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# **Governance in Indonesia: Some Comments**

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Governance is often a difficult process. Proper governance ideally involves formulating an overall strategy of operations, translating this strategy into specific policies and decisions, and then implementing the decisions through selected activities. This process is challenging for nations even when things go smoothly, and it can be complicated when leaders fail to muster support for their plans, or when circumstances change as a result of financial or natural disasters.

This paper offers some thoughts about the governance of Indonesia, a nation of over 220 million people and the fourth largest in the world. The topic is vast and is one of great complexity. However the focus of this paper is more modest, and merely aims to outline a few strategic issues of governance in Indonesia and to suggest some options for change.

### **Definition of Governance**

Just as one famous, brief definition of economics says that economics is about, “who produces what, and for whom,” so a brief definition of governance might be, “who controls what, and for whom.” This paper emphasizes the following concepts of governance:

- the processes by which governments are chosen, monitored, and changed;
- the systems of interaction between the administration, the legislature, and the judiciary;
- the ability of government to create and to implement public policy; and
- the mechanisms by which citizens and groups define their interests and interact with institutions of authority and with each other.

As in other countries, governance in Indonesia is about exercising different types of power—ideological, political, legal, military, economic, administrative—and using combinations of these powers to govern. Additionally, there is a distinction between issues of governance at the macro and micro level that reveals how broad and complex the issues of governance in Indonesia really are.

### **Macro Issues of Governance**

Every country has issues of high importance on the national agenda that are debated over decades. However, Indonesia has an especially daunting array of core issues that have yet to be properly resolved. Much of this “unfinished business” arose from the turmoil of a hurried transition to Independence in 1945. So over the past 60 years, other more immediate priorities have delayed effective resolution of key problems in governance. Because the rules at the macro level of political, administrative, legal, and economic and commercial life remain vague and unsettled, it is not uncommon to hear Indonesians lament that, “we don’t have the rule of law in this country” and to also hear them comment about the *kacau* (confused) state of Indonesian society.

### **The State and the People**

In every nation a social contract exists between the leaders of government and the populace. As a nation born through revolution one basic, unsettled macro issue facing Indonesia is the role of the state vis-à-vis the people. Indonesia’s first President, Sukarno, frequently drew on the revolutionary spirit to bolster his legitimacy and power for two decades up to the mid-1960s. The second President, Soeharto drew from Javanese symbols of princely authority to govern, while at the same time promoting

*pembangunan* (development) that in turn fostered institutions of a centralist and regulatory “developmental state.” In the brief seven years since the end of the Soeharto presidency in May 1998, four Presidents with markedly different styles and priorities have led the Indonesian state.

The enduring influence of Sukarno and Soeharto presidential legacies (Booth 2005) leads many to argue that the social contract in Indonesia has often been strongly influenced by patron-client relationships. Many of the strongest patrons in Indonesia have derived their power and influence through access to state-controlled resources (e.g. Sukarno and the nationalized Dutch enterprises in the late 1950s, and that of Soeharto and the oil industry in the 1970s). These relationships have fueled expectations that the Indonesian state would play a paternal role in protecting the *wong cilik* (small people) and would ensure that patrons dispensed state resources in a beneficent way. This post-Independence viewpoint still influences attitudes about the appropriate role of the state in Indonesia. Renewed debate on this issue would be a step towards better national governance in Indonesia (World Bank, 1997).

## **Government Resources**

Another important macro issue of governance is Indonesian economic history and the fluctuating financial resources and capacity of the central government since Independence.

During the Sukarno presidency careful economic management was neglected. By the mid-1960s, with government spending at less than 10% of GDP (Hill 1994), the central government struggled to support even basic functions of the state. The early years of the Soeharto government operated under improving but still restricted budgetary constraints until 1974 when windfall gains from the first

oil boom, and the second oil boom in the late 1970s, permitted rapid increases in real government spending on public services. The oil booms, combined with useful financial assistance from the international donor community, roughly doubled government expenditures as a share of GDP from about 12% in 1970 to a peak of almost 25% a decade later (Hill, 1994).

Government spending peaked in the 1980s (Booth 2005) and two longer-term trends set in, one on the revenue side of the budget and one on the expenditure side. On the revenue side oil receipts began to decline while domestic consumption rose and increasingly depleted the surplus available for export. On the expenditure side, as oil revenues began to decline, debt service obligations began to rise. This markedly eroded the financial capacity of the government to deliver public services and sustain investment. Today Indonesia is no longer a net oil exporter and from the budgetary standpoint the oil boom is over. And as is well known, debt service obligations expanded again dramatically in the wake of the 1997–98 financial crisis.

These trends, aptly described by Hill (1994) as a “scissors effect,” have increasingly limited the delivery of public services and investment in public infrastructure. Other factors such as the decentralization to regional governments, the financial impact of the tsunami disaster of December 2004, and the rapid increases in fuel subsidy costs, have put the central government in a financial squeeze with little room to maneuver. Thus, with limited resources the Indonesian government must better focus its discretionary resources and spending.

## **Three Arms of Government**

Macro level public policy discussions often draw distinctions between three arms of government: the administration, the legislature, and the judiciary. In countries where the relationships between these governmental arms are established the overall quality of governance is much better than in countries where the relationships are in a state of flux. Many developing countries, including Indonesia, fall into the latter group. For these countries, establishing productive and stable governing relationships between the three arms of government takes considerable time, and such changes are greatly influenced by the political processes.

But Indonesia also has other influential arms of government, less beholden to political processes, that often wield considerable real power. Since Independence the military has played an important role in civilian and commercial affairs, as have various state owned enterprises (SOEs). And especially large SOEs, like Pertamina, are seen as influential “states within a state.” Thus a well-functioning political process in Indonesia is necessary to achieve acceptable and effective balances of power between these various arms of government.

## **Political Industry and Political Markets**

Because political processes are central to good governance, Indonesian political industry and markets present important macro issues of governance. Considering the political process as an “industry” with a focus on the structure-conduct performance paradigm provides a convenient framework to assess the relationship between political processes and governance.

Like other industrial sectors, domestic political industries must be productive and efficient in order to realize satisfactory outcomes.

An effective political industry must create opportunities for civil society institutions to participate in decision-making that reflects the interests of citizens, and it must also produce a reliable stream of good decisions. While decisions keep the processes of government moving along and ensure implementation of timely reforms, they also must link to outcomes.

So just as many agricultural, industrial, and labor markets in developing countries are chaotic and in need of reform, the political markets could also benefit from reform. Three areas for political industry reform illustrate this point well: competitive arrangements, selection of the chief executives of the organizations (CEOs), and regulatory controls.

First, competitive arrangements in political markets need not just competition, but healthy competition. A central problem with the competitive arrangements in developing country political markets is that too often there is either little effective competition (Indonesia during the Soeharto era)—or too much (Indonesia since the Soeharto era)! When there is too much competition—say, more than 20 parties contesting national elections—the process becomes chaotic, particularly when contrasted to the duopolistic political markets in Western countries or to countries with a Westminster system.

Secondly, the selection process of CEOs in developing countries needs reform. As the leaders of nations, if CEOs are inexperienced at government and if they cannot skillfully manage board meetings (e.g. Cabinet meetings) then governance is likely to suffer. Compared to the rigorous CEO selection process in developed countries, where it is unusual for a person to reach the top without many years of experience and without being closely scrutinized by the national media over a long period, the CEO selection process in developing countries is often poor.

Thirdly, political markets in developing countries like Indonesia operate in an uncertain and rapidly evolving regulatory environment where rules of the game are not especially well known or understood. To be orderly the political market needs clear regulatory rules—and those rules need to be enforced. Electoral commissions must exist in order to conduct free and fair elections, and to take action when there is abuse of the electoral process.

Similarly, regulatory rules must extend to financial flows within political industries. Like private sector firms, political firms should be required to maintain audited internal accounts and publish proper annual financial reports. Related to this is the need to promote a more realistic compensation scale for parliamentarians while avoiding regulation or suppression of nominal salaries. Just as attempts to suppress the price mechanism in foreign exchange markets led to currency black markets in the 1970s, attempts to set incomes below equilibrium prices in political markets encourages the growth of black markets in political activities.

## **State and Market**

Indonesia is a highly market-oriented society with many markets operating in loosely regulated ways. Yet widespread market and government failure in many market sectors raises interesting questions about the best and most effective regulatory role for the Indonesian state.

In the mid 1980s, economic liberalization became a key part of Indonesia's national economic agenda. At the time, the international community pressed the Indonesian government to loosen economic controls and promote entrepreneurship, private sector and market forces, and competition as a means of spurring economic development. Similar policies continued to be urged upon Indonesia

in the early 1990s. And then came the great financial crisis of 1997-98 that brought huge damage to the Indonesian economy and was arguably caused by a combination of both market failure and government failure (Hayami 2003).

Looking back over Indonesian experience with controls and liberalization in recent decades, there are three broad observations that may be made (World Bank 2002, McMillan 2002, and Sato 2005). First, market liberalization has social and political implications as well as economic ones, so the pros and cons of policy changes require public discussion. To use jargon from the “Star Wars” film series, fair and legal markets can be said to have a positive “force” in that they foster higher levels of productivity and expand economic freedoms for citizens. But there is a “dark-side” in markets too, where corruption, rent seeking, and black market activities by “non-state actors” pose significant risks for regulatory agencies in developing countries.

Secondly, Indonesia’s weak legal system and chronic budget constraints limit the regulatory capacity of the state, as do the high direct and indirect costs associated with government price suppression schemes.

Thirdly, in spite of weak regulatory capacity the widespread market failures in Indonesia support strong arguments in favor of government regulation. However with such limited resources the government needs to be pragmatic and realistic in order to focus its regulatory priorities and resources on selected key sectors, case by case.

### **Selected Micro Issues of Governance**

Since the liberalizations of political activities in 1998, the civil society in Indonesia has become much more active. And yet activity

alone is no guarantee that civil society participation will enhance public policy making. In order to strengthen civil society activities, governance could be addressed at the micro level within firms, NGOs and public service institutions. The implication here is that responsibility for improved governance rests not only with high-level decision makers but also with citizens at other levels of Indonesian society.

### **Universities**

The higher education industry in Indonesia is facing many of the structure conduct-performance issues that face other sectors of the economy. The industry is dualistic with government-supported state universities coexisting along side a large number of private sector institutions that are advertised as universities yet vary greatly in quality. Micro issues of governance such as the underlying structure of the education industry, the standards in the private sector education institutions, education financing, the relative incentives provided for teaching, research and administration, and the role of peer group reviews of professional work between institutions all must be revisited. And while the supply and quality of universities has steadily improved during the past three decades, the demands on the higher education have also greatly increased. As a result, resources within the sector remain under severe strain.

### **Think tanks**

It is now widely accepted that governance is enriched by good quality feedback from “second tier” social institutions including think tanks. Across developing countries in Asia the quality of think tanks varies considerably with perhaps the strongest think tank communities being

found in India and the Philippines. In general, issues facing think tank communities across the region include the following (Stone 2005):

- the overall weakness of the think tank community in some countries, both terms of both quality and quantity;
- difficult domestic environments for intellectual activities in some countries which are not especially favorable for the operation of vigorous think tank activities; this is especially the case where there are strong, quasi-authoritarian states which are not used to active public policy debate;
- shortages of money and other resources;
- debates over objectives and modes of operation—whether think tanks should be demand-led in their activities or whether they should be more active in trying to set regional policy agendas;
- how to respond to strong external pressures to take part in discussions about global policy issues that may not be felt to be as urgent as specific local issues; and
- internal governance issues concerning such things as independence, reliance on key external funding agencies, the role of advisory councils, and human relations procedures.

In recent years, the think tank community in Indonesia has become much more vigorous than previously and is now increasingly contributing to public policy debate.

## **Conclusions**

In setting out conclusions, a distinction needs to be made between on one hand, general conclusions about governance, and on the other, specific conclusions relating to particular sectors or firms. It is often the case that important aspects of governance issues need to be tackled at the firm or industry level rather than through an economy

wide approach. Many issues relating to law reform in Indonesia, for example, are specific to the legal sector and therefore broader generalizations about governance are of quite limited relevance. But broader generalizations can be useful as well, at least in setting out a main framework for reform in any particular sector. The main conclusions that emerge from the issues set out above are as follows. First, effective governance reform at either the national (macro) level or at the level of any specific (micro) sector usually involves at least four key elements:

- The identification of a strategy or vision for change.
- The translation of the strategy into a detailed program for reform; programs should best identify expected results or outcomes set out in measurable performance indicators (MPIs).
- The effective implementation of the program.
- A focus on outcomes or results, and especially including the monitoring of progress against the initial MPIs.

Each of these steps is important seem straightforward enough yet efforts at reform often fail. Second, because issues of governance in Indonesia remain unsettled and contested. This contributes markedly to a worrying situation where many observers comment on the “lack of rule of law” and the fact that arrangements in Indonesia are felt to be *kacau*.

Measures that might be taken to respond to these issues include:

- Defining the official rules of the game more clearly in each sector; but doing so bearing in mind the current severe constraints on the capacity of the state.
- Streamlining government by simplifying regulations and procedures because, given the limited capacity of the state, there is over-regulation in many sectors in Indonesia at present;

government agencies might be encouraged to prepare lists of functions that they intend to eliminate so that they can focus on areas of higher priority.

- Accepting rather than resisting the role of markets; accepting, also, that attempts to suppress prices are frequently counterproductive and have many negative side effects.

Finally, there are many important issues of governance in Indonesia not addressed in this paper: these include the large decentralization of government in recent years, the overall financing of the military budget, the continuing need to tackle a gamut of issues related to the role of SOEs, and the need for legal reform. Each of these topics, however, is properly the subject of a separate paper.

All references cited in this summary may be found in the full text version of “Governance in Indonesia: Some Comments” that can be found in PDF format on the CD-ROM accompanying this booklet or on the ADBI website, <http://www.adbi.org/>.