

# BTI 2012 | Indonesia Country Report

|                          |      |             |             |   |
|--------------------------|------|-------------|-------------|---|
| <b>Status Index</b>      | 1-10 | <b>6.53</b> | # 37 of 128 |   |
| Political Transformation | 1-10 | 6.85        | # 39 of 128 | ➔ |
| Economic Transformation  | 1-10 | 6.21        | # 49 of 128 | ➔ |
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scale: 1 (lowest) to 10 (highest)    score    rank    trend

This report is part of the Bertelsmann Stiftung’s Transformation Index (BTI) 2012. The BTI is a global assessment of transition processes in which the state of democracy and market economy as well as the quality of political management in 128 transformation and developing countries are evaluated.

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### Key Indicators

|                          |        |       |                                |       |                      |    |      |
|--------------------------|--------|-------|--------------------------------|-------|----------------------|----|------|
| Population               | mn.    | 239.9 | HDI                            | 0.617 | GDP p.c.             | \$ | 4325 |
| Pop. growth <sup>1</sup> | % p.a. | 1.0   | HDI rank of 187                | 124   | Gini Index           |    | 36.8 |
| Life expectancy          | years  | 68    | UN Education Index             | 0.584 | Poverty <sup>3</sup> | %  | 50.6 |
| Urban population         | %      | 53.7  | Gender inequality <sup>2</sup> | 0.505 | Aid per capita       | \$ | 4.6  |

Sources: The World Bank, World Development Indicators 2011 | UNDP, Human Development Report 2011. Footnotes: (1) Average annual growth rate. (2) Gender Inequality Index (GII). (3) Percentage of population living on less than \$2 a day.

## Executive Summary

In the past two years, democracy has been further stabilized in Indonesia. The country remains the third largest democracy in the world after India and the United States. Three consecutive free, fair and transparent elections in 1999, 2004, and 2009, confirmed the incremental democratic changes. The re-election of the incumbent President Susilo Bambang Yudhoyono (SBY) with a large majority in the first of two possible electoral rounds further stabilized the political scene. Democratization has not only been established at the national, but also at the regional level along with the implementation of a decentralized system. The human and civil rights situation has also remained stable.

However, a further substantial deepening of democracy has not been reached in recent years. SBY's relatively indecisive leading style, exacerbated by some frictions within his party coalition in the house of representatives, has become a serious obstacle in policy-making processes. Widespread corruption still poses a major threat to greater transparency and accountability and the efforts of the current administration have often been proved ineffective. Indonesia's judiciary is still far from being professional and unbribable, despite the relatively good performance of the Constitutional Court. Although previously existing ethnic and religious conflicts have been reduced significantly in recent years, there is growing orthodox Muslim influence in politics, including some violent actions against religious minorities.

In terms of economics, Indonesia made remarkable progress. In contrast to other major economies, the country did not witness major economic setbacks as a result of the global financial crisis. The impact was comparatively minimal because macroeconomic preconditions were relatively good. Moreover, the central bank took decisive and swift actions at the beginning of the crisis. The Indonesian government also passed an adequate economic stimulus package that favored accelerated recovery. Another reason was the importance of the large domestic market, as domestic demand accounts for two thirds of Indonesian GDP. A remarkable GDP

growth and a big increase in FDIs show the new attractiveness of the Indonesian market. Being a relatively stable democracy and an emerging market, therefore, Indonesia is now seen much more positively by the international community than it was a decade ago. Despite all of these achievements, the road to a full-fledged democracy under the rule of law and a sustainable market economy with socio-political safeguards is still long.

## History and Characteristics of Transformation

From 1966 to May 1998, Indonesia experienced an authoritarian government under the leadership of General Suharto, based on the support of the armed forces, the extensive state bureaucracy and the quasi-state party Golkar (Partai Golongan Karya, Party of Functional Groups). Economically, Suharto transformed the country from a rather poor developing country to a lower-middle income country by relying on business cronies and family members. Indonesia has opened its markets to the influx of Western capital and developed substantial trade relations with the US, Japan, and other Western countries since the early 1970s. Initially, the government concentrated on labor-intensive industrialization with firm control over the labor movement. In this context, rapid industrialization occurred at the expense of human rights and democracy. During the New Order period, instead of developing democratic political institutions, the government prioritized economic development. Moreover, the dominant position of state authorities as actors in the development process was characteristic for Indonesia as well as for many East and Southeast Asian countries.

These conditions started to change significantly when the Asian financial crisis hit in 1997/1998. Mass demonstrations, particularly by student organizations, complained about the economic hardships of ordinary people as well as Suharto's abuse of power. More and more former allies of Suharto left the government – including the leadership of the armed forces – and defected to the opposition camp. Under pressure, Suharto finally resigned in May 1998 and left the presidency to his handpicked vice president, Bacharuddin Jusuf Habibie. The latter had no choice but to start negotiations with moderate opposition leaders, and settled an unwritten elite pact. In this context, the democratization process involved the role of both former leading regime members as well as opposition elites. Afterwards, pivotal political laws were abrogated, the constitution amended and new parties admitted.

In June 1999, the first parliamentary elections were held without major irregularities and an almost completely new parliament started its work. In October 1999, the People's Assembly (Majelis Permusyawaratan Rakyat, MPR) elected Abdurrahman Wahid as the new president. In July 2001, Wahid, who had been in growing opposition to parliament, was impeached by the MPR and replaced by former vice president Megawati Sukarnoputri. In 2004, new parliamentary elections and, for the first time in Indonesian history, the direct presidential election were held.

Incumbent president Megawati was defeated in the second round of the first direct presidential elections in September 2004 by Susilo Bambang Yudhoyono (SBY).

Under the Yudhoyono administration, the political system was further stabilized, not least because of his unfrontational and inclusive style of government. In the 2009 presidential elections, SBY was reelected for another five years with a landslide victory. Again, he formed a rainbow coalition with nearly all parties represented in the national parliament, including the powerful Golkar party and all major Islamic parties. Despite some trouble with the ruling coalition parties in the aftermath of the financial crisis, culminating in the unnecessary removal of the very successful Finance Minister Sri Mulyani Indrawati, the Yudhoyono administration further continued their unspectacular but stable government policies.

In economic terms, Indonesia witnessed remarkable macroeconomic changes after the end of Suharto's authoritarian rule, while at micro level many entrepreneurs and companies retained their economic powers. Under the strict supervision of the IMF, the administrations of the post-Suharto era (starting in 1998) have made various efforts to reform the economic sector. Indonesia restructured its banking sector and enormously reduced its state debts. In 2005, the Indonesian economy finally returned to a pre-1997 crisis level of real GDP. In the following years, Indonesia witnessed solid economic growth rates between 4% and 6% and some progress in the liberalization of its economy. The global financial crisis of 2008 – 2009, therefore, did not impede Indonesia's economic growth.

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

## Transformation Status

### I. Political Transformation

#### 1 | Stateness

Question  
Score

In the first years after the regime change, the nationwide implementation of the Indonesian state's monopoly on the use of force has been one of its greatest challenges. In nearly all parts of the archipelago communal violence occurred, sometimes spurred by ethno-religious or separatist undertones. These conflicts have been diminished significantly in recent years and the power of local guerrillas and paramilitary units have been curbed. From 2009 until 2011, separatist movements were only active in Papua. The police special unit killed Noordin Mohammad Top, the alleged mastermind of the twin suicide bombings at the JW Marriott and Ritz-Carlton hotels in Jakarta's business district on 17 July 2009, and arrested some prominent terrorism suspects, such as Abu Bakar Baasyir and Abu Tholut. In several cases, however, the police were not able to prevent violent acts committed by paramilitary units, such as the Islamic Defenders Front (Front Pembela Islam, FPI).

Monopoly on the  
use of force

7

Indonesia is an extremely multiethnic, multilingual and multi-religious state. The creation of a state within the borders of the former Dutch colony was an attempt to unite all ethnic groups in one common nation. The fast and nationwide spread of the new national language "Bahasa Indonesia" and the success in the war of independence against the Netherlands created a spirit of togetherness and Indonesian nationalism among the many different ethnic groups in the archipelago. Nowadays, all citizens have formally the same civil rights and an anti-discrimination law tries to prevent unequal treatment of Indonesian citizens. However, the decentralization process led to a revival of local identities, languages and culture, and even some cases of discrimination against local minorities. Nevertheless, the nation-state concept is widely accepted. The easternmost provinces of Papua might be an exception.

State identity

7

Since independence in 1945, Indonesia has adhered to the official state philosophy Pancasila, which is written down in the preamble of the national constitution. Based on Pancasila, Indonesia is neither a secular nor an Islamic state, although about 87% of the Indonesian population are Muslims. The large majority of them are moderate and tolerant towards other religions. Since the implementation of democratization and decentralization, however, Indonesia has undergone rapid changes, and a rising orthodox Muslim influence in politics and daily life weighs on the government to meddle in religious matters despite the fact that the majority of Indonesian Muslims are moderate. Muslim hardliners achieved success with the controversial “anti-pornography law” and many regional Shari’ah-based bylaws, not only in the province of Aceh, which has a special autonomous status, but also in other regions. This trend has continued between 2009 and 2011. Moreover, President Susilo Bambang Yudhoyono came under national and international criticism in recent years for not protecting the rights of religious minorities, such as the Christians and Ahmadi community more actively.

No interference of religious dogmas

6

The state’s fundamental infrastructure extends throughout the entire territory of Indonesia, but due to the vastness of the country its operation is deficient to some extent. The process of decentralization initiated in 1999 represents the most decisive transformation of the administrative infrastructure in Indonesia’s history. Local governments now have authority and control over about 50% of total government budget. Basic infrastructure (water, education, health) is provided by local governments, which fulfill their tasks differently in the various regions. While some provide good services to their citizens, others fail to do so.

Basic administration

7

## 2 | Political Participation

Every five years, the Indonesian people directly elect the president, the house of representatives, the regional representative council and the hundreds of local houses of representatives. Additionally, the district chiefs, mayors, and province governors are elected directly. The president and the vice president are elected directly by the people with an absolute majority. In April 2009, parliamentary elections for both chambers took place and in July 2009, incumbent President Susilo Bambang Yudhoyono was reelected with 60.8% in the presidential elections.

Free and fair elections

9

The legislative and presidential elections were considered legitimate by nearly all of their participants as well as by the vast majority of the population. However, some irregularities belittled the success of the largest elections held on one day worldwide, particularly the failure of the national election commission to register more than ten million potential voters. Similar problems also took place during elections for the direct district chief, mayor, and provincial governor elections, which suffered from the mobilization of bureaucrats, intimidation of the voters,

manipulation of votes, money politics, and the failure of the regional election commission to conduct its functions properly.

In principle, elected leaders have the power to govern without any restraint. However, there are some informal veto players still powerful enough to restrain executive actions. Most importantly, the armed forces maintain the right to interfere with the elected government if they believe the unity and stability of the Indonesian nation to be threatened. There are also some minor radical Islamic groups which seek to abolish democratic rule and to replace it with a theocratic state or caliphate. In recent years, the political influence of the military has decreased to some extent, while radical Muslim groups have gained more influence. Meanwhile, policy-making processes have also been based on political transactions between several political parties, particularly between Golkar and the Democrat Party (Partai Demokrat), involving personal as well as group interests.

Effective power to govern

7

The right to association and assembly is widely accepted and used by many Indonesians. At a national level, non-profit interest groups and independent trade unions have greater autonomy to make their demands heard. As part of the decentralization process, locally based interest groups can contribute to political decision making at the communal level. Frequent demonstrations in front of regional and national department buildings and parliaments are a common feature of Indonesia's daily life. Authorities have restricted this right in conflict areas, however. Independence rallies such as flag-raising ceremonies in Papua are routinely disbanded, and participants have been prosecuted. Additionally, militant Muslim groups are increasingly undermining the right to assemble for religious minorities such as the Ahmadi and Christians. State authorities are generally reluctant to confront the perpetrators and to protect the assembly right of religious minorities.

Association / assembly rights

7

In the years after regime change, freedom of expression has been established as a pillar of democracy. Indonesia's press is one of the freest in Southeast Asia. In the Press Freedom Index 2010, which is published annually by Reporters sans Frontiers, Indonesia ranks at place 117 out of 178 states, while countries such as the Philippines, Malaysia, Thailand and Singapore range far below it. Nevertheless, the country was downgraded from rank 100. A broad variety of television and radio stations exist, which can report relatively independently. However, there are several incidences which are not in accordance with the constitutional freedom of expression. The application of the law on Electronic Information and Transactions (ITE) paved the way for more libel accusations and other restrictions to the internet and online media. Several people and bloggers, among them a woman who complained about a hospital where she had been a patient, were sentenced for voicing their opinion. Moreover, according to the Alliance of Independent

Freedom of expression

7

Journalists Indonesia (AJI), there was an increasing number of attacks on journalists, including five murder cases. Additionally, access for journalists to the two troublesome Papua provinces is restricted.

### 3 | Rule of Law

Following the constitutional amendments which took place between 1999 and 2002, the constitution provided basic democratic constituents and set up a presidential system of government with a clear separation of powers between the executive, legislative, and judicial branches of government. Indonesia now has a system of mutual checks and balances between the three state authorities, which in daily practice functions relatively well.

Separation of  
powers  
9

The judiciary was established as a distinct profession after regime change in 1998 and now operates relatively independently. However, regime change did not result in a big exchange of personnel in this branch, which is why the judiciary has regularly been influenced by the military, business interests and politicians outside of the legal system. Moreover, bribes have frequently influenced prosecution, conviction, and sentencing in countless civil and criminal cases. Consequently, courts often made decisions in favor of the rich and powerful. Relatively low salaries for judicial officials perpetuate the problems of bribery and interference in court proceedings by government officials and military personnel at all levels. The Constitutional Court makes a valuable contribution to the democratization process by issuing reform-oriented decisions. It has demonstrated its independence in various cases. For instance in 2009, the court scrapped two articles of the legislative election law which discriminated against political prisoners of the authoritarian past. However, the bribery allegations at the Constitutional Court in 2010 indicate that this institution may not be immune from corrupt practices. Furthermore, the current nomination process for the constitutional court justices has been subject to quasi-campaign-style practices by candidates who were extensively lobbying parliamentarians for support. This raises doubts regarding judicial independence in the future.

Independent  
judiciary  
5

Indonesia is still among the most corrupt countries in the world. While the ordinary court system is ineffective in tackling corruption, the general public has a very high level of trust in the recently established national Corruption Eradication Commission (KPK). This institution has conducted investigations that led to the conviction of various high-ranking government officials and legislators, not only at the national, but also at the regional level in recent years.

Prosecution of  
office abuse  
4

However, there were also various attempts to undermine the powers of KPK. The national parliament passed a law in October 2009 that weakened the power of KPK and its corruption court by abolishing most of its hard-hitting intervention powers,



for example the deployment of bugging devices. Moreover, two chairmen of the KPK, Bibit Samad Rianto and Chandra Hamzah were arrested under dubious accusations. Only one month later, the Constitutional Court ruled in favor of the two vice-chairmen and declared their suspension to be unconstitutional. Additionally, in December 2010, Chandra Hamzah has received the Integrity Award from the World Bank in Washington DC.

A symptomatic case for dealing with prosecution of office abuse is that of Gayus Tambunan, a 30-year-old low-level tax officer, who had managed to accumulate bank balances totaling more than \$10 million by accepting bribes from various business companies. His case made headlines in the Indonesian press in 2010, since he was able to make more than 50 excursions from custody, showing up in Singapore, Kuala Lumpur and Macau and at a tennis tournament in Bali.

The overall situation for the protection of civil rights has significantly improved since the end of authoritarian rule and the cessation of many local conflicts in the following years. However, civil rights have still been violated in some parts of the country. This refers to police and military actions against civilians, particularly in the Papua. In December 2009, Kelly Kwalik, head of the West Papuan National Liberation Army (WPNLA), was killed by the Indonesian police. In 2010, some Papuan residents experienced physical intimidation by three members of military personnel. Moreover, the civil rights of women are increasingly curtailed by the implementation of Islamic regulations in about 10% of Indonesia's districts. Anti-terror laws issued after the terrorist attacks in Bali 2002 have also been criticized for curtailing civil rights. Additionally, the civil rights of the Ahmadi community as well as other religious minorities are not protected seriously enough or have even been reduced.

Civil rights  
7

#### 4 | Stability of Democratic Institutions

The performance of Indonesia's democratic institutions has slightly improved in recent years. This particularly refers to the regional governments which can now, after the implementation of the decentralized system, deal more effectively with their increasing responsibilities. At national level, reelected President Susilo Bambang Yudhoyono has not yet been able to streamline his administration. His cautious and often rather indecisive leadership style left many administrative problems untouched. The national parliament, newly elected with many newcomers in 2009, has continued the work of the previous National Assembly in nearly the same way. It works as an effective oversight institution, but is still fraught with weaknesses in its legislative function.

Performance of  
democratic  
institutions  
7

In general, all relevant political and social players accept democratic institutions as legitimate, including Islamist parties such as the Prosperous Justice Party (PKS) and Crescent Star Party (PBB). Court decisions, even if controversial, are accepted by all actors of the public. Due to the procedural flaws of the election administration, the losing parties or persons publicly questioned the validity of the election results. This happened not only in the national presidential and parliamentary elections in 2009, but also at regional level. So far, all relevant parties and candidates have accepted court decisions on these matters. The military leadership seems to accept the democratic institutions. Some radical Islamists groups such as Hizbut Tahrir Indonesia (HTI) reject more or less openly the liberal, Western-style democracy, but they are only a small minority.

Commitment to  
democratic  
institutions  
7

## 5 | Political and Social Integration

Political parties play a very important role in Indonesian politics, unlike political systems in Southeast Asia. This is due not least to various constitutional and legal provisions, for example the right of political parties to determine the presidential candidates or the proportional election system.

Party system  
6

The political parties represent distinct societal streams and are not merely vehicles of personal interest. However, there has been a trend toward personality-based political parties in recent years. The Democrat Party (Susilo Bambang Yudhoyono), the Great Indonesia Movement Party (Gerindra, led by Prabowo Subianto) and the People's Conscience Party (Partai Hanura, led by Wiranto) are cases in point.

Since a 2.5 threshold was introduced for the national parliamentary elections, the former big fragmentation of parties in parliament was effectively reduced to seven parties. The election law requires parties to open offices in most provinces of the country in order to reduce the influence of regional or ethnic interests. Most political parties propose vague ideologies and platforms by combining elements of secular nationalism and Islam.

Indonesia has various interest groups representing many aspects of social life. Islamic associations such as Nahdlatul Ulama and Muhammadiyah are the most significant and best-organized intermediary actors. They also have a certain influence on the political system since their commentaries on political and social developments are followed by a great number of people. Trade unions play a less significant role in Indonesian national politics than in other Asian countries.

Interest groups  
7

Various surveys show relatively high support for democratic values. For instance, an International Foundation for Electoral Systems (IFES) survey in September 2010 found that 72% of the respondents agreed with the statement that democracy is preferable to any other form of government, while 20% did not care for any form of government, and only 4% opted for a non-democratic government.

Approval of  
democracy  
7

In the same and other surveys, people show a high degree of trust in independent watchdog organizations such as the KPK, followed by the executive at national and local level. Parliaments, the judiciary, and political parties receive much less approval for their work.

In the years after the regime change, associational activities have increased greatly. More and more people form associations to tackle socioeconomic barriers. While the influence on the national level of civil actors or self-reliance organizations is still limited, many organizations are active at the local level. Many of them cooperate with foreign donor organizations. Indonesia has a widespread and heterogeneous network of autonomous, self-organized groups, associations and organizations.

Social capital  
7

## II. Economic Transformation

### 6 | Level of Socioeconomic Development

Question  
Score

Supported by a remarkable recovery from the global financial crisis, public aid programs and a moderate inflation rate, Indonesia continued its efforts to alleviate poverty. The population living below the national poverty line decreased from 16.6% in 2009 to 13.3% in 2010 and the unemployment rate is at 7.14%. According to UNDP, Indonesia is one of the top 10 countries with the quickest progress in human development in recent years. But with an HDI value of 0.6 in 2010, indicating a level of Medium Human Development, Indonesia still remains below the world and the regional average, positioned at 108 out of 169 countries and areas. About 60% of the population lives on less than \$2 a day. Overall development in rural areas, and in particular in the eastern provinces, is still lagging considerably. Inequality between genders remains a major concern. The UNDP's Gender Inequality Index values Indonesia at 0.680, ranking the country at 100 out of 138 countries based on 2008 data. These assessments show that despite some slow progress in recent years, Indonesian women are still disadvantaged in terms of education and income.

Socioeconomic  
barriers  
6

| Economic indicators       |          | 2007     | 2008     | 2009     | 2010            |
|---------------------------|----------|----------|----------|----------|-----------------|
| GDP                       | \$ mn.   | 432216.7 | 510244.5 | 539355.5 | <b>706558.2</b> |
| GDP growth                | %        | 6.3      | 6.0      | 4.6      | <b>6.1</b>      |
| Inflation (CPI)           | %        | 9.1      | 11.1     | 4.8      | <b>5.1</b>      |
| Unemployment              | %        | 9.1      | 8.4      | 7.9      | -               |
| Foreign direct investment | % of GDP | 1.6      | 1.8      | 0.9      | <b>1.9</b>      |
| Export growth             | %        | 8.5      | 9.5      | -9.7     | <b>14.9</b>     |
| Import growth             | %        | 9.1      | 10.0     | -15.0    | <b>17.3</b>     |
| Current account balance   | \$ mn.   | 10492.6  | 125.2    | 10628.5  | <b>5642.6</b>   |
| Public debt               | % of GDP | 36.9     | 33.2     | 28.6     | <b>26.9</b>     |
| External debt             | \$ mn.   | 133847.3 | 147621.8 | 162850.1 | <b>179063.6</b> |
| Total debt service        | \$ mn.   | 23923.5  | 21373.5  | 24878.5  | <b>29298.0</b>  |
| Cash surplus or deficit   | % of GDP | -1.0     | -0.3     | -1.7     | -               |
| Tax revenue               | % of GDP | 12.4     | 13.0     | 11.4     | -               |
| Government consumption    | % of GDP | 8.3      | 8.4      | 9.6      | <b>9.1</b>      |
| Public expnd. on edu.     | % of GDP | 3.5      | 2.8      | -        | -               |
| Public expnd. on health   | % of GDP | 2.5      | 2.3      | 2.4      | -               |
| R&D expenditure           | % of GDP | -        | -        | -        | -               |
| Military expenditure      | % of GDP | 1.2      | 1.0      | 0.9      | -               |

Sources: The World Bank, World Development Indicators 2011 | International Monetary Fund (IMF), World Economic Outlook 2011 | Stockholm International Peace Research Institute (SIPRI), Military Expenditure Database 2011.

## 7 | Organization of the Market and Competition

Although being acknowledged as the “Most Active Business Regulatory Reformer in East Asia and Pacific” by the World Bank in 2010, market-based competition in Indonesia remains constrained. Investments are furthermore hampered by a deficient infrastructure, an intransparent and corrupt bureaucracy as well as inconsistent regulations at local level. The central government tries to address the obstacles caused by the decentralization of business regulations by streamlining approval processes, e.g., for public–private partnerships in infrastructure projects, which suffer most from varying jurisdictions across districts. Additionally, most of the jobs created in the recovery from the global downturn were related to the

Market-based  
competition

6

informal sector, which absorbs about 60% of the national workforce. Nevertheless, Indonesia experienced a record high of \$12.5 billion in FDI in 2010, a 25% increase from last year, and \$16.2 billion in FPIs (foreign portfolio investments), caused by the low levels of interest rates in the developed countries after the financial crisis and the stable macroeconomic and political situation in Indonesia. After Argentina, the Indonesian stock market realized the best performance in the world. Although FPIs are expected to decrease in 2011, the development raises concerns that hot capital might accelerate inflation and destabilize the economy, as painfully experienced a decade ago. The central bank therefore started to tighten capital controls.

Although the number of SOEs has gradually declined over recent years, their stake in the Indonesian economy remains high. In some sectors, such as electricity or railways, they even come with a monopoly or overwhelming market dominance. These enterprises are protected by a widespread patronage network among administrative decision makers and the government's efforts to adjust the Law on Anti-Monopoly-Practices and Unfair Business Competition and to privatize SOEs seem to be restrained. Nevertheless, the Commission for the Supervision of Business Competition (KPPU), an independent body created in the year 2000 and reporting directly to the president, is gaining strength and public support. In 2009, the commission reported 733 cases of unfair business practices dominated by tender conspiracy. However, the KPPU has insufficient capacity to safeguard fair market competition across Indonesia.

Anti-monopoly  
policy  
5

The institutional framework for foreign trade demonstrates the cleavage between the regulatory implementation on national and local level. The central government, which is presiding over the ASEAN in 2011, proceeds in liberalizing foreign trade along WTO standards and further integrates the Indonesian economy in the ASEAN economic community. Meanwhile, the subnational governments often use local laws to introduce tariff and non-tariff barriers as an additional source for taxes and levies. These regulations are in general imposed on agricultural and forestry commodities. Furthermore, they protect local markets from being overrun by cheap imports, as Indonesian products, e.g., toys and electronic goods, struggle to compete with goods from China. In this context, the further implementation of the ASEAN–China Free Trade Agreement (ACFTA) might lead to an increase in protectionist measures at local level.

Liberalization of  
foreign trade  
7

Thanks to the comprehensive restructuring and consolidation process that followed the Asian crisis 1997/1998, the impact of the global financial crisis on the Indonesian banking system has been relatively minor. The average capital adequacy ratio was about 16.3% in November 2010. This benchmark indicating a bank's soundness in relation to risk is well above the Basel II requirements. Additionally, a gross-non-performing-loan ratio of less than 5% at the end of 2010 shows that the banking sector remains stable and continues to expand. Nevertheless, the ongoing

Banking system  
8

inefficient allocation of capital, a surge in short-term capital inflows and high inflation expectations put distinct pressure on the system. The system is shaped by 122 commercial banks, of which four are state-owned and dominate the market. Furthermore there are 1,861 rural banks. Next to the monetary authority, the central bank, Bank Indonesia, is assigned to supervise and monitor the systems' compliance to the regulatory framework. At the peak of the global financial crisis, the central bank's capacities were significantly enhanced, and it gained a stronger legal basis for handling market crises, including decisions on how and whether to bail out troubled banks.

## 8 | Currency and Price Stability

After the 2008 price hikes resulting from the soaring of global commodity prices and cuts of subsidies for fuel and gas, inflation declined over 2009. This allowed Bank Indonesia to cut its policy rates from 9.5% in November 2008 to 6.5% by July 2009 to soften the economic downturn. At the end of 2010, inflationary pressures increased again, exceeding the government-set target range. As global demand is recovering from the financial crisis and heavy rain led to losses of crops of seasonal goods, CPI inflation reached 6.96% (yoy) in December 2010. While the prices for volatile goods are expected to tighten further, core inflation remains stable. The government's decision to delay the rise of administered prices e.g., fuel and electricity, took some of the pressure. Furthermore, the continuing appreciation of the Indonesian Rupiah, underpinned by the overall sound conditions of the Indonesian economy, mitigated the rise of global commodity prices. The government and the central bank are currently alarmed by increasing inflationary pressures, since the price developments endanger the government's goal of alleviating poverty.

Bank Indonesia already tightened monetary policy by ordering banks to set aside 5% of their total foreign-exchange holdings as reserves as of March 2011 and also re-imposed restrictions on net short-term foreign borrowing by banks. The reserve requirement will then rise to 8%, effective June 2011. The central bank itself is relatively autonomous and works effectively, as their crisis management in 2008/2009 has demonstrated. However, it is the president who appoints the central bank's governor and monetary policy is coordinated in "control teams" at the central and regional levels.

Under the administration of President Susilo Bambang Yudhyoyono, public debt fell dramatically from 100% of GDP in 1999 to 26% of GDP in 2010 – a very remarkable exception in state finances worldwide. Initially imposed by the IMF after the Asian crisis in 1997/1998, the reduction of public debt was fully integrated in the government's policy program. The continuing trade balance surpluses generated by robust economic development additionally improved the fiscal

Anti-inflation /  
forex policy

8

Macrostability

9

conditions. Overdue adjustments to the tax collection system introduced by former Finance Minister Sri Mulyani also contributed to higher state revenues. Debt ratings continued to improve and in July 2010, Japan Credit Rating Agency (JCR) even raised Indonesia's sovereign debt rating to investment grade. Indonesia's vulnerability to external shocks was significantly reduced by increasing international reserves, amounting to \$96.2 billion at the end of December 2010 – equivalent to 7.1 months of imports and servicing of official external debt..

## 9 | Private Property

The enforcement of private property rights remains constrained due to a largely flawed legal and regulatory framework as well as corruption and disputable and inconsistent court decisions. Indonesia's rank (97 out of 125) on the International Property Rights Index of the advocacy group Americans for Tax Reform has not changed for the last three years due to diametrically opposed developments. While the legal and political environment improved significantly, the deterioration of the enforcement of physical and intellectual property rights offset this development. For example, 85% of the business software and 95% of the records and music available on local markets are estimated to be pirated material.

Property rights  
6

The Indonesian economy is shaped by SMEs which provide 90% of employment and are largely found in the agricultural, trade, hotel and restaurant sector. Their economic conditions remain constrained, especially in rural areas. Credit funding by banks or government-sponsored credit schemes are scarcely available. Corruption and bureaucratic arbitrariness, high administration fees and inter-regional trade barriers impede their business operations. Furthermore, the dominance of SOEs in several sectors, their influence on price formation, and the preferential treatment they are granted by the administration remain a significant obstacle to the Indonesian economy. Although some recent adjustments to the regulatory framework were conducted, a more comprehensive approach would benefit private enterprise. Accordingly, the government is about to restructure and increase the international competitiveness of the SOEs, finally increasing SOEs influence over the economy.

Private enterprise  
6

## 10 | Welfare Regime

Social safety nets are still considerably underdeveloped. Public aid is carried out via conditional cash transfers to poor families with children at school, food security programs, free medical services at public health centers and public employment programs. Additionally, the administered and often distinctively subsidized prices for several daily consumption goods like fuel and electricity protect the poorest from short-term price hikes. In rural areas with a deficient infrastructure and a lack

Social safety nets  
5

of public health care provision, the population is often dependent on private initiatives and NGOs, including faith-based organizations. In general, social welfare experiences various constraints, such as inefficiency, mistargeting and red tape within the administrative structures. Welfare policies have more fundamental weakness: they are usually crisis-oriented rather than structural long-term programs.

Participation in society remains distinctly constrained for several social groups, but is also determined by the disparities between urban and rural areas concerning education, health services and employment. The multiethnic composition of the country, the fragmented landscape of the archipelago, the deficient infrastructure, and the differing speed of economic developments across regions sets complex parameters for social policy. Thus, women still suffer from a significantly lower literacy rate and their shares in higher education and leading positions in the economy are minor. Furthermore, integration into patronage networks plays a major role in social promotion. Nevertheless, the decentralization process significantly improved political participation at local level, e.g., influence on local budgets via public hearings.

Equal opportunity  
5

## 11 | Economic Performance

Although being a relatively open economy, Indonesia weathered the global downturn remarkably well. Bolstered by a strong domestic market, a sound financial system, and well-coordinated and quite effective crisis management by the government and the central bank, Indonesia's economy grew by 6% in 2010, up from 4.5% in the preceding year. In 2010, CPI inflation was at 6.96% (yoy), after commodity prices jumped in the second half of the year and are expected to increase. This development puts pressure on private consumption as well as forcing the central bank to tighten monetary policy. Massive foreign investments are a further concern, as they carry the risk of onward inflationary pressure and bubble creation. Unemployment continued to decline to 7.14% at the end of 2010. However, most of the new jobs were created in the informal sector. The improvement of fiscal conditions proceeds due to the robust economic development and tax reforms. Thus, the government could provide its stimulus program without facing any of the distress that the periphery of the EU currently experiences. Both exports and imports increased significantly. Although the Indonesian Rupiah appreciated by 3.8% in 2010, the sound economic recovery of trading partner countries and increasing global commodity prices led to exceptionally high export growth rates. Driven by growing purchasing power and crop losses, imports soared significantly at the end of 2010 and are expected to grow further.

Output strength  
7



## 12 | Sustainability

The current administration under President Susilo Bambang Yudhoyono stated that it is aware of the ecological costs of the recent economic development, and stresses its commitment to environmental policy. In 2009, the government announced a goal of reducing the emission of greenhouse gases by 26% by 2020, by reducing emissions from deforestation and forest degradation. However, more sustainably minded policy faces grim opposition among economic interest groups – especially those from the extraction industries. They refer to the negative impacts on economic development and the loss of international competitiveness that tighter regulations would cause. The slow progress made by the government in policy formulations and efforts to fix regulatory loopholes underlines their influence. They include the Coordinating Minister for Economy, Aburizal Bakrie, whose company PT Lapindo Brantas was responsible for the ecological mud volcano disaster in Sidoarjo (Central Java). A low rank of 134 out of 163 in the Environment Performance Index also reflects the current situation.

Environmental  
policy  
4

One of the major obstacles for the economic development in Indonesia is the lack of a comprehensive national innovation system, which would improve the country's competitiveness on global markets. In fact, the government recognizes the urgency of the issue and is implementing a national innovation plan. However, the lack of policy coherence at national and local level, the predominance of public R&D as well as the poor development of innovation-clusters and networks between R&D actors need massive adjustments. Nor is there an effective institutional and regulatory framework that supports a productive R&D culture and backs innovative start-ups, and the education system does not provide a sufficient amount of highly skilled workers. Indonesia's expenditures on education were only 3.8% of GDP in 2007, which is below the regional average. Most of the higher education schools are private institutions, which admittedly offer a lower quality education than the public institutions. However, the public universities also collect tuition fees from students, increasing the expenses by up to \$7,000 per academic year. Only 3.3% of students from the lowest income quintile enroll in university, while 31% from the highest income quintile attend Indonesian universities. At about 20%, the gross rate of enrollment for tertiary education underlines a high inequality in access. In primary education, especially in rural areas and for poor and homeless children, Indonesia receives financial and technical assistance from various countries and international organizations, e.g., the US, Australia and the World Bank.

Education policy /  
R&D  
5

# Transformation Management

## I. Level of Difficulty

Indonesia is an archipelago stretching about 5,000km from west to east, consisting of more than 17,000 islands around the equator. While some areas, particularly the main island of Java, are strongly overpopulated but relatively well developed, other more remote islands – especially in the eastern part of the country – are sparsely populated and significantly less developed. It is obvious that under these geographic conditions, it is difficult for any government to provide adequate infrastructure and public services (health care, education, etc.) for all parts of the country.

Structural  
constraints  
6

Indonesia lies at the center of the “Ring of Fire,” one of most volatile regions for natural disasters in the world. These regularly occurring incidents pose a severe threat to the stability of the country. In October 2010 two natural disasters hit Indonesia within 24 hours. First, a tsunami triggered by a 7.7 magnitude earthquake slammed into the Mentawai island chain west of Sumatra. Second, Indonesia’s most active volcano, the Merapi, erupted near Yogyakarta (Central Java). Both incidents killed several hundred people. Additionally, ongoing deforestation of former jungle areas, particularly in Kalimantan, leads not only to desertification but also to landslides causing significant loss of life.

With more than 230 million people and around 300 ethnic groups, Indonesia is the fourth most populated country of the world, posing a more difficult challenge for good governance and development than other smaller states. In the last 40 years, Indonesia witnessed remarkable economic and social progress, but it is still a developing country with a high number of poor people and lacks an educated labor force.

Indonesia has a vital NGO scene, particularly in larger cities and in Java. While these organizations are led by educated persons, the people in rural area have other forms of social cooperation such as the principle of mutual assistance (gotong royong). Rural life, particularly in Java, is often dominated by cooperatives (koperasi) as the basis of economic activities. These forms of social capital play an important role in protecting the poor and vulnerable from economic hardship as well as from sociopolitical conflict escalation. Moreover, as part of the

Civil society  
traditions  
6

decentralization process, locally based interest groups can contribute to political decision-making at a communal level. NGOs who consequently address contested issues such as human right abuses, however, lack protection by the state and are often threatened by radical nationalist or Muslim groups. By far the biggest and most important organizations in the field of social welfare and education are Muslim mass organizations like Nahdlatul Ulama and Muhammadiyah. Both of them have taken a clear stance towards fundamentalist Islamic tendencies and prominent figures from these two organizations are increasingly involved in national and international networks of inter-religious dialogue.

In former conflict areas such as Aceh, Central Sulawesi, South Kalimantan or the Moluccas, the state was able to regain its administrative power and violence was contained. The relatively successful implementation of the decentralization process – which resulted in effective local autonomy – is one of the most important reasons for this development.

In the province of Aceh, one of the longest and bloodiest conflicts in Indonesia's recent past was ended with an agreement between both conflict parties in 2005. Since then Aceh has had special autonomy, a former separatist movement leader as governor, and it is the only province of Indonesia with local parties running in local elections. The smooth running of the national and local elections in 2009 further stabilized the political situation in Aceh.

While peace and a shared monopoly of power between central and provincial government in the westernmost part of Indonesia could be firmly established, the easternmost province of Papua is still riddled by various conflicts. Here, and in other remote and outer islands, the official administration is often outplayed by local strongmen and locally stationed military units.

Additionally, violence still occurs all over the country for religious issues, particularly in the case of Christians and non-mainstream Islamic groups such as the Ahmadi. Similarly, ethnic-based conflicts still exist. An example is the East Kalimantan city of Tarakan, where clashes between indigenous Dayak and Bugis migrants killed three people and caused the displacement of more than 32,000 more in 2010.

Conflict intensity

6

## II. Management Performance

### 14 | Steering Capability

Question  
Score

Economic growth is still the top priority of President Susilo Bambang Yudhoyono following his reelection in 2009. In its five-year development plan (Pelita), the Yudhoyono administration and the State Ministry of National Development Planning (Bappenas) intend to achieve economic growth of 7% per year, a lowering of the threshold of poverty to 8%, and a reduction of the unemployment rate to 5% by 2014.

Prioritization  
6

The decentralization process, another top priority of Indonesian national politics, has been further implemented and structured by several new regulations.

In general, the current Yudhoyono administration shows commitment to reform and development by supporting ongoing reform agendas and the adjustment of the economy to international standards. However, the reform process is slow and it is not pushed through as quickly as many Indonesians and most foreign advisers would like. Despite a high influx of FDI, the possibilities for economic transactions are still limited by administrative red tape and corruption. In the 2011 World Bank Doing Business Report, Indonesia was ranked 155 out of 178 countries.

Policy implementation is still a major problem concerning the ongoing political and economic reform process in Indonesia. When laws have been delayed in parliament for years their implementation proves even more difficult. The implementation of basic administration policy is sometimes inconsistent. Bureaucratic inflexibility and red tape provisions resulted in a very low realization of public investment.

Implementation  
5

For instance, the \$7.3 billion stimulus package introduced during the global financial crisis, was often not implemented by local authorities. There were massive time lags in the disbursement of funds for infrastructure projects. This can be attributed not only to a lack of capabilities of government officials, but also to delays in the tendering mechanism and a lack of general preparedness by public servants, particularly at the local level. Local officials are reluctant to spend public money because they fear that unintended misuse of this money will lead to them being prosecuted for corruption. Although the current Yudhoyono administration shows commitment to reform the legal system and to fight corruption, these attempts are dogged by short-termist political bargaining and office seeking. This became especially obvious in the Century Bank scandal, which involved Abu Rizal Bakri and his Golkar party.

During the global financial crisis of 2008/2009, Indonesia did not suffer major losses but rather gained economic strength from a comparative perspective. The experience of the Asian crisis of 1997/1998 led to a higher awareness of macroeconomic risks and to the creation of state-owned regulatory institutions such as a deposit insurance corporation (Lembaga Penjamin Simpanan, LPS) and a capital market and financial institutions supervisory agency (Badan Pengawas Pasar Modal, BAPEPAM). Additionally, in strong contrast to most developed countries, Indonesia was able to reduce its governmental debts after the global financial crisis of 2008/2009. The country is possibly a world-record holder in debt reduction, with debt levels declining from 80% (2001) to nearly 20% (2010). In 2001, Indonesia's government had to spend 23% of its budget on debt service, but that rate had fallen to about 10% in 2010, giving the country significantly more scope to pursue its development policies.

Policy learning  
7

Due to these factors, the Indonesian government was able to react more appropriately to the 2008 economic turndown than it could have done with an unregulated banking system and high state debts.

However, in other sectors, particularly administrative and legal system reforms, flexibility and policy learning are very limited.

## 15 | Resource Efficiency

Indonesia is rich in a variety of commodities, ranging from agricultural produce and metals to oil and natural gas, but the government still fails to acquire and allocate assets efficiently in order to boost economic growth as well as its own budget.

Efficient use of  
assets  
5

Indonesia left the Organization of Petroleum Exporting Countries (OPEC) in January 2009 as it had ceased to be a net oil exporting country due to a combination of rising domestic demand and stagnating domestic production caused by underinvestment and mismanagement in the state-owned oil company Pertamina. As a net crude importer, Indonesia is now vulnerable to oil price spikes. Natural resources still make up the biggest share of the national budget. However, the domestic excavation and refinement have not been improved by the government and potential assets are wasted.

A reform of the tax system introduced by former Finance Minister Sri Mulyani Indrawati raised the state income significantly, but her plans for a stricter prosecution of tax evasion and an extra tax unit for high-wealth individuals met strong resistance from vested interests. In June 2010, Sri Mulyani had to leave the cabinet, allegedly under pressure from Aburizal Bakrie – probably the richest man in Indonesia and a minister in the president's cabinet.

In the current system of government, the presidency is dependent on the support of the legislature in order to pursue its policies. After the 2009 elections, President Susilo Bambang Yudhoyono managed to reach a stable and broad majority in the legislature. He even included the very influential Golkar party in his coalition, although they had challenged him in the presidential campaign. The cooperation of the government with the national parliament is quite smooth despite some friction caused by the Century Bank Scandal in 2009 and 2010. In general, the negotiations with the parliament on specific policies are often time-consuming and delay political decision-making in several policy areas. Additionally, there are tensions between several ministries which do not pursue coherent goals. For example, the decentralization policy suffers from a lack of coordination between the ministry of finance, the ministry of home affairs, and the National Planning Board (Bappenas). Efficient policy coordination between the different layers of the national administration, particularly between the national, the provincial, and the district level is also a serious problem in Indonesia.

Policy  
coordination  
6

Additionally, there is a limited strategic orientation toward innovation which would be necessary to improve the international competitiveness of Indonesian goods. The coordination between state, private enterprises, and research institutions (universities, think tanks) could be better.

Corruption is still endemic in the Indonesian political and economic system. President Yudhoyono, who used the fight against corruption as key policy in his election campaign in 2009, enacted a special Corruption Eradication Commission (KPK) aiming to restoring investors' confidence in the rule of law in Indonesia.

Anti-corruption  
policy  
4

In the last two years, however, the presidential anti-corruption policy has lost some steam. The KPK was weakened and some of its leading figures got into political trouble (see "prosecution of office abuse"). KPK chairman Antasari Azhar was dismissed from his office in October 2009 following allegations that he was involved in the murder of businessman Nasrudin Zulkarnaen. In February 2010, he was sentenced to 18 years imprisonment.

The fact that the KPK has been weakened leads to allegations that the fight against corruption is merely given lip service by the Yudhoyono administration.

## 16 | Consensus-Building

In general, consensus exists about the goal of improving the living standard of all Indonesian citizens. Corruption has been generally defined as a major problem in society, affecting the economy and politics as well as foreign investment. However, the means to fight it have not been agreed upon. Except for a small minority of groups with an Islamist background, who want a caliphate in Indonesia, democracy

Consensus on goals  
7

has become the consensually accepted form of government, even among Islamist parties such as the PBB and PKS.

On the other hand, there is no general consensus on market economy since some political actors, such as the Indonesian Democratic Party of Struggle (PDI-P) and Gerindra, as well as some other technocrats and academicians reject the idea of economic liberalism and propose the rather vague and populist principle of an economy for the people (*ekonomi kerakyatan*). Not surprisingly, the market economy still shows signs of protectionism and limits on privatization which hamper investment and the free development of business activities. The deepening of democracy and free market economy, however, is a very difficult task as it is impeded by various social obstacles (among them corruption and a often feudal political culture), by a slow and conservative administration, and by the behavior of actors with vested interests who pursue their own narrow-minded agenda.

Although the government has shown at least some willingness to restrict the influence of Islamist groups on public life and has so far upheld the secular nature of the state, several developments described above, show that the future role of Islam in the state is still a contested issue. Foreign policy orientation towards the US and the West also remains a topic yet to be settled, since the economic and political influence of China is increasing.

The current Yudhoyono administration has to deal with two potential anti-democratic veto actors, the military and radical Islamic forces. The role of the military in politics has been contained in recent years, but generals and other high-level military personnel have been successful in provincial elections, turning the decentralization process into another dispute over military influence on the political system. Military personnel are also serious veto actors in the reform of the economic sector. Some SOEs and other relevant business structures are still under the control of high-ranking military officers. The attempt to dissolve military-owned businesses demanded by various regulations is implemented only slowly, since – particularly at the local level – armed forces members still play an important role in society.

Anti-democratic  
actors

7

Market liberalization, the fight against corruption, and bureaucratic reform pose severe threats to the oligarchic structures of old elites within the economic sector. As these old elites have a significant impact on national and local politics, reforms on these issues only took place at a slow rate.. However, the new laws on investment and income tax show a partial success for reform-oriented actors within government.

Islamic forces also pose a challenge to the reform process. Government agencies are forced to deal with an ongoing Islamization of public life, such as the occurrence of Shari'ah bylaws in various districts and violent actions against

smaller religious groups. In recent years, the government made several concessions to Islamist groups such as the passing of the anti-pornography law and the insufficient protection of religious minorities. The government's failure to outlaw radical Muslim groups such as the Islamic Defenders' Front (FPI) can be explained by its desire to avoid confrontation with the large mainstream Muslim population.

Between 2009 and 2011, the government was not able to reduce cleavages and conflicts, but it did manage not to further aggravate them. Decentralization has helped reduce the cleavage between center and periphery, namely Java and the other islands. However, Java and particularly the capital Jakarta remain the center of gravity for the economy, politics and public life. The peace process in Aceh showed the government's ability to settle long-term conflicts in a non-violent manner. After the relatively peaceful national and local elections, regional autonomy has worked quite well. Instead of blaming Jakarta for all failings and mismanagement, the Acehnese now focus on their own elites. The developments in the poorest and less developed provinces – the two Papua provinces – are more worrying. Neither the indigenous population's demand for moderate economic progress nor their requests for real autonomy are taken into serious consideration by the national government.

Cleavage /  
conflict  
management  
7

The religious cleavage has been somewhat deepened in recent years by an ongoing Islamization of public life, which can also be seen in an all too careful handling of radical Islamists. Although religiously motivated terrorism has declined, the government still lacks a long-term strategy to deal with radical, intolerant and anti-democratic Islamists.

The cleavage between work and capital has not yet been reduced in recent years. As can be seen in many other cases, the main benefits of economic progress went into the pockets of the already well-off people. Since a redistribution of wealth is only weakly implemented in Indonesia, the cleavage will deepen further.

At the national level, non-profit interests groups have great difficulty in making their demands heard because the administration still holds some resentment against them. Often, the bureaucrats regard them as sponsored by foreign donor organizations, and not representing the interests of ordinary Indonesians. A regulation from December 2008 requires NGOs to seek state approval for foreign funding. At regional level, non-profit interests groups have better opportunities for influence on policy-making processes.

Civil society  
participation  
6

Independent trade unions are of some importance in several sectors of Indonesia's industries, but are at times harassed by thugs paid by company owners, who try to prevent strikes and disturbances in production. Several cases have been reported of trade unions and other worker's organizations who have been threatened using anti-



terror laws in order to prevent them from raising environmental concerns or discussing abusive employment conditions.

Neither the political elite nor the general population seems to have accepted the need to deal with the past and undergo a reconciliation process. Only some NGOs, albeit with the support of government agencies, keep on addressing the issue despite severe harassment and threats by the military and nationalist groups.

Reconciliation  
5

The gross human rights abuses that took place during more than 30 years of conflict and occupation in Aceh have scarcely any chance of being cleared. The law on governing Aceh signed by the GAM and the government of Indonesia in August 2006 forbids any retroactive prosecution of human rights abuses. Elsewhere in Indonesia retroactive prosecution is forbidden by Article 28 I of the constitution.

Few of the thousands of victims of the Suharto dictatorship (1966 – 1998) have been rehabilitated. Some of the worst atrocities happened not during the Suharto-era but in the transformation period. In East Timor the most serious human rights abuses took place during the referendum on East Timor's independence from Indonesia in August 1999. The Indonesian military and pro-Indonesian militia murdered some 1,500 civilians and forced the flight of around 70,000 more. While the United Nations established a hybrid tribunal in East Timor, Indonesia established its own ad hoc tribunal in Jakarta, leaving high-ranking military figures untouched, and convicting only minor militia members instead. However, even these men have all been absolved – the last one, Enrico Guterres, leaving prison in April 2008. A law on a truth and reconciliation commission was abandoned in 2004 after it had been criticized for offering amnesty in return for confessions. Consequently, Indonesia is characterized by a culture of impunity among the military and other key figures responsible for past injustices.

## 17 | International Cooperation

Many of the major reform programs, such as reform of the SOEs, infrastructure reform, and programs on poverty reduction are mainly sponsored by organizations such as the United Nations, the Asian Development Bank (ADB) and the World Bank. However, international cooperation is still heavily constrained by corruption, an inefficient bureaucratic system and red tape within the implementing organizations. Evaluations of aid programs have demonstrated misuse of assets among bureaucrats and the organizations in charge of implementation.

Effective use of  
support  
7

During the global financial crisis, Indonesia reacted with a specific set of national policies instead of seeking support from other states or multilateral organizations. However, during regular meetings within important international organizations such as ADB, the World Bank, and G20, the Indonesian government coordinated their

efforts with other bi- and multi-lateral partners. The multilateral organizations facilitated the financial implementation of the stimulus package and other measures against the negative impacts of the global financial crisis.

Indonesia is a generally reliable member of the international community. Indonesia's relatively consistent management of the financial crisis of 2008/2009 has strongly increased international trust in the Indonesian economic system. The number of FDIs has risen enormously since then.

Credibility  
9

The country has close strategic and economic ties with the United States and Europe. In recent years, other East Asian states, particularly China, have become more important in economic terms.

With its Muslim majority, the country is very sensitive in regard to developments in fellow Muslim countries. The military actions in Afghanistan and Iraq and the ongoing conflict in Palestine are highly controversial issues in which the Indonesian government did not necessarily adopt the stance of Western countries. Since the Bali bomb attacks in 2002, the government has become more aware of the dangers of Islamic terrorism and has acted as a reliable partner in the U.S.-led war on terror. Terrorism suspect Noordin Mohammad Top was killed by security forces in October 2009. In December 2010, Indonesian police charged the prominent radical Muslim leader Abu Bakar Baasyir with inciting others to commit terrorism and with involvement in plans for terrorist activity and military training in Aceh.

Indonesia has gained a lot of prestige at the highest international level during the last two years. The country became a member of the influential G20 group and was among the very first members to manage the effects of the global financial crisis well. Current foreign minister Marty Natalegawa made a statement demanding more activism in foreign policy and describing Indonesia as a new power in international relations.

After becoming a democratic country, Indonesia showed great commitment toward regional integration within the ASEAN framework. The ASEAN Charter, signed in November 2007, settles a schedule for a tariff union within ASEAN for the first time, in order to enhance market integration. Indonesia took over the ASEAN chairmanship in January 2011.

Regional  
cooperation  
8

Prior to this, ASEAN and China negotiated a 2010 free trade agreement which led to Indonesian fears that domestic industry would come under threat.

Migration and forest fires still pose a severe challenge to relations with Malaysia, Brunei and Singapore. Hundreds of thousands of Indonesian migrants are illegally based in these three neighboring countries, and exploited as cheap and unprotected labor. The abuse of Indonesian migrants led to severe diplomatic tensions with Malaysia in September 2009, when the Indonesian Navy also had to chase a

Malaysian attack ship out of disputed waters in the oil-rich region of Ambalat. In January 2011, the Indonesian government blocked the official sending of workers to Malaysia until the rights of workers are better protected by the Malaysian government. The forest fire issue was not as relevant between 2009 and 2011 as in previous years.

## Strategic Outlook

In the past two years, Indonesia's democracy has been further stabilized and macroeconomic growth has had a positive impact on the country's overall development. However some serious challenges need to be tackled, and remain in the near future.

Among the most serious problems in the field of politics and economy is the rampant corruption, including that affecting the judiciary. Despite recent government efforts which slightly improved the situation, the overall impact of the anti-corruption measures has been limited. The government should not underestimate the economic and political costs of the endemic corruption and therefore it needs to maintain and further strengthen its commitment to fighting against corruption. In this regard, there has to be a particular emphasis on court members, since corrupt judges, who do not sanction power abuse and patronage, endanger the credibility of the entire political and economic system.

The huge task of implementing the decentralized system in terms of the central and regional government relationship is of utmost importance for the success of the democratization process in general. The economic competition between rapidly progressing regions and less developed areas, particularly in the eastern parts of the country, has led to an increasing inequality of living standards as well as public services. Moreover, the decentralized system has also led to questionable ecological policies in several regions. Indonesia is one of the world's biggest emitter of greenhouse gases. Corruption is also widespread at regional level. To address such issues, the national government must take further action to prevent abuse of power and natural resources in the regions without re-concentrating power in Jakarta. In general, the central government must force the regional governments to implement their functions properly, particularly in providing public services.

The continuing Islamization of the country could jeopardize the democratization process as well as social peace in this multiethnic and multi-religious country. The government should hold up the tolerant values of the Pancasila state doctrine and, in cooperation with the courts, abolish discriminatory laws such as the national anti-pornography law and regional Islamist bylaws. International organizations need to continue their support for the ongoing democratization process as Indonesia is not only the fourth populous country of the world but also the one with the biggest Muslim population. In this sense, success in establishing democratic values and practices in Indonesia could serve as a global example of the compatibility of Islam and democracy.

In economic terms, domestic consumption is vital for sustained growth and has improved in recent years. Indonesia was not severely hit by the global financial crisis, which instead affected countries dependent on exports. The government should therefore further strengthen broad-based domestic consumption in order to stabilize the economy in coming years.

Indonesia is becoming much more attractive for investors than it was several years ago. In the aftermath of the global financial crisis, massive foreign capital influx to Indonesia was registered. While these investments may stimulate the local economy, there is also the danger of bubble-building and inflation. Goldman Sachs predicted that Indonesia is not only one of the “Next 11” big emerging markets but also that country will be among the 15 largest economies by 2020. Morgan Stanley stated that Indonesia should be considered as a new BRIC (Brazil, Russia, India, China group) country and renamed this term BRIIC (Brazil, Russia, India, Indonesia, China).

With the newly established ASEAN–China free trade area, many Indonesian companies which were previously protected have to deal with global competition. However, the competitiveness of many Indonesian products on the world market seems to be weak. In order to have a chance to compete in an economically more open region, the government has to remove more administrative hindrances to economic transactions. Although the SBY administration has been able to pass some important business laws, such as the investment law and a reform of tax legislation, there are still many areas where the national business climate can be improved.

Despite these encouraging estimations, the current reality is not so bright. Indonesia is still a developing country where half of the population lives below or just above the poverty line. Inadequate welfare systems and suboptimal education and health care systems – particularly in the eastern parts of the country – constrain human development. The creation of well-paid jobs for the growing population, and the improvement of the living conditions of large parts of the society are major challenges for the Yudhoyono administration. In this sense, Indonesia needs to re-arrange its health, education and welfare systems in order to give the majority of the population a better chance to improve their livelihood.

In summary, political stabilization and economic progress, the two major characteristics of Indonesia’s overall development in the past two years, have been reached, but there is no guarantee that this will continue automatically in the near future. More efforts are needed by the state and society as well as the international community to keep Indonesia on track.