Chapter 26

Contract and contract enforcement in Indonesia: An institutional assessment

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In Indonesia prior to the Asian financial crisis of 1997, the legal enforceability of contracts was not a necessary pre-condition for macroeconomic growth, Weberian assertions in development literature notwithstanding. In an earlier essay, I described the devices used by international investors to insulate their contracts from the Indonesian legal system and its courts, including political patronage, choosing a governing law other than Indonesia's and inserting arbitration clauses designed to keep commercial disputes away from Indonesian courts (Taylor, 1999).

Those comforting arrangements came unstuck for many companies in the wake of Indonesia's financial crisis in 1997. Commercial cash flow problems, bankruptcies and the end of the Soeharto regime caused many foreign investors to discover the weakness of contract law and the Indonesian court system, particularly when trying to recover in insolvency proceedings (Lindsey and Taylor, 2000). The 1997 crisis became the catalyst for a wave of donor-funded commercial law reforms that established a new Commercial Court in 1998 in Jakarta (and four other locations in 1999) and induced new legislation in areas such as insolvency, banking, competition, intellectual property rights and consumer protection. Most of these externally-mandated legal changes were designed to reform areas of regulatory law. For the most part they left the fundamental contours of contract law and practice in Indonesia undisturbed.

This chapter revisits the institutional environment for contract in Indonesia using interview data collected during 2003. It reports on what interviewees in the universities, practising Bar, donor community, government agencies and foreign investor organisations were saying about forming and enforcing contracts in Indonesia at that time. The chapter is a commentary on the USAID C-LIR[1] Assessment for Indonesia and should be read in conjunction with the published report (Booz Allen Hamilton, 2003a). A disclaimer also applies. Part of the new wave of 'metrics-based' approaches to assessing attributes of law in transition economies, USAID's C-LIR methodology is superior to a number of other evaluative approaches (Taylor, 2005a), but as I discuss below, however, it is not without methodological problems.

The key findings with regard to contract presented in the C-LIR Assessment are not new. Contract law in Indonesia 2003 seemed old-fashioned but relatively robust. Few attorneys were openly critical of the formal legislation. However,

1 United States Agency for International Development Commercial Law and Associated Institutional Reform Activities.

One explanation for this is what was described as low levels of both social trust and trust in government. A paradigm contracting story runs thus:

> Nike had subcontracted its manufacturing in Indonesia to South Korean shoemakers. This is labor intensive work and great for the skills level of Indonesian workers. The contracts were transferred to the PRC, leaving tens of thousands of workers unemployed. A lay-off allowance is mandatory under Indonesian labor law. Two weeks before the announced closure of the factories, Korean management just got on a plane and left. There was no recourse for the workers … The government exists not to safeguard its citizens, but is just one vast extortion regime. Extremely low trust is driven by extreme vulnerability. People will not directly confront someone because you don't know when you will need him (or where the next attack will come from). By contrast, the 1950s literature suggests that there was a time when there was a more benign central government. (Donor legal advisor, 2003)

Long-timer observers suggested that the public expectation of government in relation to law remains very low. This is not to say that law reform issues and problems afflicting the legal system were not widely understood and widely reported on in both the English language and vernacular press in Indonesian during this period. Perhaps we should also distinguish public perceptions and expectations of public legal reforms (such as the establishment of a Corruption Court) from those relating to institutions perceived as serving the private law needs of business. As one donor representative told us:

> We attempted a public debate on the Commercial Court by publishing the decisions. No-one responded. The systemic triggers are in place, but society refuses to be triggered. (Donor legal advisor, 2003)

One of the recurring themes in the interviews is the idea that 'everybody wants a hero' – that a champion or team of champions will emerge and will provide sufficient traction to shift bureaucratic legal culture and somehow provide systemic legal coherence by reconciling sedimentary commercial law with the latest reform enthusiasms of foreign donors. If Hadfield's analysis (2004) and the findings of this Assessment suggest anything, it is that implementing and supporting institutions cannot be assumed but need to be built, induced and supported. In other words, pouring resources into 'the courts' is unlikely of itself to create the institutional supports necessary elsewhere to help the courts function. If this is the case, then the 'hero' model will be of limited utility. Indonesian legal reformers and foreign donors may disagree about their preferred institutional targets, reform priorities and sequencing, but, going forward, both groups of stakeholders may need to find a different, more complex, narrative with which to understand and advocate commercial legal and institutional reform.

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