disciplined with the debts repayment and hasn’t repudiated foreign debts. It is fair if Indonesia receives bonus for that.

Second, Indonesia was badly hit by the economic crisis in late 1990s and since then has not been recovered. The World Bank and other multilateral donors have to be also responsible for the leakage or corruption in the foreign debts.

Third, Indonesia was hit by tsunami and earthquakes in several places, starting from Aceh and Nias, Yogyakarta and

Central Java and West Java. Indonesia was also hit by floods and landslides in many regions in the country.

Fourth, Indonesia's environmental condition is degrading. The tropical forest cover degrades by years. There is a need for recovering the forests that will contribute to the reduction of global warming.

Fifth, Indonesia's achievement for MDGs is not moving forward, even regresses. Paying the debts will become the main obstacle for Indonesia to achieve the MDGs targets. Indonesia can negotiate with the creditors for debt relief for the achievement of MDGs.

Sixth, Indonesia is improving its governance system towards good governance, as indicated by the introduction of Integrity Pact in almost all government bureaucracy and the establishment of the special Commission on Anti-Corruption. This will guarantee better economic cooperation in the future with international partners. The establishment of good governance and anti-corruption efforts need extra financial resources, including the set-up of better recruitment system of civilian bureaucracy, the improvement of salary system, the promotion of procurement system, setting up of good corporate governance, legislative control, the better functioning of democratic institutions, capacity building for bureaucrats, etc. Investing in good governance of the present government, by for instance debt Restructurization will bring better harvests in the future in terms of better economic cooperation and better investment climate for global corporations including the corporations from the creditor countries.

The government of Indonesia up to now is still reluctant for proposing debt relief. The classic reason is that if the government requests debt relief or hair cut, Indonesia will be isolated by the international society. This in turn will degrade the bargaining position of Indonesia in international forum. The government prefers to negotiate rescheduling, that only shift the burdens from the present regime to the future generation, which means that the present government shifts the responsibilities to the future governments and to the future generations. This reason is not based on facts. Argentina is now attractive for international investment and the economic growth reaches the rate that never existed in the history of Argentina.

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