

The New

VAN ZORGE

REPORT ON INDONESIA

Behind the Headlines

INTELLIGENCE:

Golkar everyone's plaything
The president's banking options

IN BRIEF:

Extractive industry transparency
The national habit
BI without Boediono

SPECIAL FEATURE:

JI: down but not out
Palembang: Radicalisation up close



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Editor-in-Chief
James Van Zorge

Publisher
Dennis Heffernan

Managing Editor
Sam Polk

Assistant Editor
Tiarna Siboro

Contributing Editor
William Robertson

Office:

Sequis Center
(S. Widjojo), Lt 8
Jl. Jendral Sudirman #71
Jakarta 12190
Phone (6221) 5290 3988
Fax (6221) 5290 3989

Website:

www.vanzorgereport.com

Send comments to:
polks19@yahoo.com

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Table of contents

FROM THE EDITOR:	4
Indonesia's political ghettos	
INTELLIGENCE	
Golkar everybody's plaything	6
The president's banking options	7
SPECIAL FEATURE:	
Jemaah Islamiyah: down but not out	10
Radicalisation up close	13
IN BRIEF:	
The EITI: a potential boon to anti-corruption drive	15
The national habit	18
BI without Boediono	22
'Freewheeling politicians' pose challenges for decentralisation	23

FROM THE EDITOR...

Indonesia's political ghettos

In 1998, Indonesian campuses were a beehive of political activism and served as the vanguard for pushing Suharto out of the palace. Buzzing with excitement and a newly found belief that they could change their world with the power of protest, students continued their marches in the streets and took aim at Suharto's protégé and successor, B.J. Habibie, until he, too, was unceremoniously shown the exits.

Today, more than a decade later, the scene is strikingly different. Universities across the country have turned conspicuously quiet. Most of all, one is struck by the lack of interest by students in anything to do with politics. Rather than engage in debates about democracy or mobilise for a cause, students would rather think about their job prospects and, if they feel the urge to find a ballast in life, visit the local mosque or church. When students do talk about politicians and possibilities for change, you are more likely to hear cynical remarks and pessimism, not dreams for a better future.

In many ways, the rise and fall of Indonesian student politics is reminiscent of the tumultuous 1960s when American and European campuses had become a hotbed of public protest. In the U.S., students found common cause because of a deeply ingrained belief the Vietnam War was unequivocally wrong and the only honourable policy was one of retreat.

Protest found purpose not only in the immorality of war, but in perceived injustices against minorities, as well, spawning a nation-wide cry for social revolution. Across the Atlantic, there emerged an obsession with overturning the old order, manifesting itself more often than not in violent protests in the streets of Berlin, Rome and Paris. Even behind the Iron Curtain in the East, students in Warsaw and Prague took the radical cue from their counterparts across the Wall and protested for more political openness. Everybody at the time, it seemed, had a cause.

By the early 1970s, however, youthful zeal for change was quickly diminished. The prosperity of the '60s came to a sudden end, and in the midst of high inflation and deepening structural unemployment with no apparent fix in sight, communitarian causes took a backseat to individual needs.

It would be wrong to conclude, however, that economic

concerns were the only reason for which students decided to put down their rocks and Molotov cocktails. Having seen the end of the Vietnam War and unprecedented legislation in protection of civil rights, expanded social welfare and equal opportunity, student activists in San Francisco and Berlin walked away from their campuses and into the mainstream with a sense of real accomplishment.

Having achieved so much, most students felt that they did have any battles left to fight. Sure, there were some radical exotica that persisted, mostly para-Marxist groups and anarchists like the Bader-Meinhoff gang of Germany, but for the most part their theories and illusions of revolution were viewed as strange curiosities rather than something to be desired or emulated.

In stark contrast, Indonesian students in the late '90s must have regretted what could be viewed, in retrospect, as a premature return to their campuses. Indonesian students were naïve in believing that, when the two icons of political dissent during the Suharto era rose to power, first Abdurrahman Wahid and then Megawati Sukarnoputri, they would become the protagonists and guardians of democratic reform. Over time, these hopes were replaced by a bitter realisation that neither leader had the capacity or will to make any bold moves as president. Reform stopped dead in its tracks.

When Susilo Bambang Yudhoyono took office, university students felt they had good reason to cheer the demise of Megawati. On the one hand, most students generally liked Yudhoyono and trusted him as a national figure with true democratic intentions. On the other hand, they also had more than their fair share of disappointment. If students were once exuberant, they now realised it was an exuberance born of innocence, and turned therefore to a colder, more jaded view of politics in general and Indonesian politicians, in particular. Universities were no longer hotbeds of dissent and reformist sentiment—rather, they had become, for the most part, political ghettos.

In any healthy democracy, universities are a place for critical discourse. Intellectual society especially plays a crucial role in challenging conventional thought and fostering public debates about political and social life. As such, what rectors, professors and students alike need to recognise is that while the great debates and fight for replacing dictatorship with democracy are over, more

sober yet equally important debates await them. While democracy is here to stay and direct elections are a fact of life, most Indonesians are wondering what democracy means for them personally. Is it just the right to vote, or is it something bigger?

For some, this vacuum on university campuses has not gone unnoticed. In part, it has been filled by religious organisations, even on traditionally secular public campuses such as the University of Indonesia and the Bandung Institute of Technology. One political party, the Prosperous Justice Party, or PKS, has been clever enough to recognise Indonesian students' feelings of estrangement with politics, especially on issues related to the moral turpitude of public officials. Using ancient scripture as their weapon of choice, PKS leaders and activists have successfully organised students in support of their party.

The political ghetto I speak of, then, is not one where university students are absolutely disengaged. In many instances, students are being engaged, but unfortunately it is in a dangerous fashion, primarily because of a political party that utilises religion as its ideology. Religious parties of any ilk, whether they are linked with Muslim, Christian

or other faiths, are driven primarily by moral absolutism, which, as history clearly shows by numerous examples, is incompatible with democracy.

Given this state of affairs inside Indonesian universities, what should be done? It seems clear that the onus for creating a healthier political atmosphere on campuses lies with the national government and educators. The national government, in particular the Ministry of Education, should take a serious look at outdated public school curricula and pose one question: Now that Suharto is dead and gone, what type of coursework is needed to strengthen a student's understanding of and appreciation for a secular, liberal democracy?

Educators can play an important role, as well, by creating a vibrant atmosphere for more diverse student politics and stimulating intellectual debates on public issues, hence removing the monopoly held by religious groups and parties. If the government and educators can achieve this, then it would prove to be an eloquent recognition and fitting respect for the sacrifices made by the students of '98, who, in the end, made democracy possible for Indonesia. □

INTELLIGENCE

Golkar everybody's plaything

After years of Golkar politicians manipulating other parties to get their desired outcome, it's now Golkar that has become a political tool of others, a source within the party tells the *Report*.

Despite Vice President Jusuf Kalla's nomination by Golkar to take on his boss, President Susilo Bambang Yudhoyono, in the July election, key party executives are in fact making moves to bring Golkar behind each of the other two competing coalitions in a second round of presidential voting in the likely scenario that Kalla and his vice presidential candidate Wiranto do not make it out of the first round.

Tycoon Aburizal Bakrie of Golkar is the leader of the camp that would like to bring Golkar behind president Yudhoyono, says the source. Many expect Bakrie to take leadership of Golkar from Kalla in the party's extraordinary meeting (*munaslub*) that is planned to be moved up to September of this year—three-months earlier than the initial plan to hold it in December.

Bakrie has already made moves in this direction, holding a meeting of other top party officials at his house on May 20, reportedly to move the *munaslub* up and to oust Kalla in the event of his defeat.

While Bakrie's meeting was attended by party heavyweights Agung Laksono, Priyo Budi Santoso, and Firman Subagyo, his isn't the only backdoor move to lay the groundwork for steering Golkar behind Kalla's current competitors.

Media mogul Surya Paloh also has ambitions to lead the party, says the Golkar source. Though he's currently tendering his full support to Kalla, in the event Kalla is defeated, Paloh would attempt to steer Golkar into a coalition with the Indonesian Democratic Party of Struggle (PDI-P). Prior to Kalla's declaration of his presidential candidacy, Paloh had already attempted to broker a deal with Taufik Kiemas, husband of former president and current candidate Megawati Sukarnoputri.

The split between those who would like to see Golkar return to a coalition with Yudhoyono's Democrat Party, and those who would like it back Megawati and PDI-P following a potential Kalla defeat is just one dynamic shaping the struggle for the party's support, however. The source inside Golkar told the *Report* that intelligence officials would attempt to support Bakrie's bid to become the party's chairman. No additional information was available on how the intelligence services would push the party to Bakrie's camp, however.

Asked what interest intelligence services might have in Golkar coming under Bakrie's control, the source said that if Golkar were to return to a coalition with the Democrat Party, it would help "prevent political domination by PKS cadres." The conservative Islam-based Prosperous Justice Party (PKS) is currently the second-largest party after the Democrats in the coalition supporting Yudhoyono's re-election bid.

When pushed to elaborate on the issue, the source, a senior Golkar member, explained that President Yudhoyono wants continued Golkar support for his coalition. “Yudhoyono needs a nationalism-based party to be engaged in the already crystallized coalition developed by his Democrat Party together with three Muslim-based parties, including Prosperous Justice Party (PKS),” the source told the *Report*. “Yudhoyono’s interests align with those of officials of the State Intelligence Agency (BIN), which is now seeking way to curb PKS influence in the country’s politics,” said the source.

If true, this would not be out-of-keeping with the suspicion many within the security apparatus have long harboured regarding the aims of Islam-based parties, including the PKS. Even some former members of the intelligence and military services close to the president have expressed concern over the PKS’s influence in a potential second Yudhoyono administration, and the possibility that the party might make larger gains in 2014.

The president’s banking options

With Boediono having left the top job at Bank Indonesia (BI), the country’s central bank, a political game is unfolding over who should be named the vice presidential candidate’s successor. Sources close to the president tell the *Report* that the president is manoeuvring to avoid yet another fight with the often adversarial House of Representatives, and will likely wait until after the upcoming presidential elections—and even perhaps until a potential second term—to fill the now vacant position.

Shortly after Boediono’s announcement that he would be joining incumbent president Susilo Bambang Yudhoyono on the campaign trail, legislators began to call for a speedy process to replace Boediono. Agung Laksono, a Golkar Party member and speaker of the House, told reporters that Boediono’s replacement should be named this May, and Hafidz Zawawi, the chairman of the House’s Commission XI on financial affairs, began naming potential candidates—BI Deputy governor Hartadi Sarwono and Finance Minister Sri Mulyani Indrawati first among them—almost as soon as Boediono was out the door.

The source in the president’s inner circle, however, denied that Sri Mulyani was likely to be nominated to head the bank (for more on the president’s plans to juggle his financial team, see the In Brief section). Nor, they say, is he likely to keep on the bank’s Senior Deputy Governor Miranda Goeltom, who in lieu of a speedy appointment and confirmation process for a new permanent bank chief, will lead the bank until her term ends in July.

The president could extend her term of service, but that would be only the “worst case scenario,” the source close to the president told the *Report*. “The president doesn’t want Miranda.” Goeltom, says the source, has not been in the president’s favour on account of what Yudhoyono believes was her meddling in the earlier attempts to find a permanent bank chief.

In April 2008, the president was faced with appointing a new bank governor to replace the outgoing Burhanuddin Abdullah, who was jailed in February for five-and-a-half years for embezzling U.S. \$10.3 million in bank funds.

At that time, Yudhoyono nominated two candidates, economist Raden Pardede, and president director of state-owned Bank Mandiri Agus Martowardojo. Their nominations were both scuttled by the House committee, however, leading the president to believe that Goeltom was behind the action.

“Yudhoyono was in Malaysia when he got information about House’s move to drop his proposed candidates,” says the source. “He knew that Miranda was behind the move because she had ambitions to get the top BI post.”

Goeltom, it appeared at the time, was the candidate of choice for House Commission XI legislators from Golkar and the Indonesian Democratic Party of Struggle (PDI-P). It has since been alleged by whistleblower Agus Condro, a PDI-P member who has since been removed from the legislature by his own party, that he and other commission members each received Rp 500 million (\$48,500) to approve Goeltom’s nomination as BI deputy governor.

The president, according to the source, has two strategies for dealing with the empty BI governorship besides the worst case scenario of extending Miranda’s term. First, he could opt simply not to fill the position, letting Goeltom lead the institution until July. Yudhoyono’s nominee to replace her as senior deputy governor, Darmin Nasution, currently the director general of taxation at the Finance Ministry, is expected to be approved by the House. If approved, Darmin could lead the bank as senior deputy governor until the president to selects a permanent BI chief at a time of his choosing.

This strategy would have several up sides for the president. First, it would prevent the BI chief’s nomination process from interfering with the Yudhoyono’s campaign ahead of the July 8 presidential poll. Second, if re-elected, Yudhoyono would be dealing with a legislature likely to be far more amenable to his desires than is the current one. “[The president] would prefer to deal with newly elected legislators as it would involve less politicking,” says the source.

The Democrat Party will have 150 seats in the upcoming House, as compared to the mere 57 seats it has in the current one. The commission on financial affairs would also consist of different legislators than the ones that shot down his top two picks for BI chief in 2008.

The second strategy would be to go ahead and nominate candidates now, despite the heated political environment. “There are several names, including Raden Pardede, Agus Martowardojo, and Darmin Nasution, who will be on Yudhoyono’s list,” says the source. While those names include the two that were originally rejected by the House commission, there’s reason to believe they might stand better chances this time around.

Maruarar Sirait was among the PDI-P legislators who initially rejected President Yudhoyono’s proposed candidates, Agus and Raden, the first time around, but is now singing a different tune. While still mentioning Miranda

as a PDI-P favourite, as well as National Banking Association head Sigit Pramono, Maruarar signalled that he and others from his party were open to endorsing Yudhoyono's likely picks.

"The situation has changed," Maruarar told the *Report*. "Three private banks have collapsed, and financial support has failed to reach businesses in real sector." □

FEATURE: BY NOOR HUDA ISMAIL*

Jemaah Islamiyah: down but not out

The recent arrest in Johor Bahru, Malaysia of Mas Selamat Kastari, a Singaporean member of the Jemaah Islamiyah (JI) terrorist group is a significant achievement in the effort to root out terrorism in Indonesia, but significant threats remain. In particular, a continued leadership split in Islamic militant circles and the release from prison of unreformed members of the group have raised the possibility that splinter factions might seek to energise the movement through violent attacks.

Numerous senior JI leaders remain at large, including key leader Noordin Top; Zulkarnaen, JI's military commander; Dulmatin, an electronics and bomb-making specialist; and recruitment expert Umar Patek, who has sought sanctuary with the Abu Sayaf Group in the Philippines.

Pressured by security operations since the Bali bombings, JI is no longer a cohesive organisation with a clear, unified leadership structure. In fact, deep divisions have arisen among group members since the first Bali bombing, including the emergence last year of JI spiritual leader Abu Bakar Ba'asyir's new group, *Jama'ah Anshorut Tauhid* (JAT).

There is also a divide within JI over tactics, with one faction advocating al Qaeda-style attacks like the Bali bombings that directly targeted Westerners and Western interests, and another faction that has consistently opposed such bombings and encouraged JI members not to participate in the kind of large-scale attacks that catapulted JI onto the international stage.

The latter faction, led by the now-imprisoned Abu Rusdan, accepts the legitimacy of the Bali type of attacks, but believes that turning to such tactics is premature. "The time isn't yet ripe to wage *Jihad* in Indonesia," Rusdan told the author in a recent exclusive interview, referring to attacks against foreigners and foreign interests in Indonesia. Instead, he says, JI should restrict its militant activities to defending Muslims in conflict areas as it did in the restive regions of Ambon and Poso.

Rusdan further told the author that attacks like the Bali bombings have damaged the image of JI and done a disservice to Islam. Moreover, he contended, the attacks have hurt the organisation by bringing its activities and operations under the now constant scrutiny of the security services.

The division between the two factions has become deeper in recent times. One JI member convicted of involvement in terrorist activities and subsequently released from prison told the author that an influential individual from Rusdan's faction moved to isolate convicted JI members because of the attention they might bring to the group and fear that they may have decided to become spies.

"We testified in the court and this was seen as revealing secrets of the

* Noor Huda Ismail is the executive director of the International Institute for Peace Building. He can be reached at noorbudaismail@yahoo.com.

organisation,” said the recently released JI member. “Moreover, we are told that we are being monitored by authorities.”

There are, in fact, hundreds of JI members who are now being released from jail because they have finished their prison sentences. Some of them had significant roles in the organisation, including Abu Tholut, a former JI regional commander and a military trainer in the Hudaibiyah Camp in Mindanao, southern Philippines. He had been arrested for weapons possession.

The exclusion of a character like Abu Tholut from the central JI would be unlikely to prompt him to give up his militant aims. If he were to be shunned by Rusdan’s faction, he and others now leaving jail would be more likely to be drawn into more violent factions of JI, like Noordin Top’s group or JI splinter groups that continue to fly below the radar of the security services.

These hardcore groups believe that the use of violence against the “enemies of Islam” is justified in any situation. Far from satisfied with the Bali bombings and other attacks now years in the past, they dismissively refer to many senior JI members as “NATO”—No Action, Talk Only.

Members of this faction are a fringe minority even within a radical movement like JI, but nevertheless they are a potentially very dangerous one. While the sustenance of JI as a whole requires a wide array of logistical operators, ideologues, trainers, recruiters and the like, simply carrying out an isolated attack can be done with only a handful of cadres. Only three people from this faction were able to cause significant carnage in the second Bali bombing.

Identifying and thwarting these fringe groups poses significant challenges. The typical conception of the would-be radical as a young, male, religiously devout, alienated, angry, disenfranchised, and living on the edges of society is increasingly insufficient.

JI and its affiliated groups continue to engage what would otherwise be referred to as “homegrown” terrorists from different socio-economic backgrounds and professions, and with wildly different technical and operational abilities. Rather than a specific “terrorist profile,” it is a complex radicalisation processes that shape these disparate individuals into terrorist operatives.

The complexity and now more decentralised structure of the militant movement is also evident in the increasingly wide-ranging efforts to find moral justification for violent acts. Rather than simply seeking permission for the acts through a *fatwa*, or religious opinion issued by a senior cleric, the pro-al-Qaeda-style-attack faction of JI still believes finding fatwas is important, but has turned to the internet to find ones that justify their actions.

Both the fringe groups and the mainline JI continue to rely on the traditional tools of recruitment such as schools, kinship networks, friendships and small Islamic discussion groups. These groups, consisting of six-to-ten people, meet regularly for a number of social and religious activities. Their perceived harmless nature can inhibit authorities from identifying groups that might ultimately turn to violence.

To make matters more difficult, these groups have also embraced new technologies such as CDs, DVDs, coded SMS messages, secure e-mail, and password-protected websites to communicate and reach out to potential new members.

An Afghan war veteran who formerly served as JI's chief recruiter for suicide bombers, Tony Togar, told the author in a recent interview in his Medan prison cell that Asmar Latin Sani, the JW Marriot Hotel suicide bomber, sent him an email saying that he was ready to "get married" as a code for becoming a suicide bomber.

To stay ahead of splinter factions and the more activist, al Qaeda-inspired element within JI, the authorities will have to pay keen attention to events and developments that could move these groups to action. The execution of the three main perpetrators of the first Bali bombing could be one such event. The death by firing squad of Imam Samudra, Mukhlas and Amrozi will clearly not stop the spread of their ideology. The group will perceive the execution as a sacred date to be leveraged in order to attract new support and recruits.

In Indonesia's militant Muslim circles, the Bali bombers are regarded as heroes that have poured their blood onto the fertile ground of the jihad movement. In this view, the authorities responsible for their execution are the enemies of Islam, justifying virtually any kind of retaliation against them to defend the radicals' cause.

Aside from identifying and neutralising violent radical groups, building on the successes of the current counterterrorism effort will require that the government also find a way to address the unemployment, poverty, and corruption that continue to contribute to the spread of, and support for, the ideology of violence.

Empowering moderate Muslims from mainstream organisations such as Muhammadiyah or Nahdlatul Ulama to counter radical ideologies is important, but it may not ultimately have much impact for two straightforward reasons. First, the majority of the members of the fringe groups do not listen to them, and second, these two mainstream organisations do not fully understand the nature and dynamics of the fringe groups.

The best way to counter radical ideology is by empowering repentant militants whom the fringe groups continue to trust, such as Afghan or southern Philippines veterans who are now lying low. This is a challenging strategy both because identifying the individuals ready to take such a step will be difficult and because the political backlash from enlisting former radicals in the government's effort could be strong. Nevertheless, it may represent the most effective means of actually reaching those who may very well be planning the next major attack.

JI has indeed changed significantly since the first Bali bombing brought the group to international prominence in 2002. The main JI faction has in recent years limited its direct support for violence, and the group has also clearly suffered from a loss of leadership following arrests and internal discord.

However, the emergence of hardened, experienced militants from the conflict in the southern Philippines and the release of JI cadres from prisons, who have been somewhat ostracised by the mainstream JI group, is breeding new fringe groups. The Indonesian government and religious and community leaders will have to continue to take effective action in order to stem the emergence of these fringe movements. □

Radicalisation up close

The emergence of radical splinter groups from the JI mainstream has already occurred. One need look no further than Palembang, South Sumatra, where a group of individuals only very loosely connected to JI undertook plans to launch a series of attacks on Christians and foreigners in Indonesia.

The 10 individuals involved in the group recently stood trial, and in April 2009, received jail sentences for their actions, which included killing a Christian teacher, and an aborted attempts to bomb a café frequented by foreigners in Bukittinggi, West Sumatra.

Sidney Jones, a noted expert on JI with the International Crisis Group (ICG), cites groups like the one in Palembang as one of the challenges that remains for Indonesia's effort to combat terrorism despite the significant progress that has been made in degrading JI. "If you're looking at sources of threat in the future, one of the things to look at is the emergence of militant splinters," says Jones, "although I think we're still dealing with a very tiny number of people."

A new report from the ICG provides a detailed examination of the facts that emerged from the trial as well as additional information that has come to light about those involved in the plots.

"Indonesia: Radicalisation of the 'Palembang Group'," released on May 20, 2009, gives a unique window into how individuals from a disparate set of radical groups, motivated by concerns about Muslims converting to Christianity and bound by charismatic leaders, were able to turn to otherwise unthinkable violence. They did so, the report notes, with very little money, receiving only around U.S. \$1000 in income during the group's existence.

Central to the process was an outsider who was able to provide the motivation for the group members to take seriously the idea of committing violence against people they had never known or met. A JI member who had been sought in his native Singapore in connection with an alleged plot to blow up the Singaporean airport, the report says, "was to have a deeply radicalising influence on a small group of local activists; without him, the Palembang group would not have come into being."

Fajar Taslim, the Singaporean, had become a JI member in 1998, and through Hambali, received military training in Afghanistan. In Palembang, Fajar came into contact with another JI member named Ani Sugandi, according to the report, who had also received international militant training along the Afghanistan-Pakistan border between 1987 and 1992. Sugandi ran a school about five hours from Palembang.

The two JI members, a handful of people from the local branch of the Forum Against Conversion Movement (*FAKTA*), and another radical who was wanted in connection with the communal violence that had afflicted Ambon from 1999-2005, were the key individuals through which the Palembang group was formed, the report says.

After a failed attempt to murder an evangelical Christian leader, group members were able to procure a revolver, with which they murdered the Christian teacher, and another member in direct contact with Noordin Top was able to introduce the group to a bomb-making specialist.

With their newfound firepower, the group decided to target the Bukittinggi café, which group members had heard was a popular place for American tourists to hang out. As part of that plot, operatives brought a live bomb to the targeted café on two occasions, but decided not to detonate it because of the number of locals hanging out there—including one group of women wearing Muslim headdresses.

The group attempted—and failed—at a number of other attacks as well. Despite their bungled efforts, however, the ability of the group to form through a loose network of radicals, acquire weapons, and plan attacks is a worrying prospect, as the ICG report makes clear. That their plots were only happened upon by police searching for Noordin Top, who remains at large—and not because they had uncovered the Palembang group's plots—is all the more concerning.

The ICG report outlines a series of important lessons from the Palembang group. Among them is recognition that a fear of “Christianisation” remains a potential catalyst for radicalisation. In addition, the report's authors write, “a loose association of current or former JI members, including Noordin Top, the Malaysian responsible for the major bombings in Indonesia between 2003 and 2005, apparently continues to look for and train proxies to undertake attacks on the U.S. and its allies.”

Finally, the report mentions attention to JI-affiliated schools and ongoing efforts to increase the professionalism and investigative capacity of the Indonesian police as critical to preventing further attacks. □

IN BRIEF

Governance Structure of the EITI

The EITI holds a global conference every two years.

The EITI Board oversees the initiative between the global conferences.

The Board has 20 members, with national governments, non-governmental organisations, and private sector companies being entitled to representation.

An independent validation is conducted regularly to assess how countries and companies are progressing in their implementation of the initiative.

Implementing country governments pay for the implementation and validation of their EITI process.

Source: <http://eititransparency.org>

Extractive Industries Transparency Initiative a potential boon to anti-corruption drive*

In a bid to boost foreign investment, the Indonesian government is trying to improve transparency requirements for the country's oil, gas and mining industries. In March 2009, the finance minister and the minister for energy and mineral resources announced their intention to work towards compliance with the Extractive Industries Transparency Initiative (EITI). Indonesia will also apply to become an EITI member. In May 2009, Karen Agustiawan, the newly appointed president of state oil company Pertamina, pledged that the company will become an EITI member under her leadership.

The EITI aims to strengthen governance by improving transparency and accountability in the extractive sector. The initiative encourages oil and mining companies to report what they pay to governments while governments are urged to disclose what they receive. The two sets of independently reported figures are then compared and supervised by a multi-stakeholder committee consisting of government, civil society organisations, and private sector companies.

The Yudhoyono administration has several incentives for implementing the EITI:

— Improving resource sector investment climate

Joining the EITI will improve the transparency of information on extractive sector revenues and open up a debate about how such revenues are spent in Indonesia. This should improve investment in the sector.

Currently, Indonesia does not capitalise enough on its vast gas, oil and mineral deposits, despite a global scramble for hydrocarbon and mineral resources. In the mining sector, for example, no new major investment has occurred in over 10 years. One of the main reasons why investor confidence in the extractive industry is low is because many foreign companies do not understand Indonesia's byzantine revenue system. Implementing the EITI will not only lower information costs for new investors, but also increase incentives for investment in the industry overall. Nigeria attracted U.S. \$9 billion in new energy investments and was able to borrow foreign funds at lower interest rates after it joined the EITI.

— Curb spending in state budget by addressing inefficiencies

Joining the EITI will also improve transparency and accountability in the oil and gas sector's cost-recovery mechanism under which companies can claim the repayment of expenses from the Indonesian government (see box). The Indonesian government has come under increasing pressure to reform the cost-recovery mechanism. Last year, the national parliament capped cost-

* This part of the brief was provided by Michael Buehler, Postdoctoral Fellow in Modern Southeast Asian Studies at Columbia University in New York. He can be reached at mb3120@columbia.edu

IN BRIEF

The Cost-Recovery Mechanism

The Energy and Mineral Resources Ministry returns part of the oil and gas revenues via the so-called cost recovery mechanism to production-sharing contractors (PSCs). Under the scheme, funds spent by oil and gas operators on exploration activities are reimbursed by the government after the production phase begins.

Initially designed as an incentive for investors to develop Indonesia's oil and gas sector, the cost recovery mechanism has drawn criticism. The Oil and Gas Law No 22/2001 keeps cost recovery data confidential. Due to this lack of transparency and accountability the scheme has been subject to abuse in the past.

The Supreme Audit Agency (BPK), for example, stated in a 2005 report that oil and gas contractors claimed expenses for goods and services such as DVDs, parties, dancing courses, charities and pilgrimages to Saudi Arabia.

recovery at \$12 billion in the 2009 state budget law, a first since Indonesia adopted the production-sharing contract mechanism. This means that the Government of Indonesia now has to control cost-recovery spending.

In an effort to decrease spending on cost recovery in the state budget, in July 2008, Evita Herawati Legowo, the director general for oil and gas at the Energy and Mineral Resources Ministry, was publicly discussing the idea of scrapping the cost recovery scheme altogether and replacing it with a system in which investors are chosen that give the largest production split to the country instead. Priyono, chairman of upstream oil and gas regulator BPMigas, strongly opposed this proposal. "Without the cost-recovery mechanism, we are unable to verify that the investors have correctly implemented their plans," he said in 2008.

It is in this context that Purnomo Yusgiantoro, minister for energy and mineral resources, stated in May 2009 that the government did not want to abolish the cost-recovery-mechanism but merely to improve it. Against this backdrop, a ministerial decree was issued in 2008 that listed 17 cost items to be excluded from cost recovery claims.

A new government regulation is currently being drafted that will extend this list and exclude certain cost components, such as spending on pipeline transmission systems and Liquefied Natural Gas (LNG) terminals, from the cost-recovery mechanism. Still, attempts by the government to reform the abuse-prone mechanism are met with great suspicion, as evident during the annual convention of the Indonesian Petroleum Association (IPA) in May 2009. Various PSCs expressed their fears that the government's efforts to control contractors' cost-recovery spending might lead to violations of PSCs' rights.

In light of the confusion and suspicion surrounding the PSC mechanism, the EITI will support the government's plans to bring down cost-recovery without antagonising the contractors themselves. Increasing transparency and accountability in the cost-recovery mechanism, the EITI will allow the government to detect abuse, identify inefficiencies, and curb waste in the way the mechanism is carried out, thereby lowering pressure on the state budget.

At the same time, the EITI allows for the cost-recovery system to be kept in place, thereby reassuring oil and gas contractors.

— Strengthening Yudhoyono's political profile

Joining the EITI is also likely to reinvigorate Yudhoyono's reform credentials. The president's progressive image has been damaged by recent scandals including the arrest of the head of the Corruption Eradication Commission (KPK) as a suspect in a murder case and increasingly criticised for the failure of the KPK in past years to bring to justice corruption suspects politically affiliated with Yudhoyono himself.

The president's reform program has also come under pressure from the House of Representatives, which is increasingly resistant to the KPK's probes and charges. The legislature has repeatedly postponed the adoption of a law that would renew the mandate of the Anti-Corruption Court beyond December

IN BRIEF

2009. It has also tried to weaken the court by changing its structure. Against the backdrop of the upcoming July 2009 presidential election, the president has a key interest in portraying himself as a politician who would stay on the graft-busting course in a second term.

There are no other presidential candidates that share Yudhoyono's popular perception as a reformer. Successfully adopting the EITI could therefore help strengthen Yudhoyono's reformist credentials and sharpen the contrast between him and his opponents, particularly because the extractive sector is widely viewed as an exception to the general progress the president has made towards forging an open and accountable government.

At the same time, joining the EITI is also likely to strengthen the international standing of Yudhoyono during a potential second (and last) term as president of Indonesia. More than 20 countries in Africa, South America and Central Asia, all with large petroleum or mining industries, have joined the EITI to date. However, there are currently no Asian members, apart from natural gas-rich Timor Leste.

Indonesia is not only the world's most populous resource-rich state, but also the only country that is classified by the International Monetary Fund (IMF) as both hydrocarbon- and mineral-rich. The size and importance of Indonesia in these sectors provides Yudhoyono with ample leverage to shape the future course of the EITI. For example, the initiative is strong in tracking financial flows with the energy and mining sector but has made few innovations in terms of keeping track of volumes of commodities which companies sometimes convey to governments without paying taxes.

About 80 percent of Indonesia's energy and mining revenue consist of such commodities. Future efforts of the government to track such commodities would therefore be cutting-edge and allow Yudhoyono, working on his reformist legacy during his last term in office, to position Indonesia as a world leader within the initiative.

Challenges remain

While there is much to gain for the Indonesian government—and especially its current president—from adopting the EITI, various challenges remain. Adherence to the EITI's reporting standards is voluntary, and although 25 countries have pledged to adopt them, none have as of yet fully complied.

In fact, until May 2009, only five countries out of the 25 countries that have signed up to the initiative have produced reports. It remains to be seen whether Indonesia manages to keep the promises made under the EITI. More importantly, the EITI will be applied only partially in Indonesia. In the first reporting period, the EITI in Indonesia will only cover the largest producers, while smaller players are exempt. Only the inclusion of all domestic players will make the EITI successful in Indonesia.

The EITI will also not be able to tackle corruption at the local government level as it is a national initiative. Local corruption worsened significantly

IN BRIEF

in resource-rich areas following the implementation of various decentralisation laws in the last decade. Local level administrators who now have more power than ever, are not held accountable under the initiative. Expanding the EITI to local level governments is urgent, especially as resource-producing regions in Indonesia have some of the country's worst development indicators.

The national habit

The number of smokers in Indonesia is likely to continue to grow unabated, given the political and economic clout of the tobacco industry.

Indonesia's draft tobacco bill was finally introduced into the national legislative plan in December after years of delays and pressure from local and international groups. The bill includes recommendations from the World Health Organization's Framework Convention on Tobacco Control (FCTC). Indonesia is the only Asian nation not to have ratified the treaty.

Consumer groups, however, are pessimistic about the bill's chances of making it through the legislature. The Indonesian Consumers Organization (YLKI), along with the Jakarta Citizens' Forum, the Indonesian Cancer Foundation and the group Indonesian Women Against Tobacco, among others, are bringing a "legal standing case" against the House of Representatives and the president, alleging that current tobacco policy, including not ratifying the treaty and delaying the passage of the bill, is in conflict with existing environment and health legislation, as well as with the Constitution.

Far from aiming to curtail tobacco use and the associated public health problems, the government is seeking to increase domestic consumption, say anti-tobacco activists. Dr. Widyasastuti Soerojo, chairperson of the Tobacco Control Support Center for the Indonesian Public Health Association, said that the government would be unlikely to adopt international tobacco control measures primarily because it was more concerned with its tobacco Industry Road Map, which aimed to increase the domestic consumption of sticks to 260 billion by 2020 from the 240 billion consumed in 2008.

That strategy made little sense in light of tobacco-related health costs, she said, which she contended amounted to a cost seven times larger than the revenue the government derived from the excise tax on tobacco. Tobacco consumption accounted for the second highest household expenditure—surpassed only by rice—she said, quoting a 2007 survey by the country's statistics bureau. "The poorest two percent of Indonesians spent 15 times on tobacco what they spend on meat and eight times what they spend on education," said Widyasastuti, who also leads ASEAN's tobacco control unit.

"The evidence we have is clear," Widyasastuti said. "Government policy is from the company's point of view. The industry would not like to have their business restricted like in other countries, because they see Indonesia as a potential market, based on the country's high production level [of tobacco] and the population increase."

IN BRIEF

Why would the government push a policy so clearly detrimental to the health and economic welfare of its people? Tulis Abadi, coordinator of the YLKI, and other anti-tobacco activists have their own explanation. They allege that funding from the industry has prevented successive Indonesian governments, including that of current President Susilo Bambang Yudhoyono, from adopting tougher anti-smoking measures.

Abdurrahman “Gus Dur” Wahid received financial support from tobacco interests during his presidency, as did Megawati during her reign, according to Tulis. “Megawati received money in the 2004 campaign, and her husband had said while campaigning to tobacco industry workers in East Java, ‘Megawati will not ratify the FCTC,’” Tulis told the *Report*.

Anti-tobacco activists say that support to pro-Yudhoyono organisations from a foundation linked to a tobacco giant may be at the root of the president’s unwillingness to push for tougher tobacco control. Both Tulis and Sri Utari Setyawati, executive director of the Indonesian Forum of Parliamentarians on Population and Development, claimed that the Blora Center, a think tank and media centre tied to the president, received funding from the Sampoerna Foundation.

The Sampoerna Foundation is led by Michelle Sampoerna, the daughter of Sampoerna family patriarch Putera Sampoerna. The family ran Indonesia’s biggest tobacco company, HM Sampoerna, until it was bought out by American-owned Philip Morris International in 2005 for U.S. \$5 billion.

While the Sampoerna Foundation is a separate entity from HM Sampoerna, the tobacco company, sources from the anti-tobacco groups contend that the Sampoerna Foundation’s giving priorities have a distinctly political flavour.

“If you want to see evidence of that close relationship,” one source told the *Report*, “look at how many joint projects exist between the Blora Center and [the] Sampoerna [Foundation].” The source also claimed that Jurnal Nasional, the newspaper founded by the president and widely viewed as a mouthpiece for his Democratic Party, was jointly funded by the Blora Center and the Sampoerna Foundation.

That alleged funding does not necessarily suggest some special affinity for Yudhoyono. Instead, Sri said, the tobacco industry simply did what is common practise among major Indonesian companies: it supported whoever it felt was likely to win the elections.

A lack of transparency in the campaign funding regime makes it nearly impossible to track down exactly how much certain individuals and companies contributed to candidates or party campaigns, but tobacco companies made their political influence unmistakably clear in Central and East Java in the lead up to the recent legislative elections, according to several sources contacted by the *Report*. Tobacco companies used the Indonesian Association of Tobacco Producers, the sources said, to spread the word to tobacco grower’s unions not to support candidates that supported the draft tobacco control bill.

IN BRIEF

The tobacco lobby's efforts to thwart initiatives to discourage smoking in the country appear to be succeeding. Despite the draft tobacco bill now being on the legislative agenda, it was still unlikely to be passed this year, says Sri. While the bill had the support of 40 percent of the House, no special committee had been established to discuss it.

Moreover, attempting to push the tobacco control bill through the House appears to have come at significant political costs for its proponents. Dr. Hakim Sorimuda Pohan—the draft tobacco bill's strongest supporter in the House—and other supporters of the bill, such as Mrs. Tuti Loekman Soetrisno, were not re-elected this year.

For their part, the president and his wife have remained vague and noncommittal in public about tobacco control policy. One source who works for the anti-tobacco lobby group Indonesian Women Against Tobacco (WITT), however, contends that the President's wife Ani Yudhoyono has sought to squelch opposition to tobacco control measures.

The source told the *Report* that she had met with Ani Yudhoyono just before the official opening ceremony for international smoke free day 2008, which was held at the presidential palace. At the event, says the source, the first lady said, "You can talk about everything and anything, but not the tobacco control issue." Not long thereafter, at the opening of the ceremony, Ani spoke passionately of the dangers of tobacco to children but refrained from mentioning the WHO treaty or the draft bill.

The Industry Roadmap and other tobacco-related policies make the government's pro-tobacco standpoint clear enough, however. Fahmi Idris, the Minister of Industry, publicly stated in March that the government rejects the WHO framework because, he claimed, raising the excise tax to the rate recommended by the WHO would drive down government revenue by reducing sales and thus tax revenue, and cause many of the 12 million people working in both tobacco farming and production to be laid off.

Speaking at a gathering of journalists last month, Nasruddin Djoko from the Ministry of Finance said that rather than increase the excise tax for tobacco products, the government was instead revamping and simplifying the complicated tax. After questions put to him by David Stanford, an advocate working for YLKI, however, Nasruddin conceded that the changes were unlikely to result in an increase in tax revenue.

There is reason to doubt the government's arguments, however. Abdillah Ahsan, a researcher in the Department of Business and Economics at the University of Indonesia (UI), told the *Report* that the contention that employment and state revenue would suffer if Indonesia adopted tobacco control measures did not make economic sense.

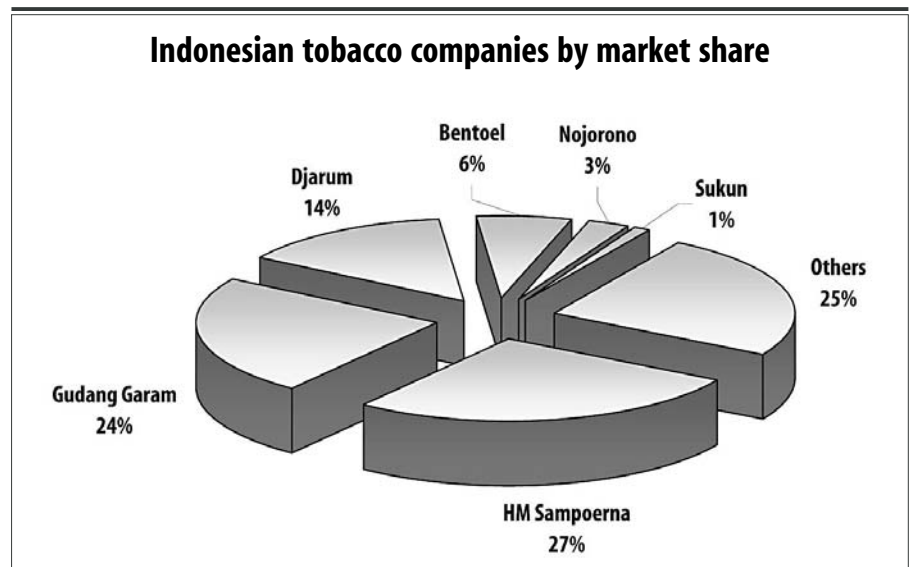
An UI study, entitled "Tobacco Economics in Indonesia," showed that implementing the maximum legally allowable tobacco tax rates could prevent between 1.7 and 4.0 million tobacco-related deaths among smokers and generate additional revenues of \$3.2 to \$6.5 billion for the government.

IN BRIEF

The employment figure of 12 million quoted by the industry minister was inflated, Abdillah told the *Report*, because it included retailers and the families of tobacco workers. “Actually, the number of people directly employed in cigarette manufacturing and tobacco farming combined is less than one million. If you include clove farmers—it’s two million—or less than one percent of the total labour force,” he said, citing 2005 figures from the UI study.

Abdillah added that the tobacco manufacturing and farming industries were only economically significant to three out of 32 provinces, and that seasonal tobacco farmers were the lowest paid workers in the agricultural sector.

The Indonesian Tobacco Institute, an industry group, said in a statement issued to the *Report* that tax revenue from the tobacco industry in 2008 had contributed \$4.8 billion to the economy, or 6.45 percent of GDP in 2008. The relatively small but growing export market for cigarettes and tobacco had risen in value from \$296 million in 2007 to \$360 million in 2008.



Source: 6 May 2009 Danareksa report on Gudang Garam

A Jakarta-based economist from a major international company, who wished not to be named, said that domestic consumption was being driven by increased market penetration drives into the regions and the rapid increase in female smokers. The lack of tobacco control measures in Indonesia encouraged big tobacco to aggressively expand their business into the youth market, which is increasingly being protected in other countries that had instituted strong tobacco control measures.

“The percentage of female smokers is still very low,” the economist said. “There’s also more competition and more advertising in rural areas, with some of the big players making plays in the regions with increased advertising and promotions.”

Data from Indonesia’s National Child Protection Agency (NCCP) shows that women accounted for the greatest rise in demand, with consumption

IN BRIEF

increasing tenfold in the 15-18 year old female demographic between 2001 and 2004.

Perhaps most alarming, the 5-9 year-old demographic was also showing growth, according to the NCCP. That may bode well for the future of the tobacco industry, but it also represents a public health and economic liability that will be with the country for years to come.

BI without Boediono

Boediono's departure from Bank Indonesia (BI) to become the running mate in incumbent President Susilo Bambang Yudhoyono's re-election campaign is unlikely to have a major effect on the bank's well-established monetary policy. It has, however, sparked rumours that powerful Finance Minister Sri Mulyani Indrawati might be shifted to BI.

While the timing of Boediono's exit amid the ongoing global financial crisis may not be optimum, the key mechanisms and strategies in place for interest rate policy depend little on BI's leadership in the short term. Interest rates will continue to be set by the Board of Governors, and the bank's long-standing inflation-targeting strategy remains the key guiding monetary policy.

If there was a time when a steady hand at the bank's helm was needed, it would have been this past October or September, during the onset of the crisis when the bank leadership was debating whether to protect the rupiah with high interest rates, or cut rates to stimulate consumption.

Purbaya Yudhi Sadewa of the Danareksa Research Institute explains that the experience has helped shape monetary policy going forward. "The paradigm changed last November, and they cut rates, which they thought would weaken the rupiah," says Yudhi. "But on the contrary it started to strengthen from 13,000 [to the U.S. dollar] to 11,000, and they started cutting more aggressively."

That change beginning last December, he adds, reinforced the impression that "cutting doesn't necessarily weaken the rupiah."

The real significance for BI of Boediono's move to join President Yudhoyono is instead the political dynamics that have begun to play out. Rumours have already circulated that Yudhoyono summoned Sri Mulyani to his Cikeas residence to offer her the now vacant post.

She has refrained from commenting on the issue or on what was discussed during the meeting. That either of them would consider it an option comes as a surprise to many observers, given the key role she has played in pressing ahead with economic reforms, and in taking on entrenched interests in her roles as finance minister and coordinating minister for the economy. Yudhi described the potential removal of Sri Mulyani from the cabinet as "like chopping off [Yudhoyono's] right hand."

Sources close to Yudhoyono tell the *Report* that the president has decided

IN BRIEF

against moving Sri Mulyani. Nevertheless, the rumours may not have appeared out of thin air. Despite the united front usually shown by the current economic team, a policy dispute had some at BI hoping Sri Mulyani would come their way, says a BI source.

The dispute centres on the future of bank supervision. Under the 2004 law on the central bank, an independent financial services authority to supervise and regulate banks is to be created by the end of 2010. Bank supervision is a core function of BI, while supervision of non-bank financial institutions falls to the Capital Market and Financial Institutions Supervisory Agency (*Bapepam-LK*).

According to the BI source, Sri Mulyani has argued that the increasing diversity of investment products that are easily substituted for traditional banking services like savings accounts requires an agency that integrates supervision of both banks and non-bank financial institutions under one roof. Many developed Commonwealth countries already use that model.

The rumour that Sri Mulyani was offered the BI job could reflect the wishes of some at BI for it to retain the bank supervisory function. If put in charge, it is felt she would be resistant to seeing bank supervision removed from BI's mandate, and might try to amend the law to keep it within the central bank. This, they argue, would help BI retain a key lever to implement monetary policy, because the ability to audit and place BI members inside financial institutions could remove hurdles that have prevented benchmark interest rate cuts from translating into an easing of credit and liquidity.

That's a contentious point among economists. Yudhi of Danareksa says that the failure of interest rate cuts to be passed on to consumers reflected a lack of competition in the banking sector, and that more competition—rather than an aggressive supervisory role—is the answer to the problem.

That's in addition to the fact that BI has taken criticism for being less than effective in its supervisory role. "In the past, people have often questioned the efficiency of [BI's] supervisory function, and people said it had to be separated so that the bank can be better performing—if it were separated, BI could focus just on monetary policy," he says.

Rather than put Sri Mulyani's name forward as a candidate, however, palace sources say she would likely stay on as coordinating minister in a second Yudhoyono administration, while another person would take over as finance minister. Acting solely as coordinating minister, she would have less formal powers than as finance minister.

But in that role she could consolidate her power in a number of ways, one being through the bringing the National Planning and Development Planning Agency (Bappenas) under the coordinating ministry, as had been done in the past. While indeed it may be true that her formal powers could be diminished as coordinating minister, she would undoubtedly continue to play a critical role in Yudhoyono's government.

IN BRIEF

‘Freewheeling politicians’ pose challenges for decentralisation

The reduced number of parties in the House of Representatives may indeed make that notoriously unwieldy body more manageable, but it could also further complicate an already dysfunctional relationship between the national legislature and its regional counterparts. The different electoral rules at the national and sub-national levels appear in some cases to have resulted in local legislatures dominated by parties that will have no national representation, potentially presenting obstacles to achieving a speedy and effective policymaking process.

At the heart of the matter is the 2.5 percent parliamentary threshold that was meant to limit the number of political parties that made it into the national legislature was not applied to the provincial legislatures. As a result, the composition of legislative bodies at the two levels is likely to differ widely.

The Democratic Party, Golkar Party, and Indonesian Democratic Party of Struggle (PDI-P) will dominate a national legislature in which only 9 of the 38 national parties competing nationally are to be represented. By contrast, parties among the 29 that did not earn seats in the House of Representatives, plus the six local parties in Aceh, are likely to be well-represented at the provincial and local levels, particularly in outlying areas where the traditional national powerbrokers have less power. Some of those parties may even dominate local legislative bodies.

Those who cast their votes for parties that did not make it into the House hardly account for a trivial share of the electorate. “Quick count” tallies and preliminary results indicate that those 29 parties that failed to clear the 2.5 percent bar accounted for up to 25 percent of the total vote at the national level—and perhaps even more at the local level.

In theory, no matter what the composition of the various legislative bodies may be, they would be able to work with one another to ensure that the give and take of the policy process results in the passage of laws vital to the operation of government. The reality, however, is that the party cadres and legislators at the sub-national levels lack the capacity to develop and pass legislation, and they thus often turn to Jakarta on critical issues.

“The central government is still the key player in local budgets,” says Tommy Legowo of the parliamentary watchdog Formappi. “The problems go like this: local legislatures dominated by parties with no national representation might not adopt budgets [sent to them by the national level].”

On critical issues, local legislators and executives often turn to their party bosses in Jakarta for guidance and to ensure that their interests are provided for in the budgets and policies passed on to the regions from Jakarta. Without a direct connection to the legislative process at the national level, those legislators and executives might not like what comes through the pipeline, but they might also lack the capacity to amend and develop their own policies, resulting in delays and whole provinces operating with outdated budgets and key measures.

IN BRIEF

“This is bad now,” says Tommy, “but it could be worse after this election.” Indeed, not only will the next House have nine parties compared to the 16 represented in the current one; Changes in the electoral rules could further weaken party discipline and strain relations between Jakarta and regions, even within parties themselves.

Cecep Effendi, a senior national advisor on decentralisation issues at the German Technical Cooperation, places the coordination problems between national and local legislative bodies in the context of these broader challenges regarding political parties.

“When someone becomes a candidate for a political party now, most of them are not party members,” he says with regard to rule changes that allow for the direct election of local executives and for House seats to be allotted to candidates who win the most votes in an electoral district regardless of their ranking on the so-called party list. “The party doesn’t have the capacity to provide quality leaders from within, so they have to look for candidates from outside.”

The result, he says, has been a breakdown in party discipline and coordination that could be amplified after the new legislatures have taken office, with serious implications for the ongoing process of political and fiscal decentralisation. Legislators at the national level, no longer dependent on their parties for their House seats, will have less incentive to look out for the interests of the party throughout the regions, and local executives who either run as independents or use political parties merely as a vehicle to get elected will likely not have the networks to secure their interests in Jakarta’s halls of power.

Tommy from Formappi agrees that the new rule changes could contribute to a decline in party discipline. “We could see a lot of freewheeling politicians with no connection to the national level,” he says. □