**Closing Case: Indonesia—The Troubled Giant**

Indonesia is a vast country. Its 220 million people are spread out over some 17,000 islands that span an arc 3,200 miles long from Sumatra in the west to Irian Jaya in the east. It is the world’s most populous Muslim nation—some 85 percent of the population count themselves as Muslims—but also one of the most ethnically diverse. More than500 languages are spoken in the country, and separatists are active in a number of provinces. For 30 years, this sprawling nation was held together by the strong arm of President Suharto. Suharto was a virtual dictator who was backed by the military establishment. Under his rule, the Indonesian economy grew steadily, but there was a cost. Suharto brutally repressed internal dissent. He was also famous for “crony capitalism,” using his command of the political system to favor the business enterprises of his supporters and family.

In the end, Suharto was overtaken by massive debts that Indonesia had accumulated during the 1990s. In 1997, the Indonesian economy went into a tailspin. The International Monetary Fund stepped in with a $43 billion rescue package. When it was revealed that much of this money found its way into the personal coffers of Suharto and his cronies, people took to the streets in protest and he was forced to resign.

After Suharto, Indonesia moved rapidly toward a vigorous democracy, culminating in October 2004 with the inauguration of Susilo Bambang Yudhoyono, the country’s first directly elected president. The economic front has also seen progress. Public debt as a percentage of GDP fell from close to 100 percent in 2000 to less than 60 percent by 2004. Inflation declined from 12 percent annually in 2001 to 6 percent in 2004, and the economy grew by around 4 percent per annum during 2001 to 2005.

But Indonesia lags behind its Southeast Asian neighbors. Its economic growth trails that of China, Malaysia, and Thailand. Unemployment is still high at around 10 percent of the working population. Inflation started to reaccelerate in 2005, hitting 14 percent by year end. Growth in labor productivity has been nonexistent for a decade. Worse still, foreign capital is fleeing the country. Sony made headlines by shutting down an audio equipment factory in 2003, and a number of apparel enterprises have left Indonesia for China and Vietnam. In total, the stock of foreign direct investment in Indonesia fell from $24.8 billion in 2001 to $11.4 billion in 2004 as foreign firms left the nation.

Some observers feel that Indonesia is hobbled by its poor infrastructure. Public infrastructure investment has been declining for years. It was about $3 billion in 2003, down from $16 billion in 1996. The road system is a mess, half the country’s population has no access to electricity, the number of brownouts is on the rise as the electricity grid ages, and nearly 99 percent of the population lacks access to modern sewerage facilities. The tsunami that ravaged the coast of Sumatra in late 2004 only made matters worse. Mirroring the decline in public investment has been a slump in private investment. Investment in the country’s all-important oil industry fell from $3.8 billion in 1996 to just $187 million in 2002. Oil production has declined even though oil prices are at record highs. Investment in mining has also fallen from $2.6 billion in 1997 to $177 million in 2003.

According to a World Bank study, business activity in Indonesia is hurt by excessive red tape. It takes 151 days on average to complete the paperwork necessary to start a business, compared to 30 days in Malaysia and just 8 days in Singapore. Another problem is the endemically high level of corruption. Transparency International, which studies corruption around the world, ranks Indonesia among the most corrupt, listing it 137 out of the 158 countries it tracked in2005. Government bureaucrats, whose salaries are very low, inevitably demand bribes from any company that crosses their path—and Indonesia’s penchant for bureaucratic red tape means a long line of officials might require bribes. Abdul Rahman Saleh, the attorney general in Indonesia, has stated that the entire legal system, including the police and the prosecutors, is mired in corruption. The police have been known to throw the executives of foreign enterprises into jail on the flimsiest of pretexts, although some well-placed bribes can secure their release. Even though Indonesia has recently launched an anticorruption drive, critics claim it lacks any teeth. The political elite are reportedly so corrupt that it is not in their interests to do anything meaningful to fix the system.