

# BTI 2014 | Indonesia Country Report

<b>Status Index</b>	1-10	<b>6.67</b>	# 35 of 129	
Political Transformation	1-10	7.05	# 38 of 129	➔
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	scale	score	rank	trend

This report is part of the Bertelsmann Stiftung's Transformation Index (BTI) 2014. It covers the period from 31 January 2011 to 31 January 2013. The BTI assesses the transformation toward democracy and a market economy as well as the quality of political management in 129 countries. More on the BTI at <http://www.bti-project.org>.

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**Key Indicators**

Population	M	246.9	HDI	0.629	GDP p.c.	\$	4955.9
Pop. growth <sup>1</sup>	% p.a.	1.2	HDI rank of 187	121	Gini Index		38.1
Life expectancy	years	70.4	UN Education Index	0.577	Poverty <sup>3</sup>	%	43.3
Urban population	%	51.4	Gender inequality <sup>2</sup>	0.494	Aid per capita	\$	1.0

Sources: The World Bank, World Development Indicators 2013 | UNDP, Human Development Report 2013. Footnotes: (1) Average annual growth rate. (2) Gender Inequality Index (GII). (3) Percentage of population living on less than \$2 a day.

## Executive Summary

During the period under review, Indonesia's democracy experienced neither a serious crisis nor significant progress. With President Susilo Bambang Yudhoyono preparing to end his second and final term in October 2014, he has found it even more difficult than usual to bring major political initiatives to the point of implementation. As a result, his popularity has declined dramatically, and many citizens have called for stronger and more decisive leadership. Several populist figures associated with the former authoritarian regime have benefited from these rising public sentiments, and they have declared their candidacies for the 2014 presidential elections. At the same time, the rule of law has remained weak, and there have been few indications that the country's notoriously endemic corruption is on the decline. Most seriously, Indonesia has seen a notable erosion in religious tolerance, with attacks on non-Muslims and Islamic sects increasing and the government showing little inclination to put an end to this dangerous trend.

The overall parameters of Indonesian democracy continue to be stable. The competitiveness of elections remains high (there were numerous local elections between 2011 and 2013), as do voter turnout and the wider population's support for democracy. The level of political conflict has been low, especially if compared to some of Indonesia's neighbors. Similarly, despite the chronic low-level attacks on religious minorities mentioned above, there has been no outbreak of large-scale ethnic, religious or other grassroots violence. Given that more than 10,000 people were killed during communal clashes in the transitional period between 1998 and 2003, the absence of any comparable conflict should not be taken for granted. Moreover, the Indonesian state has continued to strengthen its hold over remote territories, with more local government structures and institutions established during the period under review than at any other point in Indonesian history. Finally, while human rights abuses persist, they are now mostly of a nonpolitical nature, with the exception of violations in the restive province of Papua, where the state continues to fight a poorly organized separatist movement.

Indonesia's economy consolidated considerably between 2011 and 2013. Indonesia's GDP passed the \$1 trillion threshold during the period, marking a milestone in the country's economic development. On the basis of most economic indicators, Indonesia performed exceptionally well: GDP growth has been above 6% for eight consecutive quarters between 2010 and 2012; poverty and unemployment has declined; the government debt to GDP ratio decreased to 25%; the stock market reached record heights in 2011 and 2012; and foreign direct investment (FDI) flooded the country. However, the economic boom encouraged Indonesia to adopt an increasingly protectionist posture. In a series of policy decisions heavily criticized by foreign investors, the government issued regulations that imposed new import and export taxes, limited economic freedoms, and strengthened the role of the state in key areas of the economy. In addition, the government has been slow to address the country's most serious economic deficiency, an aging and underdeveloped infrastructure. Overall, then, Indonesia's political system has remained stagnant, while its economy has struggled to accommodate the country's rapid growth.

## History and Characteristics of Transformation

Indonesia's democratic transition began in May 1998, when longtime autocrat Suharto resigned from the presidency after 32 years in office. Supported by the military, the bureaucracy and his Golkar party electoral machine, Suharto had ruled the archipelago with an iron fist after bloodily putting down a communist coup attempt in October 1965. For much of his tenure, Suharto governed with a mixture of repression, patronage and performance legitimacy – the latter drawing on the high levels of economic growth under his watch. But the Asian financial crisis of 1997 – 1998 led to the collapse of the Indonesian economy, destroying Suharto's power base and sending poor Indonesians to the streets. As a result, cracks in the regime emerged, which in turn emboldened street protests and encouraged Western capitals to reconsider their support for their former anti-communist ally. When the armed forces deserted him as well, Suharto had no other option but to resign.

While Suharto's resignation occurred amid significant mass mobilization, the regime change itself took place as a pact-based transition. Opposition forces allowed Suharto's vice president, the hugely unpopular B.J. Habibie, to take power in exchange for assurances of substantial political reform. Indeed, Habibie's reforms – most of which he began implementing only a week after Suharto's fall – far exceeded the opposition's expectations: He scheduled free and fair elections, lifted restrictions on the press, released political prisoners and even launched a decentralization process that turned the heavily centralized state into one of the most decentralized polities of the developing world. The June 1999 parliamentary elections were globally praised as free, fair and competitive, and Habibie handed over power to his successor Abdurrahman Wahid in October 1999. However, Wahid was elected by the partially appointed People's Consultative Assembly, tainting the democratic quality of Indonesia's first nonautocratic power transfer and making political conflict unavoidable. Backed only by a small faction in the legislature, Wahid was soon locked in a hostile conflict with all other political forces. Following his attempt to dissolve

parliament in an unconstitutional manner in July 2001, the legislature impeached him. He was replaced by Vice President Megawati Sukarnoputri, who governed between 2001 and 2004.

While Megawati's presidency has often been described as visionless, it was during her term that the most important reforms of the post-1999 era were launched. Direct presidential elections were introduced, giving the head of state a popular mandate; a Constitutional Court was established that soon evolved into an effective arbitrator of political conflict; an Anti-Corruption Commission was founded that took on high-profile cases involving senior politicians; and direct local elections for governors, mayors and district chiefs were enshrined in the decentralization laws. When these reforms became fully operational in 2004 and 2005, Indonesia finally completed its democratic transition and moved into an early phase of democratic consolidation. The main beneficiary of this trend was Susilo Bambang Yudhoyono, who won the first direct presidential elections in 2004 and was re-elected in 2009. While he further stabilized the polity by integrating most political forces into his government and thus avoiding tensions, he has often been accused of inactivity. To be sure, he ended the war in Aceh in 2005, and has overseen Indonesia's entry into the G-20 and the club of the world's largest economies. But not a single major political reform project has been initiated since 2005, and Yudhoyono has stood idly by as the country's longstanding reputation for politico-ideological moderation was damaged as a result of continuous attacks on religious minorities. As Indonesia approaches the 2014 parliamentary and presidential elections, the legacy left by Yudhoyono for Indonesian democracy has been widely questioned.

The BTI combines text analysis and numerical assessments. The score for each question is provided below its respective title. The scale ranges from 1 (worst) to 10 (best).

## Transformation Status

### I. Political Transformation

#### 1 | Stateness

The Indonesian state's monopoly on the use of force is generally accepted. In the context of decentralization, the number of districts, sub-districts and villages has increased significantly, leading to the highest level of state penetration in remote areas since the country's independence. While Acehese rebels held around two-thirds of the province's territory in the early 2000s, the conflict was settled peacefully in 2005. In Papua, guerilla fighters continue to challenge the Indonesian state, but their forces are relatively few and do not exercise any effective territorial control. In most Indonesian provinces and districts, there are ethnic or religious groups (such as the Betawi Brotherhood Forum or the Islamic Defenders Front) that lay claim to some law enforcement functions. However, they often do so in cooperation with the police, who view them as fulfilling a useful political purpose. Importantly, whenever terrorist Islamist groups have tried to establish training camps in territorial enclaves (as in Aceh in 2010 and Poso in Central Sulawesi in 2012), the Indonesian state has quickly and harshly clamped down on them. As a result, terrorist Islamist groups have increasingly shifted targets so as to attack the police.

The vast majority of Indonesians have a strong sense of nationalism and enthusiastically support the nation-state as the final and exclusive form of state organization. The only exceptions are Papua, where many citizens demand their own state, and a number of marginal Islamist groups, which advocate for a Muslim caliphate in Southeast Asia. In the latter category is Hizbut Tharir Indonesia, which operates as an officially recognized organization. However, its campaign has failed to attract a mass following. Similarly, while decentralization has led to the revival of local identities, languages, customs and local strongmen, this pattern has not undermined the strength of national identity. If anything, it has strengthened it. Unlike the authoritarian regime, the current democratic regime does not deny any particular groups access to citizenship. From the founding of the nation in the 1940s until the early phase of democratic transition in the late 1990s, ethnic Chinese had found it

Question  
Score

Monopoly on the  
use of force

8

State identity

8

difficult to gain citizenship. In the last decade, however, Indonesia has made remarkable progress in this regard, reducing discrimination against ethnic Chinese people and opening up opportunities for them in terms of cultural, political and social participation.

As a state with around 87% Muslim inhabitants, Indonesia has traditionally struggled to maintain a balance between promoting Islamic values and the rights of non-Muslim minorities. While the Indonesian constitution guarantees the freedom of religion, this right has not been consistently upheld in recent years. To begin with, state and society have increasingly moved against atheists and their beliefs. In one case in 2012, a Sumatran man who declared his atheism on his website was first threatened by a mob and later sentenced to two and a half years in prison. Separately, Canadian liberal Muslim activist Irshad Manji was attacked in Yogyakarta when she discussed her first book, entitled “Faith without Fear: The Challenge for Muslims Today.” The police paid little attention to the case. In the same vein, orthodox Islamic views have had increasing influence on political attitudes and law enforcement practices, both at the national and local levels. At the national level, President Yudhoyono has refused to take tough action against Islamist groups that have attacked non-Muslim constituencies and Muslim sects viewed by the Islamic mainstream as heretic (such as the Ahmadis and the Shi’ites). Shari’ah law has been enforced with increasing strictness in Aceh province. Other districts and provinces have issued bylaws that enforce Islamic dress codes or require civil servants to be able to recite the Quran. These bylaws threaten women’s rights and the ability of religious minorities to practice their faith, as obtaining licenses for non-Muslim places of worship has become increasingly difficult.

No interference of religious dogmas

6

The Indonesian state has a functioning administration that reaches into all levels of state organization. Indeed, the expansion of the state apparatus that accompanied the post-decentralization explosion in the number of districts, sub-districts and villages has vastly increased the reach of the Indonesian bureaucracy. However, the quality of the public services delivered by the administration is often low. About 55% of Indonesians still lack access to sanitation, while 43% lack access to clean water. The country has one of Asia’s lowest sewage-infrastructure penetration levels. On the other hand, democratic elections have forced local incumbents to improve health and education services. Many incumbents now try to score points with the electorate by introducing free schooling and health care programs; this has led to a qualitative improvement in such services in some – but not all – areas.

Basic administration

7

## 2 | Political Participation

Every five years, Indonesians go the polls to elect the president, members of the House of Representatives and Regional Representative Council, and members of provincial and district-level parliaments. They also vote for governors, mayors, and

Free and fair elections

9

district and village heads. The direct ballots for president, governors, mayors and district heads include the possibility of run-offs. Accordingly, some Indonesians might go to the polls as many as seven times in a five-year cycle. Most Indonesians, as well as outside observers, believe that these elections are generally free, fair and competitive. There have been no known cases in which election results differed from the quick counts held by various polling institutes – the best indication that no large-scale manipulations have taken place. The number of local election disputes reviewed by the Constitutional Court in 2012 was also lower than that of the previous year. This does not mean that electoral management has been flawless, however. On the contrary, significant technical problems with voter registration persist. These are largely the result of Indonesia’s manually maintained citizen registry, with electoral commissions unable to update their voting lists quickly enough to handle the millions of voters who move between election cycles. The Home Ministry is currently finalizing its electronic citizen registry, which it claims will be ready for the 2014 elections. Generally, all political parties have access to the media, but some party leaders (such as Abdurizal Bakrie, Surya Paloh and Hary Tanoesoedibjo) own influential media outlets, giving them a competitive advantage.

While democratically elected politicians can generally govern without outside intervention, some veto powers continue to interfere in policymaking processes. Significantly, the military, whose influence has been much reduced, is no longer the most important veto power. Rather, oligarchs and business groups exert the greatest pressure on parties and politicians today, both with respect to the executive and the legislature. Given the absence of a functioning party and campaign financing system, many politicians have become dependent on external sponsors to finance their operations. In return, they pass regulations that benefit their sponsors and/or approve business projects proposed by donors. In 2011 – 2012, a large-scale corruption scandal involving senior figures of President Yudhoyono’s Democratic Party revealed the extent of this collusion with oligarchic interests. Partly because of this special-interest meddling, the legislative branch has been unable to implement its legislative and budgeting functions properly.

In most parts of the archipelago, the freedom of association and assembly is upheld. Indeed, Indonesia now has one of the most vibrant civil societies in Asia, with labor unions, grassroots advocacy groups, women’s rights associations and other bodies mushrooming and making their voices heard. Demonstrations in front of government buildings are a common sight and are usually not restricted by the police. However, this freedom still does not extend to groups that promote separatism, radical leftist ideologies or nonmainstream religious views. Supporters of Papuan independence are not allowed to organize freely, and some have been sentenced to long prison terms because they participated in peaceful flag-raising ceremonies. In October 2011, the police violently disbanded the Third Papuan People’s Congress after it became clear that the event would call for the province’s independence. At least five Papuans were

Effective power to govern

7

Association / assembly rights

7

killed in the police operation, and a number of activists were put on trial. In the same vein, openly communist groups are still officially outlawed. However, their membership numbers have been so small that the police have mostly ignored them. Finally, nonmainstream religious groups have also been constrained in their ability to assemble freely. Violent mobs have often disturbed their activities, with the state failing to offer protection or effective law enforcement.

Developments in the area of the freedom of expression were mixed between 2011 and 2013. On the one hand, Indonesia continues to have one of the freest presses in the region. Press reporting on government policy and other key issues is critical, and often even highly aggressive. On the other hand, the level of violence against journalists has increased significantly in recent years, with several journalists killed or kidnapped. As a result, Indonesia's ranking in the Reporters Without Borders' Press Freedom Index has fallen dramatically, from 100th in 2009 to 117th in 2010 and further to 146th in 2011 – 2012 (out of a total of 179 countries). This now places the country behind Singapore, Russia, Ethiopia and South Sudan. While Indonesia's press is more critical than in any of these countries, the government has failed to make the protection of journalists a political priority. At the same time, the government has limited access to the Internet. By February 2012, it had blocked 983,000 websites, a list that included openly pornographic sites, but also news articles that simply included the word "sex." Furthermore, freedom of expression has been increasingly limited for members of nonmainstream religious groups, which have to fear both societal intimidation and state prosecution if they speak publicly about their religious orientation.

Freedom of  
expression  
6

### 3 | Rule of Law

Following wide-ranging political reforms implemented after Suharto's fall, Indonesia now has a very effective system of checks and balances. While officially a presidential system, the Indonesian polity features a legislature with extensive budgetary, oversight and appointment powers. Indeed, the government cannot engage in any major policy initiative without the parliament's explicit approval. Meanwhile, the judiciary has developed into a politically independent branch of state organization, a stark contrast to the authoritarian era when judges openly served the political interests of the incumbent regime.

Separation of  
powers  
9

While the judiciary is now largely independent from political influences, it has remained vulnerable to corruption. Bribes can influence judicial procedures at all levels, from police investigations to indictments by the Attorney General's Office to court verdicts and appeals. The Anti-Corruption Commission arrested several judges in 2011 and 2012, with one sentenced to a four-year prison term for accepting bribes in a commercial case. In November 2012, a Supreme Court judge was forced to resign because he had personally reduced the sentence of a notorious drug convict to 12

Independent  
judiciary  
5



years although the panel of judges had agreed on 15 years. It was widely suspected that the judge had received financial inducements to do so. As a result of its corrupt nature, the judiciary has been unable to develop a differentiated and professional organization, despite the existence of a large network of formal institutions and channels. The only key judicial institution that has managed to insulate itself from the endemic corruption plaguing the legal sector is the Constitutional Court. While allegations of bribery have regularly been made against that court as well, in most cases these have remained unsubstantiated. Consequently, the Constitutional Court – whose nine judges receive higher salaries and allowances than their colleagues at the Supreme Court – stands out as a solitary exception from the incessant corruption that continues to undermine the effectiveness of Indonesia’s judiciary.

Corruption and abuse of power remain endemic in Indonesia. However, in contrast to the early post-Suharto period, many officeholders are now prosecuted for their actions. Between 2004 and early 2012, a total of 1,737 members of local parliaments have been investigated for abuses ranging from corruption (29% of cases), physical harassment (11%), document forgery (11%) and fraud (11%). Over the same period, the president authorized the legal prosecution of 173 local government heads. Many of these prosecutions have resulted in prison terms for the accused, especially in those cases handled by special corruption courts in the capital Jakarta. In 2012, the Constitutional Court scrapped the regulation that required presidential approval for investigations of governors, district heads and mayors, making it likely that the number of corruption cases will increase further in the years ahead. Most successfully prosecuted cases against officials were initiated and processed by the highly popular – albeit sometimes controversial – Anti-Corruption Commission, which has indicted a growing number of politicians and businesspeople in the highest echelons of power. In September 2012, for example, the commission arrested one of President Yudhoyono’s closest political allies and donors for bribery of a local official. Such successes have encouraged some political elites to propose reforms that would curtail the powers of the commission, but so far these attempts have been unsuccessful.

Protection of civil rights weakened somewhat in the period between 2011 and 2013. Three factors were particularly responsible for this. First, there has been a qualitative and quantitative deterioration of civil rights in Papua, with the police and military taking increasingly harsh measures against peaceful pro-independence activists and ordinary citizens suspected of assisting them. In August 2011, the Indonesian human rights group Kontras published reports of police abuses during an operation in Abepura, during which suspects were “struck with rifle barrels, kicked, cuffed, beaten and stepped on with military boots while handcuffed or tied.” Second, the police have increasingly sided with large companies in land and natural-resource disputes, leading to violence against people protesting that their land or traditional usage rights had been illegally taken from them. In August 2011, police used violence against protesters in Tiaka in Central Sulawesi, who claimed that an oil rig had destroyed

Prosecution of  
office abuse

5

Civil rights

6

their fishing grounds and demanded the compensation that had been promised to them. Two of the protesters were killed as a result of the police action, and six others seriously injured. Third, the civil rights of nonmainstream religious group followers are no longer effectively protected. Ahmadis, Shi'ites and other groups viewed by the Muslim mainstream viewed as heretic can no longer count on the state to guarantee their basic rights as citizens. In 2012, for example, both Ahmadis and Shi'ites faced community attacks on their mosques and homes in Madura, with state authorities unable or unwilling to protect them unambiguously.

#### 4 | Stability of Democratic Institutions

Overall, Indonesia's democratic institutions are functional and operate in an effective manner. There have been no serious conflicts between the executive and the legislature since 2001, when parliament impeached then-President Wahid. Similarly, the executive has honored the decisions made by the Constitutional Court, although many of its verdicts have openly contradicted government policies. Problems with the performance of democratic institutions usually do not arise as a result of interactions between state bodies, but rather have their roots in dynamics within them. For instance, the inclusiveness of government coalitions (six of the nine parliamentary parties are currently represented in the cabinet) slows down executive decision-making processes. In addition, as ministries have a high level of autonomy and are controlled by different parties or technocrats, the government does not always act as a coherent entity. In parliament, decisions are rarely made by majority vote along party lines, but are mostly the result of consensus-oriented negotiations that involve individual legislators and commissions as much as parties and caucuses. This leads to highly protracted policymaking processes and in some cases low-quality legislation. In 2012 alone, the Constitutional Court overturned 30 unconstitutional measures that had been enshrined in national law, pointing to serious problems in the legislative process.

All major social and political forces accept Indonesia's democratic institutions as legitimate. No key political actor has questioned the legitimacy of the democratically elected president since the chaos surrounding Wahid's impeachment in 2001. Similarly, disputes over legislative and local executive election results have been settled effectively by the Constitutional Court. So far, there has been only one known case (occurring in 2011) in which a local election commission refused to implement the court's decision, an instance that observers agreed was highly questionable. Most importantly, the armed forces have been successfully subordinated to the civilian democratic leadership. The last time the military pursued a policy that went against the declared wishes of the civilian government was in 2003, when it sabotaged the peace process in Aceh underway at that time. Importantly, Nahdlatul Ulama and Muhammadiyah, the two biggest mainstream Islamic organizations, have also

Performance of  
democratic  
institutions

7

Commitment to  
democratic  
institutions

8

endorsed the democratic system. Thus, the only forces that continue to reject the incumbent democratic system and its institutions are Islamist groups such as Hizbut Tahrir Indonesia. While not irrelevant in terms of their social significance, these organizations' following is not large enough to pose a serious threat to the democratic polity. It is important to note, however, that some populist leaders who currently pledge their allegiance to democratic institutions and are prepared to participate in competitive elections may privately have other agendas in mind should they successfully assume power. These leaders include former key figures of Suharto's New Order regime, who were ardent supporters of authoritarianism before 1998 and whose subsequent democratic turn is widely seen as a pragmatic maneuver rather than a genuine change of heart.

## 5 | Political and Social Integration

Indonesia's party system is fairly stable and socially rooted. Voter volatility, as measured by total net volatility, currently stands at 26.0, which is considerably lower than in many other new democracies in Eastern Europe, Latin America or East Asia. The level of polarization is also low. The stability of the current Indonesian party system contrasts sharply with the excessive polarization and volatility of the party system in the 1950s, the only other democratic period in the country's history before the 1998 regime change. In 2012, the parliamentary threshold (i.e., the vote percentage a party needs to achieve nationally in order to enter parliament) was raised to 3.5%, which is set to further consolidate the party system after the 2014 elections. Indonesia's political parties tend to be anchored in specific religio-political constituencies, although the switch to a more candidate-centered electoral system after 2004 has also led to the emergence of catch-all presidentialist parties such as Yudhoyono's Democratic Party.

Party system

7

Indonesia has a wide variety of interest groups that reflect competing societal interests. There are Islamic organizations such as Nahdlatul Ulama and Muhammadiyah, which are among the largest Muslim groups in the world; there are hundreds of labor unions that – although not centrally organized – were highly effective in achieving large increases in the minimum wage in 2011 and 2012; there are grassroots groups, women's rights associations, church networks, human rights NGOs, agrarian organizations, think tanks, mass media organizations, and many more associations that mediate between society and political parties. In combination, these groups have formed a powerful counterweight to the rising influence of oligarchic business interests. Of course, some societal interest groups have pursued an anti-democratic agenda: while numerically small, violent organizations such as the Islamic Defenders Front have successfully used the mushrooming of NGOs throughout the country to masquerade their attacks on nonmainstream religious groups as legitimate expressions of civil society activism.

Interest groups

7

Most Indonesian citizens strongly support democracy, both as a principle and as the basis of the current political system. In May 2011, 77% of respondents in a poll stated that democracy was the best form of government for Indonesia, a number that has been stable for much of the post-authoritarian period. Moreover, a majority of Indonesians regularly express satisfaction with the way democracy works, common complaints about politicians notwithstanding. There are two caveats to this general pattern, however. First, there is no joint understanding among Indonesians of what democracy actually means. In some surveys, many respondents have defined democracy essentially as the state's satisfactory provision of welfare. Second, some key institutions of Indonesian democracy, most notably political parties and the parliament, have invariably received bad marks from Indonesian citizens. Given that these two entities often suffer from low levels of popularity in advanced democracies as well, this should not come as a surprise. Many other institutions, including the presidency, the armed forces, the Anti-Corruption Commission, the Constitutional Court and various levels of local government enjoy generally high approval ratings.

Approval of  
democracy  
7

Indonesia has a large number of autonomous self-organized groups, associations and organizations. A 2012 study found that 84% of Indonesians belong to at least one such organization, as compared to a world average of 63% (as a regional comparison, this figure is 61% in Malaysia and 51% in Thailand). The number of people belonging to three organizations or more is nine times higher in Indonesia than in the Philippines or Singapore, and three times higher than in Thailand. In the study's sociability index (which measures the degree of intragroup loyalty and incidence of activities such as joining religious organizations), Indonesia has a score of 0.79, significantly above the world average of 0.49, the Philippines' score of 0.54 and Singapore's score of 0.49. However, the level of trust between citizens is not always as high. In the 2011 – 2013 period, there have been numerous incidents of intervillage clashes and ethnic tensions over relatively small issues, sometimes resulting in deaths and serious injuries. For instance, a violent clash among villagers erupted in Mataram (West Nusa Tenggara) in March 2013, resulting in the death of one resident and injuries to six police officers.

Social capital  
7

## II. Economic Transformation

### 6 | Level of Socioeconomic Development

Despite significant economic growth in the last 10 years, Indonesia continues to face serious development problems that effectively exclude large sections of the population from socioeconomic participation. In the 2011 Human Development Index, Indonesia placed 124th out of 187 countries surveyed. Moreover, its index score has increased only slowly, from 0.613 in 2010 to 0.617 in 2011. By far the

Question  
Score

Socioeconomic  
barriers  
5

country's biggest socioeconomic challenge is persistent poverty. While the official poverty rate declined from 13.3% in 2010 to 11.9% in March 2012, this statistic is based on a national poverty line of \$1.13 a day, significantly below the \$1.25 a day threshold used by the Asian Development Bank and the now widely recommended poverty line of \$2 a day. If the later formula were to be applied to Indonesia, about 51% of the population could be considered poor or near-poor. While in absolute numbers most of these are on Java, in percentage terms eastern Indonesia has the highest concentration of poverty. The concurrent economic boom and persistence of poverty has led to increasing levels of inequality. Whereas Indonesia's Gini index score of 36.8 gives the country a middle ranking in terms of overall inequality, the wealth concentration index value gives a very different picture: At 6.22, this is 25 times higher than Singapore's and three times greater than Malaysia's. Indonesia's 40 richest citizens are far wealthier than those of Thailand, Malaysia or Singapore, collectively holding \$71.3 billion in 2010. Women are particularly affected by this increasing level inequality. Indonesia was ranked only 100th in the 2011 Gender Inequality Index, with a score of 0.505.

Economic indicators		2009	2010	2011	2012
GDP	\$ M	539580.0	709266.0	846483.5	<b>878192.9</b>
GDP growth	%	4.6	6.2	6.5	<b>6.2</b>
Inflation (CPI)	%	4.8	5.1	5.4	<b>4.3</b>
Unemployment	%	7.9	7.1	6.6	-
Foreign direct investment	% of GDP	0.9	1.9	2.3	<b>2.3</b>
Export growth	%	-9.7	15.1	13.7	<b>2.1</b>
Import growth	%	-15.0	17.2	13.5	<b>6.7</b>
Current account balance	\$ M	10628.5	5144.3	1685.1	<b>-24073.9</b>
Public debt	% of GDP	28.6	26.8	24.4	<b>24.0</b>
External debt	\$ M	179394.5	195172.1	213540.8	-
Total debt service	\$ M	24897.9	29342.3	31240.5	-

Economic indicators		2009	2010	2011	2012
Cash surplus or deficit	% of GDP	-1.7	-0.6	-1.1	-
Tax revenue	% of GDP	11.4	10.9	11.8	-
Government consumption	% of GDP	9.6	9.0	8.9	<b>8.9</b>
Public expnd. on edu.	% of GDP	3.5	3.0	2.8	-
Public expnd. on health	% of GDP	1.1	1.0	0.9	-
R&D expenditure	% of GDP	0.08	-	-	-
Military expenditure	% of GDP	0.6	0.7	0.7	<b>0.8</b>

Sources: The World Bank, World Development Indicators 2013 | International Monetary Fund (IMF), World Economic Outlook 2013 | Stockholm International Peace Research Institute (SIPRI), Military Expenditure Database 2013.

## 7 | Organization of the Market and Competition

While Indonesia's economy is generally based on free market principles, there are important exceptions. First, Indonesia's informal sector is extraordinarily large, with around 65% of the workforce employed in informal businesses (which in turn generate around 38% of total GDP). This informal sector is directly and indirectly supported through the government's fuel and food subsidies, while the level of taxation is low. Second, Indonesia has increasingly turned to protectionist measures, and the state has re-strengthened its grip over key areas of the economy. In September 2012, it was announced that the state-owned logistics agency Bulog would once again control the supply and prices of three main commodities – rice, sugar and soybeans. Bulog originally lost this authority in 1998, when Indonesia deregulated its economy at the insistence of the IMF. The new Bulog initiative reflected a broader move toward a higher level of state interventionism in the economy. This increased state control of economic life followed significant public criticism of ASEAN's 2010 Free Trade Agreement with China, which opened Indonesia's market to free competition with Chinese imports. Third, Indonesia has forced a number of foreign investors, particularly in the oil and mining sector, to agree to renegotiate their long-term contracts with the government. This has led to complaints among investors about the long-term legal certainty of their contracts. Not surprisingly, Indonesia slipped four ranks in the 2012 – 2013 World Competitiveness Report, placing 50th out of 144 countries. By contrast, it had climbed 11 places in the preceding two years.

Indonesia's anti-monopoly measures are relatively effective. The state no longer grants monopolies to politically connected entrepreneurs, as was the case under Suharto's authoritarian regime. Many business fields previously monopolized by state-owned enterprises are now also open to competitive private investment. In the

Market-based  
competition  
6

Anti-monopoly  
policy  
6

2012 – 2013 World Competitiveness Report, Indonesia was ranked 40th out of 144 nations in terms of the effectiveness of anti-monopoly policy, 10 ranks better than its overall rating in the report. To some extent, Indonesia's success in controlling monopolization trends is due to the work of the Commission for the Supervision of Business Competition (KPPU), established in 2000. However, some of the KPPU's recent decisions have been overturned by the Supreme Court. In August 2012, the Supreme Court ruled that KPPU had wrongly accused Pfizer of using its dominant position in the antihypertensive products market to overcharge consumers. In the same month, the court also sided with state oil company Pertamina, private investor Medco and Mitsubishi, which the KPPU had accused of conspiracy in the context of a liquefied natural gas (LNG) project. Thus, while anti-monopoly policies are stronger than in the past, the weak Indonesian court system continues to undermine the KPPU's effectiveness.

As a country whose growth is driven largely by domestic consumption rather than foreign trade, Indonesia has had fewer incentives to liberalize its foreign trade regime than have many of its neighbors in Southeast Asia. In 2011, Indonesia's export volume to GDP ratio was 31%, while the percentage of imports in total GDP was just 24.6%, indicating a very low rate of foreign trade and placing it 132nd in the World Competitiveness Report in that category. In other indicators of the openness of its trade regime, Indonesia ranked slightly better, but still exhibited a tendency toward protectionism and cumbersome trade procedures. For instance, it was ranked 75th with respect to the prevalence of trade barriers, 73rd for the burden presented by customs procedures, 61st for the extent of trade tariffs, and 78th for the business impact of foreign direct investment rules. In 2012, Indonesia imposed significant restrictions on foreign investment in the mining sector. Under the terms of a new decree, foreign firms are required to start reducing their stakes in mining entities beginning with the sixth year of extraction, leading to no more than 51% domestic ownership by the 10th year of operations. Similar trends have occurred in the agricultural sector. For instance, Indonesia tightened quotas on imports of beef and live cattle in 2011, with the declared goal of achieving self-sufficiency by 2014.

After collapsing in 1997 – 1998, Indonesia's banking system has made a remarkable recovery. Its current indicators point to overall stability. Indonesia's bank-capital-to-asset ratio was 11.4% in 2010, its capital adequacy ratio (CAR) was 16.05% in late 2011, and the banks' share of nonperforming loans was 2.9% in 2011. All of these figures are far better than the Basel II requirements for a healthy banking sector. There are also comparatively few restrictions on foreign ownership in Indonesian banks. However, some uncertainty has arisen with the creation of the Financial Services Authority (OJK), which is scheduled to become operational in 2013. The OJK will combine the supervisory functions of the Central Bank (BI) and the capital market watchdog, called Bapepam-LK. Observers have questioned the necessity of creating the OJK, as both BI and Bapedam-LK had received good marks for securing

Liberalization of  
foreign trade

6

Banking system

8

the stability of the post-1998 banking system. Given that the majority of OJK officials have a strong BI background, however, most experts expect that the establishment of the OJK will bring continuity rather than radical change. Thus, the current independence and effectiveness of the regulatory regime is likely to be sustained. In terms of the accessibility of the Indonesian banking sector for foreign investors and banks, there have been calls by populist politicians to impose tighter restrictions. After the 1997 – 1998 crisis, Indonesia allowed foreign banks to hold up to 99% of shares in Indonesian banks. Recent draft bills for a new banking law, by contrast, call for a reduction in the maximum foreign-owned share to between 40% and 49%. These demands reflect the widespread disappointment among the Indonesian elite that Indonesia's openness to foreign investment in the banking sector has not led to reciprocal moves by its neighbors, most notably Singapore.

## 8 | Currency and Price Stability

Indonesia has been widely praised for its prudent anti-inflation and monetary policies. Annual consumer price index (CPI) inflation stood at 4.6% in August 2012, which was within the central bank's 2012 target range of 3.5% to 5.5%. This number has been stable for much of the 2011 – 2013 period. The only exception has been food price inflation, which was significantly higher (between 7% and 8%), largely as a result of domestic and international droughts and the government's imposition of import restrictions. Indonesia has also been comparatively successful in maintaining national currency stability. While the rupiah declined by 6% in 2012, the central bank intervened regularly to prevent a more drastic fall. This intervention provided certainty for both importers and exporters. As stated above, the central bank – widely seen as the guarantor of stable monetary policy since 1998 – will lose some of its authority to the newly formed OJK in 2013.

Anti-inflation /  
forex policy

8

One of the biggest successes of the Yudhoyono presidency has been the reduction of the government-debt-to-GDP ratio from 60.5% in 2004 to 25% in 2012. While external debt increased from \$132.6 billion in 2006 to more than \$225 billion in 2012, the rapid expansion of the broader economy has made this rise easy to manage. In the same vein, Indonesia increased its foreign reserves from below \$40 billion in 2004 to more than \$110 billion in 2012. However, growing populist spending on fuel subsidies (totaling \$32 billion in 2012, \$8 billion more than planned) has led to the highest budget deficit in a decade, reaching 2.3% in late 2012. At the same time, Indonesia recorded current account deficits throughout 2012, reaching a high of \$7.7 billion in June 2012 (in 2006, it had still registered record surpluses of \$3.8 billion). While these deficits point to Indonesia's increasing need for imports to fuel its booming economy, they will become a source of concern if sustained over the long term.

Macrostability

8



## 9 | Private Property

Private property rights are generally upheld, but remain vulnerable to the uncertainties inherent with a corrupt judiciary. Especially in the area of land rights, courts often side with the party that offers the largest bribe to the judges handling the case. Thus, in the 2012 International Property Rights Index, Indonesia ranked only 86th out of 130 surveyed countries. While this constituted an improvement over previous years in terms of ranking, Indonesia's 2012 score actually declined from its 2011 level. Within this index, Indonesia has recorded a particularly poor result in the protection of intellectual property rights, where it ranked 103rd. This reflected the open availability of pirated software, movies and music DVDs across Indonesia, against which the government and law enforcement agencies have taken no serious measures. For example, in a 2012 survey of 33 countries undertaken by the Business Software Alliance, 86% of Indonesian respondents confessed to using pirated software – second only to Venezuela (88%) and ahead of China (77%).

Property rights  
6

The Indonesian state views private enterprises as primary engines of economic production. Indeed, much of the government's long-term economic planning relies on investment by and the role of private businesses, especially with respect to developing infrastructure and fueling growth. Private business organizations such as the Chamber of Commerce (Kadin) and the Association of Indonesian Entrepreneurs (Apindo) have become increasingly powerful. Since 1998, the government has privatized many state-owned enterprises (SOEs) in an attempt to reduce its debt, and has pledged to make the remaining ones operate more professionally. Initially, privatization processes were handled by a government-run debt restructuring team, but in recent years, international financial firms have been hired to manage initial public offerings (IPOs). The national airline Garuda was listed on the stock market in February 2011, achieving record levels in mid-2012 after an initial drop in its share price. At the same time, the previously loss-making company began to report profits, registering a more than 50% rise in net revenues in the third quarter of 2012. Three more SOEs – PT Primmissima, PT Kertas Padalarang and PT Sarana Karya – are scheduled for IPOs in the near future. These privatization initiatives, which have largely followed free market principles, stand in contrast to the abovementioned strengthening of the state's Bulog logistic agency, which is in the process of re-establishing a monopoly on the trade and distribution of important food items. Contradictory trends such as these point to inconsistencies and infighting within the Yudhoyono government and affiliated state agencies.

Private enterprise  
7

## 10 | Welfare Regime

The social safety nets remain underdeveloped. However, in the 2011 – 2013 period, Indonesia took a huge step toward a more effective social welfare system. In October 2011, parliament passed a law that will merge four state-owned insurance companies – Jamsostek, Taspen, Asabri and Aske – into two social security agencies (BPJS). The first will become operational in January 2014 and will provide health insurance to all Indonesians. Those with a regular income will pay monthly premiums, while the government will pay premiums for the poor or unemployed. In July 2015, a second agency will be launched, offering accident and life insurance as well as pension programs. This policy breakthrough was universally praised, and it appears that Indonesia will have a basic social insurance system for the first time in its history. But the country has made progress beyond simply initiating a national social security scheme. More and more districts and municipalities have introduced their own systems, offering free health care and schooling to their citizens – Aceh and Jakarta being two key examples. Electoral competition is mostly responsible for these programs, but increased prosperity in some regions has also played a role.

Social safety nets  
6

While equal opportunities to access education, public office or employment are generally available to citizens regardless of ethnicity or religion, there are significant hurdles for women, the poor and rural citizens. To begin with, women are underrepresented in the workforce, with 52% of women having some form of employment as opposed to 86% of men. Women are also less likely to have completed secondary school than are men (24% as compared to 31%). Only 18% of national parliamentarians are women, and just a handful of governors, district heads or mayors are female. Besides women, the poor also face significant challenges in obtaining high-quality education or employment. While literacy and gross primary school enrollment levels are high in Indonesia (92% and 120% respectively), the overall quality of education offered in public schools is below international standards. Many parents can't afford to keep their children in school, often requiring them to work in the informal family business instead. Moreover, it is still common for government offices to charge civil-service job applicants an unofficial "fee" if they want to be considered for employment. Finally, rural Indonesians are disadvantaged vis-à-vis those who live in the city. Based on official statistics, 8.8% of urban citizens were poor in March 2012, versus 15.1% of the rural population. While the government has declared that it wants to reduce barriers to opportunity for women, the poor and rural Indonesians, any change in this situation is likely to be slow and will need generations to take root.

Equal opportunity  
5

## 11 | Economic Performance

Indonesia's overall economic performance is good. GDP growth has been mostly above 6% per year since 2006, with the exception of a period in 2009 and 2010 while the country recovered from the global financial crisis. But even during this slowdown, GDP growth never fell below 4% per year, an exceptionally high growth rate at a time when many countries recorded GDP contractions. Nominal GDP per capita nearly doubled between 2007 and 2011, from \$1,859 to \$3,495. In purchasing power parity (PPP) terms, GDP per capita was above \$4,500 in 2011. The official unemployment rate stood at 6.14% in April 2012, down from 11.24% in October 2005. Foreign direct investment (FDI) inflows hit a record \$19.3 billion in 2011, with the 2012 figures topping this number by between 22% and 30% in the first three quarters of the year alone. As noted in earlier sections, inflation was stable at an annual rate of around 4.6% in 2012, and Indonesia has dramatically reduced its government-debt-to-GDP ratio to 25% (from more than 60% in 2004). Similarly, while the current account and budget deficits have increased slightly in 2012, they remain low by international standards. In the same vein, although the tax-revenue-to-GDP ratio stood at an unsatisfactory 12% in 2012, this was not unusual for the Asian region. Generally, then, Indonesia's macroeconomic indicators in the 2011 – 2013 period were more than sound, constituting significant improvement relative to the 2009 – 2011 statistics.

Output strength  
8

## 12 | Sustainability

In 2009, Yudhoyono announced that Indonesia planned to reduce its emission of greenhouse gases by 26% by 2020. This, the president said, would be achieved by slowing down deforestation and forest degradation. In May 2011, therefore, the country signed a two-year moratorium on new forestry concessions as part of a \$1 billion deal with Norway. But critics have pointed out that the agreement included too many loopholes, and that it did not introduce sufficiently credible measures against illegal logging. A 2012 study predicted that the scheduled expansion of palm oil plantations alone would lead to a dramatic increase – not a reduction – in emissions. The researchers projected that the new plantations will add more than 558 million metric tons of carbon dioxide into the atmosphere by 2020 – more than all of Canada's current fossil fuel emissions. In addition, Indonesia continues to build coal-fired power plants; one such plant was opened in West Java in November 2012, and more are currently being developed. The country has not developed any incentives (tax-based or otherwise) for its population to reduce fuel and electricity usage. On the contrary, the government continues to subsidize gasoline for private cars. Under these circumstances, it is difficult to see how the goal of reducing emissions can be

Environmental  
policy  
4

achieved. Consequently, Indonesia was ranked only 74th on the 2012 Environmental Performance Index, achieving no improvement over previous years.

Indonesia's education and research facilities are generally of poor quality. While primary education enrollment is satisfactory, Indonesia's secondary education enrollment levels are low (77.2% in 2012) and its tertiary education enrollment well below international standards (23.1%). At 3.0 % (in 2010), the ratio of public education spending to GDP was also below average. However, even more worrying are the substandard levels of R&D spending. At an estimated 0.20% of GDP in 2012 (up from 0.10% in 2010), Indonesia had the smallest investment in research and development of all large world economies. Brazil, for instance, spent 1.25% of its GDP on R&D in the same year. In the 2012 – 2013 World Competitiveness Report, Indonesia was ranked 101st out of 144 surveyed countries in the number of patents per 1 million of a country's inhabitants (0.1). Similarly, the number of published scientific articles per 1 million inhabitants in Indonesia was 0.9 in 2010 – significantly lower than Singapore (831), Malaysia (24) and Thailand (20). However, not all of Indonesia's indicators in the field of education and R&D are poor. According to the 2012 – 2013 World Competitiveness Report, Indonesia was ranked 30th with respect to the capacity for innovation, 25th in company spending on R&D, 40th in university-industry collaboration in R&D, and 39th in the extent of staff training. The number of scholarship programs for students, state university lecturers and public servants provided by the central and local governments (including in Aceh, Papua and West Papua Provinces) has also increased. Thus, while the quality of education and research remains subpar, there are some indications that Indonesia is taking measures to address the problem.

Education policy /  
R&D  
5

## Transformation Management

### I. Level of Difficulty

The main constraints on the Indonesian leadership's governance capacity are widespread poverty, low education levels, severely limited public infrastructures especially in the regions outside Java, endemic corruption and geographical factors. With more than half of the population living on less than \$2 a day, Indonesia's political leaders have to focus much of their attention on fulfilling the population's basic needs. This in turn often contributes to short-term policies rather than long-term solutions. Similarly, the lack of an educated workforce makes Indonesia's transformation into an industrial, modern and sophisticated society difficult. Particularly serious is the low percentage of Indonesians with a tertiary education – 23.1% as compared to Thailand's 45%, for example. In the same vein, the rampant corruption and weak rule of law continue to sabotage the development of a modern economy and of public infrastructure such as roads, bridges, electricity generation and transmission facilities and clean water. Finally, Indonesia's geographic conditions also constrain governance capacity. As an archipelago stretching about 5,000 kilometers and encompassing three time zones from its western to its eastern end, the country faces considerable transportation, communication and infrastructure challenges. One important aspect of this vulnerability to geographic factors is the high likelihood of natural disasters, especially volcanic eruptions, earthquakes, tsunamis, floods and landslides. An 8.6 magnitude earthquake off the coast of Sumatra in April 2012 sent a timely reminder that a disaster like the 2004 Boxing Day tsunami, which caused around 170,000 deaths and billions of dollars in damage, could strike again at any time.

Structural  
constraints

6

While Suharto's authoritarian regime sought to control and suppress civil society activism, the regime change led to an explosion in the number of NGOs and other societal organizations. In 2012, at least 19,000 NGOs were registered with the Ministry of Social Affairs alone, while the Ministry of Religious Affairs recorded 9,000. Many more are listed with other ministries or not listed at all. These civil society groups have scrutinized government policies, demanded more popular participation in budgeting and policy planning, protested against corruption and other transgressions, and have represented the poor and underprivileged vis-à-vis bureaucrats, employers and law enforcement institutions. Indeed, civil society is at

Civil society  
traditions

6

the moment the strongest bulwark of Indonesian democracy, presenting strong resistance against any elite force that may try to initiate a return to authoritarianism. While civil society activism is stronger in the urban centers than at the local levels, decentralization has strengthened NGO operations in the districts as well. Despite the strength of civil society activism, it is vital to recall that not all civil society groups are supportive of principles of good governance, the development of social capital and popular participation. Some groups (Hizbut Tahrir Indonesia, for example) openly pursue nondemocratic goals, such as limiting the rights of religious minority groups. Some others are under control of politicians, and are used to support their sponsor's individual and group interests. Dealing with these groups is a constant policy challenge for incumbent governments at both the national and local level. Throughout the 2011 – 2013 period, Islamist groups have led violent protests against churches (mostly in West Java) that they viewed as lacking building permits, forcing the police and local administrations to pull resources from other areas to manage this problem.

After high levels of religious, ethnic and separatist conflict in the early phase of the post-authoritarian transition, the extent of communal violence is now relatively low. To be sure, clashes between religious and ethnic groups still do occur, but on a much smaller scale than in the late 1990s and early 2000s. For example, violence between Balinese transmigrants and indigenous villagers in Lampung on Sumatra led to the deaths of 12 people in October and November 2012. But in contrast to previous episodes of ethnic violence on Kalimantan more than a decade ago, the conflict was quickly contained. Political conflicts resulting from local elections also still occur in some regions. At the national level, the nature of political competition is largely noncombative, despite the fact that many parties are grounded in specific religio-social constituencies. Indeed, these cleavages are crucial for the maintenance of an effective party system, which requires a certain degree of politico-ideological partisanship in order to survive. One indication of the political sustainability of Indonesia's cleavage structure is that it has not triggered significant mass mobilization. The only instances of large-scale mass protests in recent years have involved labor unions demanding higher wages and better working conditions. While some of these actions have interrupted industrial production and the traffic in urban centers, they have also led to considerably higher minimum wages for Indonesian workers. Overall, the level of societal and political violence is moderate to low.

Conflict intensity

5

## II. Management Performance

### 14 | Steering Capability

In the broadest of terms, the Indonesian government has set some fundamental policy priorities and has implemented them. For example, the executive has prioritized macroeconomic growth, drawing criticism from many observers who have argued for a more people-oriented strategy. The main indicators of the Indonesian economy (GDP growth, debt ratio, budget deficit) demonstrate that the government has stayed its course. However, successive cabinets have failed to tackle one of the state's most urgent policy priorities: the ballooning fuel and electricity subsidies. While the Megawati and Yudhoyono governments each acknowledged the seriousness of the issue and at times tried to resolve it, they mostly aborted their efforts in the face of public resistance and political machinations. For example, when Yudhoyono attempted to raise fuel prices in April 2012, parties belonging to his coalition engineered a vote in parliament that postponed any such move. Within the coalition, Golkar and the Islamist PKS party have gained a particular reputation for voting against government policies that could attract popular opposition. Similarly, the government has increasingly resorted to economic protectionism, despite its public commitment to free trade principles. In the noneconomic policy arena, the government has defined the defense of Indonesia's pluralist constitution as a major priority. But while it does so rhetorically, it has frequently failed to confront radical Islamist groups that attack religious minorities or Muslim sects they view as heretic. Hence, while the government defines strategic priorities and mostly defends them, it occasionally gives in to public pressure and postpones or aborts important policy measures.

While the setting of executive priorities is complicated by conflicts within the ruling coalition and the pressure to adopt populist policies, actual policy implementation is made difficult by Indonesia's multilevel system of checks and balances. For instance, parliament often alters government policies despite the fact that the coalition holds 70% of all seats. Beyond the issue of fissures within the coalition, individual legislators often have locally defined and/or material interests that drive them to seek amendments to national policies. Similarly, government policies are often overturned by the Constitutional Court. In November 2012, for example, the court disbanded a regulatory body in charge of overseeing oil and gas contracts, originally established by the government as a means of combating rampant corruption within Pertamina, the national oil company. In the same month, the court handed authority to propose mining zones to local governments, further reducing the authority of the central administration in this field. Generally, national governments have found it much

Question  
Score

Prioritization  
6

Implementation  
6

more difficult to implement national policies in the wake of the decentralization that became fully operational in the mid-2000s. More than 40% of the national budget is now spent by local governments, up from 17% in 2000. Other hindrances to effective policy implementation include corruption, noncompliance and ineffective bureaucracies. For instance, in late 2012, the bureaucratic apparatus within the Electoral Commission openly refused to take orders from their superiors (the commissioners), severely obstructing the agency's work. It would be wrong, however, to suggest that government policies are only rarely implemented. In fact, given the myriad problems in day-to-day governance, a surprising number of policy initiatives actually do get realized by national and local executives.

In the early post-authoritarian transition, Indonesian governments were highly innovative. Learning from the mistakes of previous autocratic regimes, post-Suharto rulers introduced effective democratic institutions and the basic structures of a market economy. Since the mid- to late 2000s, the pace of innovation has slowed down, and the government has been less creative in developing new policies. For instance, the government is fully aware that the fuel and electricity subsidies are unsustainable and are simply bad policy. Yet the cabinet had still not come up with a practical solution to the problem by early 2013, despite regular announcements that it would. Similarly, the government is aware that the country's consistent GDP growth has not translated into sufficient employment growth. Nonetheless, it has continued policies that are based on the expectation that economic growth will eventually lead to more and better-paid jobs. Accordingly, while the government has been innovative enough to create a stable electoral democracy and good macroeconomic fundamentals, it has found it much more difficult to take the country to the next level of development.

Policy learning

6

## 15 | Resource Efficiency

Indonesia faces significant problems in using its available human, financial and organizational resources effectively. For example, national and local executives spend more on administration and salaries than is usual in most other countries (in some districts, nearly 70% of the total budget is allocated for the management of the bureaucracy), but there has been no dramatic improvement of public services that could justify such expenditure. Similarly, the recruitment of civil servants is often not based on merit – in some cases, positions are “sold” to applicants, whereas in others they are given to associates and relatives of senior bureaucrats. While the overall budget deficit is manageable and government debt is low, there are considerable inefficiencies in budget management as well. Indeed, these inefficiencies often result in a situation in which governments struggle to spend the money available. For instance, in mid-November 2012, the Jakarta city government had spent only 56% of its 2012 budget, leaving many planned projects stranded. In more general terms too, the government does not make effective use of its unique

Efficient use of assets

5



human and natural resources. While Indonesia's workforce is Asia's third largest, it is also one of the region's most unproductive. The country's abundant natural resources are often not professionally managed. Illegal logging, mining and fishing cost the state billions of dollars each year, and it has fallen behind in developing new gas, oil and mining concessions that could be of substantial budgetary benefit. Indeed, Indonesia has created a regulatory environment that many investors – both domestic and foreign – view as prohibitively cumbersome.

Post-Suharto governments have found it difficult to coordinate conflicting objectives into a coherent policy. Ministers have traditionally enjoyed a high level of autonomy in running their departments, and the level of coordination between them is low. With six rival parties holding ministries and using them as a source of patronage, cabinet members usually try to shield their departments from outside interference and scrutiny. But ministries held by parties are not the only ones to have failed to coordinate effectively: Half of the cabinet seats are occupied by non-party technocrats with widely differing objectives and philosophies. Both former President Megawati and President Yudhoyono have been notorious for their unwillingness to give detailed directives and enforce a stringent policy line in cabinet. As a result, many Indonesians have called for stronger leadership after the end of Yudhoyono's term in 2014. However, even a more decisive president will face serious difficulties in amalgamating the interests of the executive, parliament, the Constitutional Court, several levels of local government and public opinion into a coherent set of government policies. The degree of power diffusion in post-authoritarian Indonesia is extremely high, and while this has prevented the return of authoritarianism, it has also complicated policymaking. For example, the urgently needed reduction in fuel subsidies failed once again in March 2012 due to parliamentary obstruction. Despite this complication, the government has been able to deliver sound macroeconomic policies, thanks in no small measure to a long tradition in Indonesian politics of entrusting the actual implementation of economic and monetary policies to a small circle of Western-educated technocrats and the independent central bank (BI).

There are today more politicians under investigation or already in prison for corruption than at any other point in Indonesian history. This signifies that an increasing number of officials are being held accountable for their transgressions, but it also demonstrates that there has been no decline in the quality and quantity of corruption. Apparently, the rewards of corrupt behavior still outweigh the risk of being caught and imprisoned. Indeed, Indonesian prisons are well-known for offering privileges to rich inmates, and sentences are often cut by half for "good behavior." As a result, the higher rate of investigations and convictions has not served as a disincentive against corruption in the way that anti-corruption experts had hoped and expected. At the same time, the auditing of state spending remains weak. Many findings from the State Auditing Agency (BPK) result in no action on the part of the government, parliament or law enforcement agencies. In the first six months of 2012,

Policy  
coordination  
6

Anti-corruption  
policy  
4

the BPK found 13,105 cases of financial irregularities involving \$1.3 billion of state funds, but there have been few legal consequences for the agencies accused of the violations. Similarly, party financing regulations are not enforced. Since the state provides only minuscule state subsidies to parties (covering far less than 1% of their operational costs), the parties' illicit fundraising activities are widely tolerated. These can include payments by sponsors to directly to politicians' private bank accounts (rather than to party treasuries), large unreported donations by party functionaries, or self-funded campaigns by candidates that do not show up in their parties' books. Consequently, the amount of money held in official party and campaign accounts is so small that the cost of the official audit is often higher than the account balance. In the same vein, while office holders have to submit regular wealth reports that are widely publicized in the media, unusual increases in wealth over time only rarely lead to legal investigations.

## 16 | Consensus-Building

The consensus among the political elite in support of maintaining the democratic system is currently strong. However, this is largely a reflection of the solid public support for democracy, both in civil society circles and among ordinary citizens. Should this support weaken (either as the result of an economic shock or long-term frustration with government ineffectiveness), it is almost certain that the pro-democracy consensus in the elite will dissipate. Thus, it is best to describe the pro-democracy attitudes of many elite segments as opportunistic rather than principled. For example, Prabowo Subianto and Abdurizal Bakrie – both declared candidates for the 2014 presidential elections with long-standing ties to the Suharto regime – will arguably operate within a democratic framework as long as the costs of moving against it would be too high for them. But should the strength of public backing for democracy decline, both figures would be likely to use that opportunity to seek significant changes to the political system. In terms of the market economy, there is general agreement that Indonesia needs to play by the rules determined by the dynamics of the global economy. However, there is also an increasing consensus that Indonesia has to shield itself from the negative consequences of globalization by protecting domestic players in the economy. Hence, the number of protectionist measures increased dramatically in the 2011 – 2013 period. That said, Indonesia is unlikely to return to the economic isolationism of the 1960s. It is probable that Indonesia will roll back its protectionist policies if and when they begin to hurt the overall economy – that is, if they have an impact on FDI and GDP growth.

In general, the Indonesian polity has co-opted rather than excluded anti-democratic actors. The armed forces, oligarchic interests and Islamist groups have all been offered a place in the post-authoritarian system. On the one hand, this inclusiveness has guaranteed the stability of the polity, giving spoilers few incentives to derail the

Consensus on goals

7

Anti-democratic actors

7

democratization process. On the other hand, the integration of potentially anti-democratic actors has slowed down reforms and reduced Indonesia's overall democratic quality. Oligarchic interests, for instance, have been increasingly powerful in party politics and local politics. Indeed, oligarchs have taken over a number of key parties, exploiting the latter's financial weakness by offering to fund their operations. In 2013, four of the nine main parties were led by financially powerful patrons, who in turn have received access to policymaking processes and negotiations over resource distribution. Local strongmen and local bossism have emerged in local politics. The armed forces, while politically emasculated, have enjoyed continued legal impunity for past (and more recent) human rights violations in exchange for their acceptance of democratic rule. By 2013, not a single high-ranking general had gone to prison for any of the systematic and gross human rights violations committed under Suharto. Likewise, the Yudhoyono government has still not revised the law on the Truth and Reconciliation Commission, which the Constitutional Court scrapped in 2006 while mandating the government to produce a replacement. Finally, Islamist parties and forces have a significant stake in the post-Suharto polity, which constrains their anti-democratic activism but also gives them political leverage to gain influence over important policy decisions.

The political leadership has been able to depolarize some cleavages better than others. At the macro-political level, the main forces engage with each other in a noncombative (some would even say collusive) manner. Similarly, most regional and urban-rural cleavages have been addressed through inequality-mitigating mechanisms built into the decentralization policies – for instance, poorer areas receive more central government subsidies than affluent ones. But while the government has managed to maintain the overall stability of the cleavage structure, it has paid less attention to what it views as secondary and therefore less important divisions. To begin with, it has not managed to deescalate religious tensions at the grassroots level. In fact, the executive's inaction has arguably fueled these conflicts, leading to an unprecedented level of attacks against nonmainstream Muslim groups and other religious minorities (mostly evangelical Christians). At the same time, the government has underestimated simmering class tensions, with underpaid workers now demanding better pay. For example, the government was seemingly unprepared for massive strikes in 2011 and 2012. In order to calm the protests, the political leadership agreed to large increases in minimum wages, despite knowing that such a short-term, unsystematic response was unlikely to solve the problem. Finally, the government also seemed surprised by renewed ethnic tensions in transmigration areas. The 2012 clashes in Lampung between locals and Balinese were eventually contained, but pointed to a larger problem that the government has not handled effectively.

Cleavage /  
conflict  
management  
6

Contrary to widespread perceptions, Indonesian civil society has a significant influence on the political process. Most importantly, there has been a notable influx of civil society activists into political parties and parliament since the mid-2000s. Women's activists, labor leaders, journalists and other civil society figures have since that time occupied critical positions in the political infrastructure, and have fought effectively for their specific issues. In addition, labor unions in particular have found it relatively easy to exert political pressure on incumbent officials at both the national and local levels – no minister, governor, district head or mayor can today issue labor-related regulations without taking the demands of the unions into account. The 2012 increases in minimum wages across the archipelago and the new restrictions on outsourcing (also passed in 2012) are examples of this. The media has also had a tremendous influence on policymaking, with government plans often faltering after attacks by newspapers and television stations. But as indicated earlier, the strength of civil society has a downside: Nondemocratic segments of civil society also have a say in the political process. Conservative religious organizations have influence on every piece of legislation that touches on issues of religious values or morals, and they even have claimed a role in their implementation. Most notoriously, the 2008 Pornography Bill gives “society” the right to help in upholding its provisions, and Islamist groups have made extensive use of this authority, as during the successful campaign against the planned Lady Gaga concert in Jakarta in May 2012.

Civil society participation  
7

Indonesian governments have traditionally shown little interest in truth and reconciliation processes, and the current administration is no exception. Most importantly, the Yudhoyono government has systematically blocked attempts to deal with the anti-communist massacres of 1965 – 1966. After Indonesia's Human Rights Commission finally declared the killings to be a human rights violation in July 2012, the Attorney General's Office refused to act on the commission's findings. Moreover, President Yudhoyono's Chief Security Minister Djoko Suyanto defended the killings as necessary in October 2012, and rejected any action on behalf of the government. As mentioned above, the president has also continued to drag his feet on the establishment of the Truth and Reconciliation Commission. This commission was first created in 2004 but was annulled by the Constitutional Court in 2006, with the judges asking the government to draft a new law. More than half a decade later, the government still has not followed up on the court's order. The failure to convene a national Truth and Reconciliation Commission has also hampered the creation of an equivalent commission for Aceh, as was mandated by the 2005 Helsinki peace accord between the Indonesian government and Acehese rebel leaders. At the same time, the president has refused to establish human rights tribunals dealing with the involuntary disappearances of 1998, which involved high-ranking military officers. This refusal comes despite the fact that parliament requested just such a move in 2009, usually the first step in the establishment of tribunals. Overall, the Indonesian

Reconciliation  
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leadership's efforts to achieve reconciliation between victims and perpetrators of past injustices thus remain marginal to poor.

## 17 | International Cooperation

In the first decade of the post-Suharto transition, Indonesian governments made extensive use of international democracy and economic assistance. In fact, the key reforms undertaken by post-1998 governments – the electoral system, decentralization, the creation of the Anti-Corruption Commission, the establishment of the Constitutional Court and international trade policies, to cite just a few examples – were mostly designed along international models. But after Indonesia repaid its debt to the IMF in 2006, and after its economy grew stronger, the country adopted a more nationalist attitude toward foreign assistance and advice. In 2009, the government forced all foreign donors to endorse the so-called Jakarta Commitment, a document that ostensibly set out a “roadmap” for Indonesia’s development until 2014 but in effect asked donors to run their programs through official Indonesian government channels. Subsequently, the Indonesian government has not used the Jakarta Commitment to draft a more coherent development strategy and coordinate this with its donors; rather, it has utilized the document as an instrument to obstruct donor activity it views as political and interventionist. For example, one European foundation with a longstanding presence in Indonesia was asked in 2011 to stop work on labor issues, and was not granted a new permit to operate in the country. Today, the Indonesian government would prefer foreign donors to simply pay for programs it views as helpful – for instance, infrastructure projects, microfinance programs, sanitation improvements and school construction. Thus, while the government integrates foreign aid into its development design, this no longer includes significant democracy and political support.

Effective use of support

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The international community considers Indonesia a credible and reliable partner. Indeed, many Western leaders (including U.S. President Obama and British Prime Minister Cameron) have increasingly been criticized in activist circles for excessively praising Indonesia’s progress and ignoring its shortcomings. For most Western countries, Indonesia is a tremendously successful example of a democratized and economically reformed Muslim nation. But Indonesia has not only been a preferred partner of the West. Its almost universal acceptance around the world is due to its politico-ideological noncombativeness and its diplomatic equidistance from the West, Russia, China, the Middle East and anti-Western powers such as Cuba, Venezuela and even North Korea. Indonesia has made sure to maintain friendly relationships with all of these forces, giving it a unique position in global geopolitics. Obviously, Indonesia’s standing in the world has also increased as its economy expanded. In June 2012, Indonesia pledged to loan \$1 billion to the IMF, marking a significant transformation from a former recipient country to one strong enough to

Credibility

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contribute. As a member of the G-20 and of the equally exclusive club of \$1 trillion economies, Indonesia is no longer seen as an economic and political basket case, as was common in the late 1990s and early 2000s. That said, Indonesia's new economic protectionism has raised some eyebrows among foreign investors, especially insofar as it has involved drastic changes to investment laws. However, while these actions (especially in the mining and oil industry) have led to some doubts about Indonesia's reliability, the uninterrupted flow of investment demonstrates that its attractiveness as a trading partner and investment destination remains exceptionally high.

Indonesia is a driver of regional cooperation and integration in Southeast Asia. After neglecting its traditional leadership role in the Association of Southeast Asian Nations (ASEAN) during much of its democratic transition, Indonesia has now once again assumed the organization's helm. As one of the few democratic states in ASEAN, it has lobbied for improved human rights and more institutional reform in other member states, particularly Burma. The ASEAN Human Rights Charter, endorsed in November 2012, was primarily the result of Indonesian pressure. While criticized for not being legally binding, the charter was nevertheless a symbolic milestone. However, Indonesia's constructive role in ASEAN does not mean that Jakarta's bilateral relationships with its neighbors are trouble-free. For instance, the relationship with Malaysia has deteriorated in the past few years as a result of the continued abuse of Indonesian workers there. This primary dispute has also triggered a number of petty conflicts over the cultural ownership of certain dishes, dances, songs and textiles. While dismissed by outsiders as insignificant, these incidents highlight a deep-seated animosity between the two countries. In October 2012, for example, Malaysian oil company Petronas had to close most of its gas stations in Indonesia because local customers refused to buy Malaysian products. Indonesia's second most problematic bilateral relationship is that with Australia. While cordial and professional, the relationship is marked by important differences over people smuggling (Indonesia is a transit point for refugees from Iraq, Afghanistan and Sri Lanka) and a variety of trade issues. It is crucial to note, however, that despite occasional tensions with Malaysia and Australia, Indonesia has consistently maintained its strategy of de-escalation and cooperation, making it a much more trusted neighbor than in the 1960s, when it was widely perceived as a security threat.

Regional  
cooperation  
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## Strategic Outlook

Indonesia faces several policy challenges in the years ahead, but a number of key problems stand out. First and foremost, the country needs to address the issue of party and campaign financing, the main source of political corruption. Under the current system (i.e., almost no state subsidies for parties and no enforcement of oversight regulations), Indonesia's policymakers have become dependent on oligarchic interests to fund their political operations. As a result, legislators and executive leaders have often prioritized the interests of their sponsors over those of the public at large. This has had a serious impact on policy decisions in crucial areas such as economic planning, poverty reduction, infrastructure development, environmental protection, income distribution and natural resource allocation. If this situation persists, there is little hope for effective reform initiatives or a decline in corruption. In order to take the actions necessary to lift Indonesia to the next level of its democratic consolidation process, its politicians must be made more autonomous from the monetary interests that currently dictate major policies. Thus, Indonesia should consider introducing substantial and institutionalized state subsidies for parties and electoral candidates, aiming to mitigate predatory funding and lobbyist behavior. Obviously, such a system would not completely root out corruption, but the experience of other countries at comparable stages of democratic development has shown that public financing can significantly reduce the dependence of parties on nondemocratic actors and narrow elite interests. Of course, these reforms need to go hand-in-hand with fundamental changes to the judicial system and continued support for the Anti-Corruption Commission.

A second important priority for Indonesia is to halt the ongoing erosion of religious tolerance. There are strong indications that the inactivity of the state has encouraged many of the attacks on non-Muslim groups and Islamic sects in recent years. Hence, stricter law enforcement based on a zero-tolerance approach toward perpetrators could go a long way toward tackling the problem. Many of the radical Islamist militias involved in the growing violence against minorities since the mid-2000s have routinely tested the government's limits of tolerance, and apparently have drawn the conclusion that there are few such limits. Setting clear boundaries for Islamist campaigns against followers of nonmainstream faiths is crucial in the effort to restore religious minorities' confidence in the Indonesian state. In the longer term, Indonesia also needs to redefine its position toward atheism. In the past, Indonesia has practiced a hands-off policy toward citizens who did not endorse any religion, but the recent persecution and imprisonment of atheists in Indonesia should be a source of concern for domestic and international democracy advocates.

Third, Indonesia should rethink some of its core economic strategies. For example, there is a significant gap between its macroeconomic indicators and its human development statistics. Given the extent and stability of its GDP growth, Indonesia should have added more jobs, reduced poverty faster, achieved better wage levels, and have moved more people from informal into formal employment. The fact that this has not occurred points to an unhealthy prioritization of capital-intensive over labor-intensive investments, which also explains the growing income

inequality. While Indonesia now has more billionaires than Japan (and per capita more billionaires than China and India), more than half of the population continues to live on less than \$2 a day. The Indonesian government should therefore adjust its development strategy so as to focus primarily on job creation and the absorption of the informal into the formal sector. GDP growth is important in achieving these goals, but has obviously been insufficient by itself. In the same vein, Indonesia should reconsider some of its recent protectionist measures. While the government is fully within its rights in renegotiating natural resource contracts signed in collusion between Suharto's cronies and large foreign companies, many of its latest agricultural policies have hurt Indonesian consumers. Increased import and export taxes as well as reduced import quotas for certain commodities have driven food price inflation up and undermined the purchasing power of the lower classes. Thus, it is difficult to see why these damaging policies should be maintained.