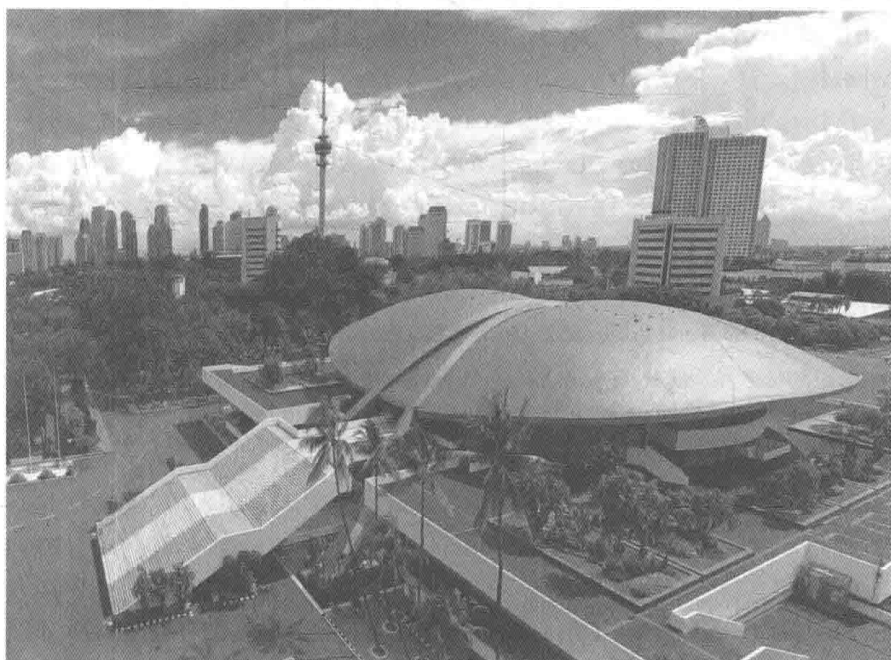


# REINVENTING **INDONESIA**

Ginandjar Kartasasmita  
Joseph J. Stern



# REINVENTING **INDONESIA**



**Ginandjar Kartasasmita**  
**Joseph J. Stern**

---

 **World Scientific**

NEW JERSEY • LONDON • SINGAPORE • BEIJING • SHANGHAI • HONG KONG • TAIPEI • CHENNAI

*Published by*

World Scientific Publishing Co. Pte. Ltd.

5 Toh Tuck Link, Singapore 596224

*USA office:* 27 Warren Street, Suite 401-402, Hackensack, NJ 07601

*UK office:* 57 Shelton Street, Covent Garden, London WC2H 9HE

**British Library Cataloguing-in-Publication Data**

A catalogue record for this book is available from the British Library.

**REINVENTING INDONESIA**

Copyright © 2016 by World Scientific Publishing Co. Pte. Ltd.

*All rights reserved. This book, or parts thereof, may not be reproduced in any form or by any means, electronic or mechanical, including photocopying, recording or any information storage and retrieval system now known or to be invented, without written permission from the publisher.*

For photocopying of material in this volume, please pay a copying fee through the Copyright Clearance Center, Inc., 222 Rosewood Drive, Danvers, MA 01923, USA. In this case permission to photocopy is not required from the publisher.

ISBN 978-981-4596-55-8

In-house Editor: Yvonne Tan

Typeset by Stallion Press

Email: [enquiries@stallionpress.com](mailto:enquiries@stallionpress.com)

Printed in Singapore by B & Jo Enterprise Pte Ltd

REINVENTING  
**INDONESIA**



## Foreword

---

Indonesia's economic and political collapse in 1997 was a dramatic moment in that country's history. Indonesia was also a highly significant casualty of the financial crisis that hit many East and Southeast Asian countries hard and nearly simultaneously in 1997 and whose aftershocks would be felt soon in countries as far as Russia and Brazil. The story of what happened in Indonesia, therefore, is a significant component of one of the most salient political and economic events in our time.

In this book, Ginandjar Kartasasmita and Joseph Stern analyze Indonesia's political economy during the unfolding of the 1997 crisis. They also explain the key drivers for Indonesia's political economy in the decades preceding the crisis and the proximate factors that led to the crisis. They go on to study Indonesia's recovery from the crisis in the years that followed.

From the mid-1980s until the 1997 crisis, as Kartasasmita and Stern show, Indonesia's economy was one of the fastest growing in the world, growing apace with those of South Korea and Malaysia, albeit from a much lower base. Although Indonesia is a petroleum exporter, its growth during these years was impressive because it took place at a time of relatively low world market prices for petroleum.

Among the reasons for Indonesia's rise was its successful implementation of important economic reforms over time. In the mid-1960s, Indonesia's per capita income declined, inflation skyrocketed, and the country's annual international debt obligations exceeded the value of its exports. In the 1970s, Indonesia stabilized its budget expenditures and gradually developed a professionally managed market-responsive exchange rate policy. In the 1980s, Indonesia adopted fiscal and trade

reforms that accounted for its non-hydrocarbons export growth in those years and in the early 1990s.

Indonesia's social performance improved as well. The incidence of extreme poverty fell. Life expectancy at birth lengthened. The proportion of the population with access to health care services, safe drinking water, and primary schooling increased substantially.

How could the 1997 crisis have happened, therefore? Kartasasmita and Stern identify three broad explanations. The first was the insufficiency or incompleteness of the otherwise successful economic reforms in advance of the 1997 crisis. In particular, Indonesia's financial sector experienced exuberant growth that took place in a climate largely devoid of proper prudential regulations; neither Bank Indonesia nor the Ministry of Finance had developed sufficient supervisory capacity. This left Indonesian financial institutions highly vulnerable to the financial crisis contagion that spread out of Thailand in mid-1997.

The second set of explanations focuses on the response of Bank Indonesia and the International Monetary Fund (IMF). Kartasasmita and Stern conclude that Bank Indonesia violated its own rules in the midst of the crisis, issuing liquidity support to failing banks without adequate safeguards regarding the quality of assets or sufficiently high interest rates. In the context of an aggravating crisis, this decision also fueled the perception that the Bank of Indonesia was bailing out large Chinese-owned banks in an ethnically divided country where all Chinese, rightly or wrongly, were perceived as wealthy elites; this would become part of the background for subsequent anti-Chinese riots.

Kartasasmita and Stern examine carefully the criticisms that have been made of the IMF's behavior and recommendations during the crisis — recommendations that were on the whole supported by the US government. Although the IMF program has come in for serious criticism and second-guessing, some of the criticism is misplaced. The authors note, for example, that a bank run was already underway before the IMF recommended the closing of 16 medium- and small-sized banks. Thus, the closure of these banks did not cause the crisis, though it is more difficult to assess the result of this decision on expectations regarding future banking failures. Secondly, notwithstanding

IMF recommendations in favor of a tight monetary stand, monetary policy remained accommodative as the crisis unfolded. It is thus difficult to assess the import of such IMF recommendations.

The authors, however, correctly take the IMF to task for using the financial crisis as an excuse to demand instant wholesale economic reforms in Indonesia. Many of those reforms were warranted; Indonesian economic reformers had advocated for years on their behalf. But by pressing for those reforms in the midst of a crisis, the IMF lost its focus and its credibility and, instead, contributed to bringing down the political system that had governed Indonesia since the 1960s.

That raises, then, the third set of broad explanations. Indonesia's institutional framework was not up to the challenge of the 1997 crisis. Its courts were often ineffective in upholding the rule of law. The central bank and associated financial regulatory agencies provided weak prudential supervision of the financial system. The bureaucracy's general administrative capacity was ineffective. The political system that had once engineered many economic and social changes had become rigid after decades of rule by a single, aging ruler. The perception of corruption and cronyism had spread. The political regime limited the development of opposition political forces and hoarded and censored information. It lacked credibility when it sought to explain and defend the social and economic gains of the quarter-century that preceded the 1997 crisis. Mass violence broke out in the face of a sclerotic political system which, by this late date, had lost its capacity to innovate, and tumbled.

Indonesia has begun to recover from both the economic collapse and the inter-ethnic political violence that accompanied the breakdown of the political system. But it has underperformed against the countries whose performance it once matched. South Korean democratic institutions made it possible for that country's citizens to replace the governing party, peacefully and fairly, with a different set of rulers who enacted new economic and political reforms. Malaysia's political system, notwithstanding its authoritarian features, has been designed to incorporate more effectively that country's plural society through political party coalitions. The South Korean and Malaysian

economies recovered from the financial crisis faster than Indonesia's, and neither South Korea nor Malaysia suffered mass violence, political instability, and economic setback on the same scale as Indonesia.

In Indonesia, one legacy of authoritarian rule was the absence of effective political parties. Indonesia's future requires the further development of political parties that are capable of competing yet also cooperating under democratic rule, focused on relaunching a pattern of sustained economic growth to engender prosperity and social improvement, whilst remaining respectful of the broad diversity of Indonesia's multicultural archipelago, and above all of the rights of each person to life and its advancement. That is Indonesia's challenge in the 21st century.

The Indonesian story holds lessons, therefore, for the management of financial crisis, the behavior of national and international institutions, and especially for the urgency of reform and development of economic and political institutions. Kartasasmita and Stern greatly advance our understanding of processes and events that have contributed to change the world in which we live.

*Jorge I. Domínguez*

*Antonio Madero Professor for the Study of Mexico*

*Director, Weatherhead Center for International Affairs (1996–2006)*

*Harvard University, USA*

## Preface

---

This book is the product of over a decade of collaboration between the two co-authors. That collaboration started in Jakarta when Ginandjar Kartasasmita was Minister of National Development Planning and concurrently the head of the National Development Planning Agency (BAPPENAS), while Joseph Stern was the project director for the Harvard Institute for International Development (HIID), which assisted the Ministry of Finance, the Coordinating Ministry for the Economy, and the National Development Planning Agency. The collaboration deepened when Ginandjar was appointed as Coordinating Minister.

In 1999, when Joseph Stern returned to Harvard University as a professor at the John F. Kennedy School of Government, the two continued their work though less intensively. But from 2000 to 2003 Ginandjar resided at Harvard, the first year as a Fellow and later as a Visiting Scholar at the Weatherhead Center for International Affairs, and they began a new phase of collaboration, this time focusing on developing a deeper understanding of the transition that was then underway in Indonesia.

This book grew out of a monograph that Ginandjar completed while at the Weatherhead Center. As the two discussed the material in the monograph, it became apparent that much more could be said about both the lead-up to the transition and the transition itself. It was agreed that after Ginandjar's return to Indonesia, Joseph Stern would work on chapters that covered the economic trends in Indonesia, while Ginandjar would document the events of those turbulent times and the political economy forces that they represented.

Work on the volume would continue and grow as Indonesia's transition to democracy took its twists and turns. Through the combination of Ginandjar's unique perspective as a participant in some of the major events of the period and Joseph Stern's ability to place some of the events into the context of other global transitions that had occurred over the previous 20 years, the story of Indonesia's transition to, and consolidation of, democracy began to gel.

While the story will never be finished, a book must ultimately be published so that it can be of use to historians and other students of Indonesia. This book covers in detail events primarily from 1997 to 2004 but includes some background on Indonesia's history and highlights of key events since 2004. Ginandjar's position as a member of the Presidential Advisory Council from 2009 to 2014 gave him a particularly good vantage point to comment on events after the 2004 elections.

Authors cannot write a book like this without extensive assistance from others. We would like to express our appreciation to our colleagues at Harvard University, including the Weatherhead Center, the Kennedy School of Government, and the Center for International Development, for their encouragement as we worked on this volume and their comments and suggestions in innumerable formal and informal presentations of material.

We would like to thank in particular a few people to whom we are very much indebted. Steve Bloomfield, Executive Director of the Weatherhead Center, has from the start supported our endeavor to tell the story of Indonesia's emergence from a near failed state to a more democratic and stronger state, thus helping to bring the study to a successful conclusion. Donald Halstead of Harvard School of Public Health gave unstintingly of his time in bringing the authors' separate visions and manuscripts together into one. This project could not have been completed without his hard work, expertise, and cooperation. Tim Buehrer, a long-term resident of Indonesia who has developed strong relations with numerous Indonesians and is fluent in *Bahasa* Indonesia, helped us gain a deep understanding of the nation, its people, and its problems as well as its eventual growth and development. William C. Kirby, T. M. Chang Professor of China Studies at Harvard University and Spangler Family Professor

of Business Administration at the Harvard Business School, provided insights and suggested the title of this volume: *Reinventing Indonesia*. Clay Delano, as assistant editor, was enormously helpful in checking and improving the language, logic, and flow of many of the chapters. And Ian Dafy Fachry and Adit Sasmito, both Indonesian graduate students, assisted in the early phase of the project with their research. Last but not least, Jorge I. Domínguez, former Director of the Weatherhead Center and now Antonio Madero Professor for the Study of Mexico at Harvard University, where he is also Vice Provost for International Affairs in the Office of the Provost, was kind enough to write the Foreword to this book.

Finally, we acknowledge our debt to our spouses, Yultin Harlotina (wife of Ginandjar Kartasasmita) and Sophia C. Stern (wife of Joseph Stern), who often asked us when this volume would be completed as the writing of this book stretched on and on. To them, we can now say that the end of our efforts has been reached. We hope this book meets their expectations and we thank them for their support and patience.

*Ginandjar Kartasasmita*  
*Jakarta, Indonesia*

*Joseph J. Stern*  
*Boston, Massachusetts, USA*

## About the Authors

---

**Ginandjar Kartasasmita** has devoted his life to the development of Indonesia from various positions in different capacities, and he was deeply involved in managing Indonesia's economic and political recovery after the 1997 Asian financial crisis which triggered political reform and regime change in Indonesia. As his last official position in the government, he served as a member of the Presidential Advisory Council of President Susilo Bambang Yudhoyono, a role he had held from 2009 to 2014. Previously he chaired the House of Regional Representatives, or Indonesia's "Upper House", which was newly established in 2004 and aimed at strengthening the legislative branch in the age of democracy. During Indonesia's crucial period of political transition (1999–2004), he navigated the tumultuous democratization process as Vice Chairman of the People's Consultative Assembly, the country's highest decision-making body overseeing the amendments to the Constitution that formed the legal foundation of its democratic institutions and political system. Over the years, Kartasasmita has had a distinguished career in the Indonesian government, as the Coordinating Minister for Economic, Financial, and Industrial Affairs (1998–1999); State Minister of National Development Planning/Chairman of the National Development Planning Agency, or BAPPENAS (1993–1998); Minister of Mines and Energy (1988–1993); and as Head of the Investment Coordinating Board, or BKPM (1985–1988). Also as an educator, Dr. Kartasasmita has been active both domestically and internationally, teaching development policies and sharing his experiences at universities such as the National Graduate Institute for Policy Studies (GRIPS) and Waseda University in Tokyo, and Brawijaya University in Indonesia. From 2000 to 2003, he resided

at Harvard University, the first year as a Fellow and later as a Visiting Scholar at the Weatherhead Center for International Affairs. Among his academic contributions are his recent book, *Managing Indonesia's Transformation: An Oral History* (World Scientific Publishing Co., Singapore, 2013), and "Globalization and the Economic Crisis: The Indonesian Story" (Working Paper No. 01-03, Weatherhead Center for International Affairs, Harvard University, 2001).

**Joseph J. Stern** was a Lecturer in Public Policy at John F. Kennedy School of Government, Harvard University (2000–2007). He has a deep knowledge of Indonesia due to his extensive experience in the country as both a scholar and an advisor to the government. As chief of a technical assistance project between the government of Indonesia and Harvard University, Stern served as Chief of Party, Projects Coordinator for the Harvard Institute for International Development (HIID) in 1990–1994 and 1996–1999. As an academic, Dr. Stern has occupied various posts, including that of Adjunct Professor, Fletcher School of Law and Diplomacy (2001–2003); Fellow, Harvard Institute for International Development (1968–2000); Executive Director, Harvard Institute for International Development (1984–1989); and Associate Director for Research, Development Advisory Service (1972–1974). He has published many books and articles over the course of his career, such as *Industrial Development and the State: The Korean Heavy and Chemical Industry Drive* (Harvard University Press, Cambridge, MA, 1996). Stern's experience in assisting the Indonesian government was documented in "Indonesia-Harvard University: Lessons from a Long-Term Technical Assistance Project" in *Bulletin of Indonesian Economic Studies* (2000).

# Contents

---

|                          |  |     |
|--------------------------|--|-----|
| <i>Foreword</i>          | v  |     |
| <i>Preface</i>           | ix   |     |
| <i>About the Authors</i> | xiii   |     |
| Chapter 1                | Introduction: From Independence to Democracy, a 60-Year Journey  | 1   |
| Chapter 2                | The Rise of the Indonesian Economy                               | 7   |
| Chapter 3                | The Early Reform Period: 1983–1993                               | 27  |
| Chapter 4                | Explaining the Demise  | 47  |
| Chapter 5                | The Crisis: 1997–1999  | 85  |
| Chapter 6                | The Chaos that Followed  | 107 |
| Chapter 7                | On the Way to Recovery and Democracy                             | 131 |
| Chapter 8                | Democratic Consolidation: The Unfinished Business                | 191 |
| Chapter 9                | Significant Milestones: Constitutional Reform and 2004 Elections | 233 |
| Chapter 10               | Postscript: Promises and Challenges                              | 259 |
| <i>Bibliography</i>      | 271  |     |
| <i>Index</i>             | 287  |     |

# Chapter 1

## Introduction: From Independence to Democracy, a 60-Year Journey

---

Indonesia's birth as an independent state in 1945 was a time of hope and great expectations. The embodiment of those expectations was Sukarno, Indonesia's first president, a man of great vision but whose presidency undercut the development of democracy and the institutions of government. When the economy collapsed in 1965 and the nation faced a coup allegedly involving the Indonesian Communist Party (PKI) and their sympathizers within the military, then Major General Suharto rose to lead a "New Order".

This book begins with a discussion of the New Order period from a political economy perspective and offers an explanation for the ultimate failure of the New Order and the rise of democracy that followed. The heart of the book, however, is a detailed account and analysis of the dynamic period starting in 1997, when Indonesia's transition to democracy began, that continued through to 2004 when the new democratic institutions began to be consolidated. This introductory chapter recounts the flow of events during the transition and consolidation periods as well as the broad themes of the rest of this volume, thereby setting the stage for the more in-depth discussion that follows.

With the overthrow of Sukarno in 1966 and the ensuing rise of Suharto, a measure of calm was established and the foundations for economic stability and growth were put into place. But the New Order continued and expanded upon the centralization of power in the presidency of the previous regime. Political parties were forced to consolidate into three government-approved organizations. The

rise of civil society organizations was stunted. The role of the military, at that time including the police, in maintaining stability and in governing grew. However, the stability and economic growth that was delivered made these limitations seem acceptable to much of the population.

For the better part of three decades, the New Order under Suharto delivered on the tacit compact with the people by ensuring stability, growth, and equity, whilst limiting political development. With varying levels of support from Suharto, a group of economic technocrats were able to put the economy on a high-growth path that delivered on the growth pillar of the compact.

But there was an underlying flaw with respect to the equity pillar of the compact: growing corruption and cronyism. And there was an unexpected, though predictable, side effect from the growth that was delivered by the New Order: increasing demand for a say in government by a growing middle-class.

These forces, combined with the inevitable aging of Suharto and the ultimate need for a transition, began straining the compact. The Asian financial crisis was the spark that ultimately led to the undoing of Suharto's regime. As will be illustrated in this volume and much like the case of Sukarno before him, the very centralization of authority that had maintained the New Order for 30 years led to its undoing and to a collapse of order in some parts of the country. When Suharto was unable to step up and make the hard decisions needed during the crisis, no other institutions were able to support him and ultimately he, like Sukarno, had to step down.

To the surprise of many, what followed was a reinvention of the Indonesian state directed initially by a man that no one would have expected would be able to do so: B.J. Habibie. Then Minister of Science and Technology, Habibie virtually had a constituency of one, Suharto, when he was named Vice President and few thought that he would be able to govern when Suharto stepped down. But he did. Not only did he manage to overcome the financial crisis and lead the economy to recovery, but through a series of sweeping reforms that he either initiated or supported, he laid the legal foundation for democracy in Indonesia.

President Habibie and his government freed political prisoners, signed ILO labor rights conventions, and ratified UN conventions on human rights. Working closely with the parliament, President Habibie put in place a series of laws that laid the foundation for Indonesia's transformation. These included giving independence to the Supreme Court, abolishing the anti-subversive activities law, separating the police from the military, decentralizing much of government and government finance to the regional level, freeing the press, and, most importantly, enacting new laws pertaining to political parties, the general election, and the removal of the military and police from the country's politics. Virtually all of this happened over a period of one and a half years in 1998–1999.

Simultaneously, the People's Consultative Assembly (MPR) — the nation's highest constitutional body which had the power to elect and impeach the president and change the Constitution — put into motion the process of amending the 1945 Constitution, a task that was led by Ginandjar Kartasasmita as its Vice Chairman. The revised Constitution established the basis for the emergence of a democratic state and provided a strong foundation for more rapid economic growth and reduction in poverty levels.

These changes transformed Indonesia, creating or strengthening the fundamental institutions needed for democracy. This led to Indonesia's first truly democratic election in more than 40 years in 1999. Forty-eight parties participated, and nearly 90% of eligible voters turned out for the election that was viewed domestically and internationally as free and fair. This was a testament to the determination of the government and civil society that a new Indonesia be born. But the continuation of democracy was not yet a given. As Huntington and others have pointed out, transition is only the first step. Consolidation is also important. The June 1999 election was for the parliament (DPR), which, when augmented with representatives from the provinces and functional groups, constituted the MPR. Subsequently, the MPR met in October that same year to elect a new president, with President Habibie standing for election.

As will be discussed in this volume, ultimately President Habibie's accountability statement to the MPR was rejected, creating a potential