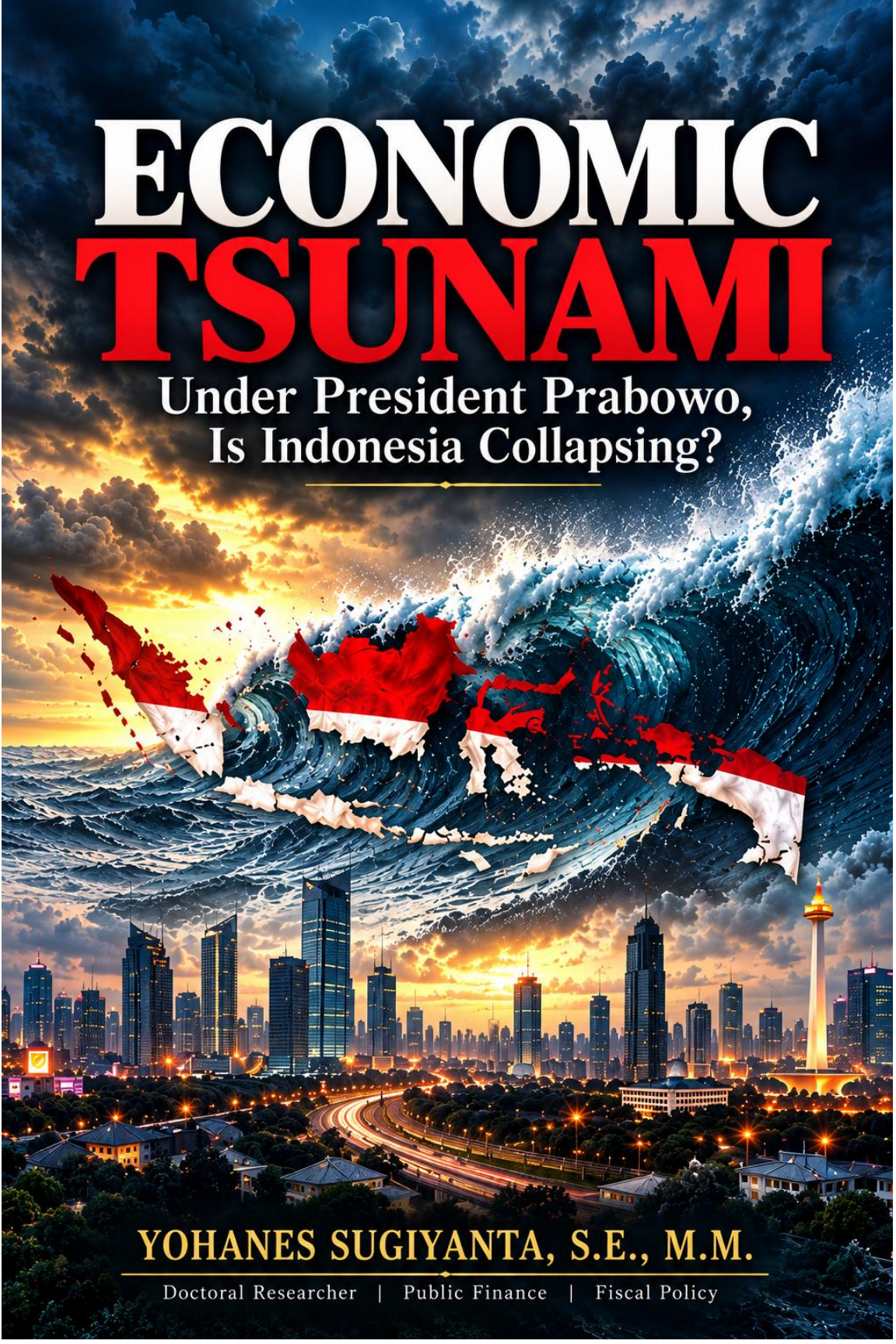
ECONOMIC TSUNAMI

Under President Prabowo, Is Indonesia Collapsing?



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First Edition • 2026

ABOUT THIS EDITION

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This book is an analytical work of economic and public-policy nonfiction. It examines Indonesia's economic conditions, policy architecture, vulnerabilities, and resilience through documented evidence, data, and analytical frameworks. The subtitle is an investigative question, not a factual assertion that Indonesia is collapsing.

Data and policy information are presented for analytical and educational purposes. Readers should consult the cited primary sources and official publications for the latest revisions, definitions, and methodological updates.

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FOREWORD

This book begins with a question: what does economic stress actually mean for Indonesia, and how should it be distinguished from crisis, correction, or structural transformation?

The question cannot be answered by a single indicator. Gross domestic product can grow while households experience pressure. Government revenue can rise while fiscal space remains constrained. The rupiah can depreciate without producing a systemic financial crisis. Investment can increase while productivity remains uneven. Poverty can decline while many households remain vulnerable to inflation, job loss, illness, debt, or regional disadvantage.

For that reason, ECONOMIC TSUNAMI does not treat the word "collapse" as a conclusion. It treats it as a proposition that must be tested. The analysis examines whether growth, households, productivity, public finance, financial markets, trade, energy and food security, regional development, and institutional capacity are functioning together; where vulnerabilities are accumulating; and what evidence would change the diagnosis.

The book is written in the context of a major political and economic transition. President Prabowo's administration has articulated objectives for growth, industrial development, food and energy security, human capital, investment, and state capacity. These objectives can be examined without assuming either success or failure. The relevant analytical question is how policy choices are transmitted through firms, workers, households, financial markets, public finances, and regional economies—and whether the resulting outcomes are measurable.

Economic policy operates through mechanisms. A tax reform affects incentives and fiscal capacity. Public investment affects infrastructure, demand, and productive potential. Industrial policy can alter investment and production structures. Financial regulation changes the distribution of risk. Social protection affects households' ability to absorb shocks. The effects depend on design, implementation, institutional capacity, timing, and feedback.

Accordingly, the central framework of this book is evidence, mechanism, and resilience. Evidence establishes what has happened. Mechanisms help explain how one variable can affect another. Resilience asks whether the system can absorb a shock without allowing temporary stress to become persistent dysfunction.

The chapters move from growth and household purchasing power to productivity, fiscal capacity, industrial policy, state capital, global trade and financial conditions, energy and food security, inequality, middle-class vulnerability, stress tests, reform, and implementation. The purpose is not to produce a single dramatic verdict. It is to provide a framework through which readers can examine the evidence and reach their own informed conclusions.

The title uses the metaphor of an economic tsunami because large shocks can propagate across interconnected systems. Yet the metaphor is not a prediction of collapse. Its purpose is to test the transmission mechanism: how an external shock can move through exports, exchange rates, prices, corporate balance sheets, fiscal conditions, employment, and household purchasing power—and where buffers can interrupt that transmission.

The evidence base is drawn primarily from official Indonesian institutions and major international organizations, supplemented by established academic literature. Economic statistics are revised, definitions differ across institutions, and forecasts are conditional. Readers should therefore consult the cited primary sources when decisions depend on the latest information.

The final question is not simply whether Indonesia is collapsing. It is whether Indonesia can use its present resilience to build greater productivity, broader opportunity, stronger fiscal capacity, deeper markets, more secure households, and institutions capable of learning from shocks. If the evidence changes, the diagnosis should change with it.

That is the standard applied throughout this book: not rhetoric, not prediction, and not political endorsement, but documented evidence, transparent reasoning, and measurable outcomes.

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PART I — THE QUESTION

CHAPTER 1

INDONESIA AT A TURNING POINT

1.1. From Political Transition to Economic Transition

A presidential transition can happen in a single day.

An economic transition cannot.

On October 20, 2024, Prabowo Subianto and Gibran Rakabuming Raka were inaugurated as President and Vice President of the Republic of Indonesia. The political transition was formal, constitutional, and visible. The economic transition that followed was more complicated. It inherited institutions, fiscal commitments, infrastructure, demographic pressures, regional inequalities, productive capacity, and external exposures accumulated over many years (Sekretariat Presiden RI, 2024).

Indonesia entered the new administration with an economy that had demonstrated resilience, but resilience should not be confused with the absence of vulnerability. In 2024, Indonesia's economy grew by 5.03 percent, slightly below the 5.05 percent growth recorded in 2023. Gross domestic product at current prices reached approximately IDR 22,139 trillion, while GDP per capita was approximately IDR 78.6 million (BPS-Statistics Indonesia, 2025).

These numbers provide an important starting point. They indicate that Indonesia did not enter the Prabowo era from a position of generalized economic contraction. Yet headline growth does not answer the deeper questions facing the country: How productive is that growth? Who benefits from it? How much fiscal space remains? Can the economy create higher-quality jobs? Can regional disparities be reduced? And can the state finance increasingly ambitious development priorities without creating new vulnerabilities?

1.2. The Economic Inheritance

Every new administration inherits an economic balance sheet. Some assets are visible: infrastructure, industrial capacity, natural resources, a large domestic market, a strategic geographic position, and an increasingly integrated digital economy. Others are less visible:

institutional capacity, human capital, productivity, fiscal flexibility, and the credibility of economic policy.

Indonesia's economic inheritance is therefore neither simply positive nor negative. It is a combination of accumulated capabilities and accumulated constraints.

The scale of the economy is one of its major strengths. Indonesia is the largest economy in Southeast Asia and has a population large enough to sustain significant domestic demand. Its geographic position connects the Indian and Pacific Oceans, while its resource base provides opportunities in energy, minerals, agriculture, and downstream industrial development.

But scale does not automatically produce productivity. Natural resources can generate export revenues without necessarily generating broad-based increases in productivity. Infrastructure can improve connectivity without guaranteeing efficient allocation of capital. A large labor force can become an economic advantage only when workers have the skills, health, productivity, and opportunities required by a changing economy.

The regional structure of the economy illustrates this challenge. Java accounted for 57.02 percent of Indonesia's economic output in 2024, demonstrating the continuing concentration of production and economic activity on one island (BPS-Statistics Indonesia, 2025). Regional development has improved in many areas, but the distribution of productive capacity remains uneven.

This matters because the future of Indonesia cannot be evaluated solely through national averages. A national economy can report stable growth while individual regions, sectors, firms, or households experience very different realities.

1.3. The Paradox of Resilience

This leads to what may be called the Paradox of Resilience:

An economy can be resilient enough to avoid collapse while remaining vulnerable enough to require structural transformation.

Indonesia's recent record illustrates this tension. The country has maintained positive growth through global shocks, strengthened its financial-system architecture, and preserved macroeconomic policy

capacity. At the same time, questions remain about productivity, job quality, fiscal capacity, human capital, purchasing power, and regional inequality.

At the end of 2024, inflation was 1.57 percent year-on-year. Bank Indonesia also reported that foreign-exchange reserves reached US$155.7 billion at the end of 2024, credit growth reached 10.39 percent, and financial-system resilience remained maintained (Bank Indonesia, 2025). These indicators are consistent with an economy whose core institutions continued to function.

But resilience is not the same as transformation. A stable macroeconomic environment can coexist with structural weaknesses that accumulate more slowly and become visible only over a longer horizon.

That distinction is essential to this book. The question is not whether Indonesia is already in collapse. The evidence does not support such a conclusion at the starting point examined here. The more important question is whether the economic model inherited by the new administration is sufficiently productive, inclusive, and fiscally sustainable to support the ambitions of the next stage of development.

1.4. The First Test

The first economic test of the Prabowo administration is therefore not simply whether GDP growth remains positive. It is whether policy ambition can be translated into sustainable economic capacity.

The administration entered office with a broad development agenda. The 2025 State Budget was positioned not only as a fiscal instrument but also as a mechanism for supporting national development priorities and the government's Asta Cita agenda (Ministry of Finance of the Republic of Indonesia, 2025).

This creates a fundamental policy chain:

POLICY AMBITION → FISCAL REQUIREMENT → IMPLEMENTATION CAPACITY → ECONOMIC OUTCOME

If policy ambitions expand faster than fiscal capacity, trade-offs become unavoidable. If spending rises without improving productivity, the economy may receive a short-term demand impulse without sufficient long-term gains. If investment is productive and institutional

capacity is strong, however, public expenditure can contribute to higher potential growth.

The Prabowo era therefore begins with a question of conversion: Can the state convert fiscal resources, infrastructure, natural resources, and political authority into higher productivity and broader prosperity?

1.5. From Political Transition to Economic Transition

Political transitions are often measured by inauguration dates, cabinet formation, electoral mandates, and changes in leadership. Economic transitions operate differently. They are measured through investment, productivity, employment, incomes, prices, public finances, exports, competitiveness, and institutional performance.

The gap between political time and economic time is important. A government can announce a policy in weeks, approve a budget in months, and begin implementation relatively quickly. But productivity gains may take years. Human-capital improvements may take a generation. Infrastructure affects economic geography gradually. Industrial transformation requires sustained investment and learning.

This difference creates a central analytical risk: judging an administration's economic trajectory too quickly, or judging it only by intentions. A serious assessment must examine both policy design and measurable outcomes over time.

For Indonesia, the period beginning in 2024 should therefore be understood as a transition between inherited conditions and a new policy architecture. The outcome will depend not only on what the government wants to do, but also on what the economy can absorb, what institutions can implement, and how households and firms respond.

1.6. The Economic Tsunami Metaphor

The title of this book uses the metaphor of an "Economic Tsunami." The metaphor is deliberately provocative, but it should not be mistaken for a prediction.

A tsunami is not created by the visible wave alone. It begins with forces that accumulate beneath the surface and become visible only

after a major disturbance. The economic analogy is useful because vulnerabilities can also accumulate beneath apparently stable headline indicators.

Fiscal pressure, weak productivity, declining competitiveness, household purchasing-power pressures, regional inequality, external shocks, and institutional constraints can interact. None of these factors automatically produces collapse. But their interaction may create conditions that deserve systematic examination.

The purpose of the metaphor, therefore, is not to declare that Indonesia is collapsing. It is to ask whether pressures are accumulating beneath the surface—and whether the country's economic institutions are capable of absorbing them.

This distinction will remain important throughout the book. Evidence must determine the diagnosis, not the metaphor.

1.7. Indonesia's Economic Starting Point



Figure 1.1 — Indonesia Economic Transition Map
The 2014–2024 period can be read as a foundation-building phase in which infrastructure, domestic demand, resource capacity, and institutional capability accumulated. The next economic transition depends on whether these foundations translate into higher productivity, stronger incomes, sustainable fiscal capacity, and greater resilience.
Source: Author's analytical framework based on Government of Indonesia, BPS-Statistics Indonesia, Bank Indonesia, Ministry of Finance, World Bank, and IMF sources cited in this tis chapter.

Higher Productivity • Inclusive Growth • Stronger Fiscal Capacity • Global Competitiveness

GEOGRAPHIC LAYERS

Sumatra • Java • Kalimantan • Sulawesi • Bali–Nusa Tenggara • Maluku–Papua

The map above is not a forecast. It is an analytical framework for understanding the transition from inherited economic conditions toward possible future outcomes.

A useful baseline is therefore not a single number but a multidimensional starting point. Indonesia entered the Prabowo administration with positive growth, relatively contained inflation, a functioning financial system, significant foreign-exchange reserves, and a large domestic market. At the same time, it faced persistent structural questions concerning productivity, regional concentration, fiscal capacity, job quality, and the ability to translate natural-resource advantages into broad-based economic transformation.

These conditions create a starting point that can be described neither as crisis nor as complacency. Indonesia begins from a position of resilience under pressure.

1.8. The First Question of the Book

The central question of this book is intentionally framed as a question:

UNDER PRESIDENT PRABOWO, IS INDONESIA COLLAPSING?

The question should not be interpreted as a predetermined conclusion. It is an invitation to test a proposition against evidence.

If collapse means severe and persistent failure of core economic functions, then the analysis must establish measurable thresholds. If the evidence instead shows resilience combined with structural stress, the diagnosis should reflect that. If pressures intensify and begin to reinforce one another, the analysis must identify the mechanisms through which that deterioration occurs.

The book will therefore move from headline indicators to deeper structures: growth, purchasing power, employment, productivity,

fiscal capacity, debt, revenue, industrial policy, external vulnerability, regional inequality, and the resilience of public institutions.

The central analytical principle is simple:

Do not ask whether the economy looks strong or weak. Ask where it is strong, where it is vulnerable, and what happens when those strengths and vulnerabilities interact.

1.9. Closing: The Transition Has Begun

Indonesia's political transition is complete.

Its economic transition has only begun.

The starting position is neither a blank slate nor a predetermined outcome. It is an inherited economic structure carrying both assets and constraints. The Prabowo administration now has to transform that inheritance into a sustainable development trajectory.

Whether it succeeds or struggles will depend on more than GDP growth. It will depend on productivity, fiscal space, household welfare, institutional capacity, external resilience, and the quality of policy execution.

That brings us to the most important conceptual question before any judgment can be made about economic collapse:

What, exactly, would economic collapse look like?

CHAPTER 2

WHAT WOULD "COLLAPSE" ACTUALLY MEAN?

Defining the Threshold Between Stress, Crisis, and Breakdown

Words matter in economics. A slowdown is not a crisis. Structural weakness is not the same as systemic failure. A period of financial stress does not automatically mean an economy is collapsing. Yet the language of collapse has become increasingly common in public debate, especially when economies face inflation, currency pressure, fiscal constraints, weak purchasing power, or uncertainty about the future.

That makes the central question of this book more difficult—and more important. If the question is, "Under President Prabowo, is Indonesia collapsing?", then the word "collapsing" cannot be treated as a rhetorical device. It must be defined in economic terms and tested against evidence.

2.1. The Problem With the Word "Collapse"

In everyday language, collapse suggests a sudden and visible breakdown. In economics, however, serious deterioration can occur gradually. Productivity may weaken for years. Household purchasing power may erode slowly. Public finances may become increasingly constrained. Investment may lose momentum. Financial vulnerabilities may accumulate beneath apparently stable headline indicators.

An economy can therefore experience significant stress without entering systemic crisis. It can also experience a crisis without immediately becoming a collapsed economy. The analytical task is to distinguish these conditions rather than treating them as interchangeable.

2.2. Economic Stress Spectrum

A useful starting point is to view economic conditions as a spectrum:

NORMAL EXPANSION → SLOWDOWN → STRUCTURAL STRESS → SYSTEMIC CRISIS → ECONOMIC BREAKDOWN

Each stage has different characteristics and different policy implications.

A slowdown means that economic growth decelerates relative to an earlier period. Growth may remain positive, employment may continue expanding, financial institutions may remain functional, and public services may continue operating. A slowdown can therefore be uncomfortable without being a crisis.

Structural stress is more persistent. It occurs when weaknesses in productivity, investment quality, human capital, fiscal capacity, competitiveness, regional development, or job quality begin to reduce an economy's ability to generate sustainable growth. Structural stress may coexist with respectable headline GDP growth.

A systemic crisis is different because pressures begin to reinforce one another. Financial stress can reduce credit. Lower credit can weaken investment. Lower investment can reduce production and employment. Weaker employment can reduce household income and consumption. Falling demand can then place further pressure on firms and financial institutions.

Economic breakdown represents a more severe condition: a sustained loss of core productive, financial, fiscal, or institutional functionality. It is not simply a bad quarter, a falling stock market, a weaker currency, or a large budget deficit. It implies that the mechanisms normally used to absorb shocks and restore economic activity have become seriously impaired.

2.3. Five Dimensions of Economic Stress

To determine where an economy sits on this spectrum, five dimensions are particularly important.

2.3.1. Growth and Production

The first dimension is the economy's capacity to produce goods and services. Persistent contraction in output, widespread production disruption, or a severe decline in productive capacity would represent much greater stress than a temporary deceleration in growth.

Indonesia's 2024 economy grew by 5.03 percent, according to Statistics Indonesia (BPS). That figure does not prove that the economy is free of structural problems, but it is fundamentally different from an economy experiencing generalized production failure (BPS-Statistics Indonesia, 2025).

2.3.2. Prices and Purchasing Power

Inflation is another critical dimension. High and persistent inflation can reduce real household purchasing power, particularly when wage growth does not keep pace with prices. But very low inflation can also require interpretation: it may reflect improved supply conditions, weak demand, or a combination of factors.

Indonesia recorded 1.57 percent year-on-year inflation at the end of 2024. Bank Indonesia also reported that financial stability remained resilient and credit growth reached 10.39 percent in 2024 (Bank Indonesia, 2025). These indicators point to an economy that was functioning, even while broader structural and external risks remained relevant.

2.3.3. Employment and Income

GDP does not fully capture household economic experience. Employment quality, real wages, labor productivity, and access to productive jobs matter because households transmit economic conditions into consumption and social welfare.

World Bank assessments have highlighted an important distinction: Indonesia has continued creating jobs, but many workers remain in relatively low-value-added activities, while pressures on middle-class households and real wages have become important policy concerns (World Bank, 2025). These conditions are better understood as structural stress and distributional pressure than as evidence of economic breakdown.

2.3.4. Fiscal and Financial Stability

Fiscal stress must also be interpreted carefully. A fiscal deficit is not automatically evidence of crisis. The relevant questions include the size and trajectory of the deficit, debt-service costs, maturity structure, exposure to foreign currency, revenue capacity, expenditure quality, and the amount of fiscal space available to respond to shocks.

Indonesia's statutory framework places a ceiling of 3 percent of GDP on the budget deficit under normal conditions. The IMF reported that Indonesia's 2024 fiscal deficit remained below that ceiling, while also emphasizing the importance of fiscal discipline, credible policy frameworks, and structural reform as the country navigates external and domestic risks (International Monetary Fund, 2026).

Financial stability is equally important. An economy can face fiscal pressure while its banking system remains functional. Conversely, a banking crisis can transform an otherwise manageable fiscal or growth problem into a systemic shock.

2.3.5. External and Institutional Resilience

The fifth dimension concerns an economy's ability to absorb external shocks and maintain the institutions that support economic activity. Relevant indicators include foreign-exchange reserves, exchange-rate stability, external financing conditions, trade exposure, financial-market functioning, and the credibility and capacity of economic institutions.

The IMF's 2026 Article IV assessment described Indonesia as remaining resilient while identifying downside risks from global trade tensions, prolonged uncertainty, and financial-market volatility. The World Bank similarly emphasized macroeconomic resilience alongside persistent productivity, labor-market, and structural challenges (International Monetary Fund, 2026; World Bank, 2025).

2.4. The Crisis Transmission Mechanism

The distinction between stress and crisis becomes clearer when the transmission mechanism is examined.

A simplified crisis loop can be expressed as:

FINANCIAL STRESS → CREDIT CONTRACTION → LOWER INVESTMENT → LOWER PRODUCTION → EMPLOYMENT PRESSURE → LOWER INCOME → LOWER CONSUMPTION → FURTHER BUSINESS AND FINANCIAL STRESS

The important point is not that every economy experiencing one of these conditions will enter a crisis. The point is that systemic crisis emerges when negative shocks interact and reinforce one another faster than policy institutions and private-sector adjustment mechanisms can contain them.

This is why economic resilience matters. Monetary policy, fiscal policy, banking regulation, foreign-exchange reserves, automatic stabilizers, social protection, and credible institutions can interrupt transmission channels before stress becomes systemic.

A crisis becomes much more dangerous when those containment mechanisms themselves become impaired.

2.5. What Would Economic Breakdown Look Like?

A useful collapse test can therefore be organized around five questions.

1. Production Failure — Has the economy experienced severe and sustained disruption in its ability to produce goods and services?

2. Financial Dysfunction — Have banks, credit markets, payment systems, or capital markets become broadly unable to perform their core functions?

3. Fiscal Incapacity — Has the government lost the practical ability to finance essential public functions or service its obligations without extraordinary disruption?

4. Household Deterioration — Have employment, income, purchasing power, and access to essential goods and services deteriorated on a broad and sustained basis?

5. Institutional Failure — Have the institutions responsible for monetary, fiscal, financial, and economic stabilization become unable to contain the shock?

A single negative indicator would not be enough. Collapse is a multidimensional condition.

2.6. What Evidence Would Change the Diagnosis?

This question is essential because economic analysis should allow evidence to change the diagnosis. The objective is not to prove that Indonesia is collapsing or to prove that it is safe. The objective is to determine which description best fits the evidence.

Evidence that would materially change the diagnosis would include a combination of severe and persistent output contraction, widespread financial dysfunction, loss of fiscal financing capacity, sustained currency or external-financing disruption, major employment and income deterioration, and weakening institutional capacity to stabilize the economy.

Conversely, continued economic growth, functioning financial institutions, contained inflation, adequate external buffers, functioning fiscal institutions, and the capacity to implement countercyclical policy would weigh against a diagnosis of systemic breakdown.

The important word is combination. No single number can carry the diagnosis by itself.

2.7. The Limits of Headline Indicators

This is why GDP growth alone is insufficient. A country can grow while productivity stagnates. Inflation can be low while households experience weak real income growth. Public debt can be manageable while fiscal space becomes narrower. A currency can depreciate without producing a currency crisis. Stock prices can fall without causing an economy-wide collapse.

Economic analysis therefore requires a dashboard rather than a single headline number.

For Indonesia, that dashboard should connect output, prices, employment, real income, productivity, fiscal capacity, debt dynamics, credit conditions, external balances, exchange-rate pressures, financial stability, regional disparities, and institutional capacity.

2.8. Indonesia on the Stress Spectrum

Where does Indonesia sit on this spectrum?

The evidence available at the beginning of the Prabowo administration does not support a description of systemic economic collapse. Indonesia entered the period with positive growth, relatively contained inflation, expanding credit, functioning financial institutions, and macroeconomic policy frameworks that international institutions continued to regard as important sources of resilience (Bank Indonesia, 2025; International Monetary Fund, 2026; World Bank, 2025).

That conclusion, however, should not be confused with an assertion that the economy is free of risk. The same evidence points to structural challenges involving productivity, job quality, middle-class purchasing power, fiscal capacity, competitiveness, and exposure to global uncertainty.

The analytical position is therefore more precise: resilience and vulnerability can coexist.

This distinction is central to the argument of Economic Tsunami. A tsunami metaphor should not be used to declare that collapse is already occurring. It should be used to investigate whether pressures are accumulating, where they are accumulating, how they interact, and whether existing institutions can absorb them.

2.9. The Threshold Problem

The threshold between stress and collapse cannot be defined by rhetoric. It must be defined by economic function.

An economy is under stress when important indicators deteriorate or structural weaknesses constrain performance. It enters systemic crisis when multiple weaknesses interact and generate self-reinforcing disruption. It approaches economic breakdown when core functions—production, finance, fiscal capacity, household welfare, and institutional stabilization—become persistently impaired.

This framework also explains why the question in this book is deliberately framed as a question:

UNDER PRESIDENT PRABOWO, IS INDONESIA COLLAPSING?

The answer cannot be assumed from the question itself. It must emerge from the evidence examined across the chapters that follow.

Chapter 1 established Indonesia's starting position: a large and increasingly complex economy entering a new political and policy era, carrying both accumulated strengths and accumulated vulnerabilities.

Chapter 2 establishes the diagnostic framework. Before asking whether Indonesia is growing fast enough, taxing enough, spending efficiently enough, or protecting household welfare adequately, we first need to know what kind of deterioration would actually constitute a crisis—and what would constitute collapse.

The debate now moves to the most visible number in Indonesia's economic story: growth.



Figure 2.1 — The Economic Stress Spectrum
Economic stress ranges from a temporary slowdown to a systemic breakdown. The diagnosis depends on the persistence, breadth, institutional capacity, financial stability, household impact, and the ability to recover. Stress is not collapse. Collapse requires persistent dysfunction across multiple economic systems.
Source: Author's analytical framework for this chapter, based on IMF (2023), World Bank (2023), BIS (2023), and related sources.

Figure 2.1 — THE ECONOMIC STRESS SPECTRUM

CHAPTER 3

GROWTH: STRONG ENOUGH, FAST ENOUGH?

3.1. The Five-Percent Question

The debate begins with the number that dominates almost every discussion of the Indonesian economy:

5 percent.

For some, it represents resilience.

For others, it raises a different question:

Is 5 percent growth enough for the Indonesia of the future?

The question is more difficult than it first appears.

An economy growing at 5 percent is not an economy in recession. It is not an economy experiencing generalized production failure. It is certainly not, by itself, evidence of economic collapse.

But growth can be positive and still be insufficient.

It can be sufficient to maintain stability but insufficient to accelerate structural transformation. It can create jobs while leaving productivity weaknesses unresolved. It can expand GDP while household purchasing power, job quality, and regional inequality remain important concerns.

The real question, therefore, is not simply whether Indonesia is growing.

It is whether Indonesia is growing fast enough, productively enough, inclusively enough, and sustainably enough to achieve the level of prosperity the country seeks.

That distinction changes the entire debate.

3.2. The Return of the Five-Percent Economy

For much of the post-pandemic period, Indonesia's growth rate has hovered around 5 percent.

In 2024, real GDP grew by 5.03 percent. In 2025, according to Statistics Indonesia, growth accelerated modestly to 5.11 percent. GDP at current prices reached approximately IDR 23,821.1 trillion, while GDP per capita reached approximately IDR 83.7 million, or about US$5,083.4 (BPS-Statistics Indonesia, 2026b).

The headline therefore appears reassuring.

Growth did not collapse.

It did not stagnate.

It remained remarkably close to the pace that has characterized Indonesia's recent economic performance.

But the stability of the number is itself analytically interesting.

A growth rate near 5 percent can be interpreted in two very different ways.

The first interpretation is resilience.

Indonesia has maintained expansion despite global uncertainty, geopolitical tensions, trade disruptions, commodity-price movements, tighter international financial conditions, and the continuing adjustment following the pandemic. Domestic demand has remained an important stabilizing force.

The second interpretation is structural limitation.

If an economy with a large young population, substantial infrastructure needs, major natural-resource endowments, and an ambition to reach high-income status grows at roughly 5 percent for an extended period, the question becomes whether that pace is sufficient to transform living standards rapidly enough.

Both interpretations can be true at the same time.

That is the central growth paradox.

Five percent can be a sign of resilience and a sign of limitation.

3.3. Growth Is Not the Same as Development

GDP growth measures the expansion of economic production.

Development is broader.

Development includes productivity, real income, employment quality, human capital, access to public services, infrastructure, technological capability, regional opportunity, and the ability of households to improve their economic position over time.

This distinction matters because GDP can increase without every dimension of development improving at the same rate.

Imagine an economy in which GDP grows 5 percent but productivity grows slowly, real wages remain under pressure, and much of the new employment occurs in relatively low-productivity activities.

The economy is growing.

But its transformation may be incomplete.

This is why the question of growth cannot be separated from the question of what produces the growth.

Growth driven primarily by temporary commodity prices, government expenditure, or a short-lived investment cycle may have different long-term implications from growth driven by productivity improvements, technological adoption, human-capital accumulation, competitive industries, and higher-value exports.

The number matters.

The composition matters more.

3.4. The 2025 Signal

The 2025 growth figure provides an important test of the argument.

Indonesia grew by 5.11 percent in 2025, slightly faster than the 5.03 percent recorded in 2024. BPS reported that exports of goods and services were the expenditure component with the highest annual growth, at 7.03 percent, while gross fixed capital formation grew strongly in the fourth quarter. Java remained the dominant contributor to national output, accounting for 56.93 percent of the economy in 2025 (BPS-Statistics Indonesia, 2026b).

This is not the statistical profile of an economy undergoing generalized collapse.

It is the profile of an economy continuing to expand.

Yet the same data raise deeper questions.

Why does growth remain concentrated around approximately 5 percent?

How much of the expansion comes from productivity rather than simply more inputs?

How much investment produces lasting productive capacity?

How widely are the gains distributed?

And can this growth rate be sustained while Indonesia simultaneously pursues ambitious industrial, infrastructure, human-capital, social-protection, and fiscal objectives?

These questions move the analysis from growth as a number to growth as a development mechanism.

3.5. The Arithmetic of Catch-Up

There is another reason the 5 percent question matters.

Growth compounds.

An economy growing at 5 percent does not simply become 5 percent larger once. If that growth rate is sustained, the economy approximately doubles in real terms over a little more than fourteen years.

This is the power of compounding.

But the same arithmetic works in reverse when comparing different growth trajectories.

A country growing at 5 percent and a country growing at 6 percent may appear only one percentage point apart in a single year.

Over decades, the difference becomes substantial.

This is why policymakers concerned with long-term development do not ask only whether growth is positive. They ask whether the economy's potential growth rate can be increased.

The issue is not about chasing an arbitrary number.

It is about understanding the consequences of small differences in sustained productivity and output growth over long periods.

For Indonesia, the long-term objective is particularly important because the country has articulated an ambition to become a high-income economy by 2045.

That objective places a much higher standard on the quality of growth.

3.6. The High-Income Ambition

Indonesia's development challenge is not simply to avoid recession.

It is to move from middle-income status toward higher-income prosperity while maintaining macroeconomic stability and social inclusion.

That transition requires more than keeping GDP positive.

It requires a sustained increase in output per worker.

It requires businesses to become more productive.

It requires workers to acquire skills that match changing technologies and industries.

It requires investment to move toward higher-value activities.

It requires infrastructure to reduce economic distance rather than merely increase physical connectivity.

It requires domestic firms to become more competitive.

It requires institutions capable of allocating public resources efficiently.

And it requires an economic environment in which private investment can complement public investment rather than depend excessively upon it.

The World Bank's 2026 Indonesia Economic Prospects emphasizes this productivity challenge, arguing that structural reforms are important for sustaining growth and creating better jobs. Its assessment projects growth around 5.0 percent in 2026, with an expected recovery toward 5.2 percent in 2027–28 (World Bank, 2026a).

The message is significant.

The issue is no longer simply whether Indonesia can grow.

It is whether Indonesia can raise the productivity foundation of growth.

3.7. The Productivity Question

Productivity is one of the least visible but most important variables in economic development.

A simple way to think about it is:

Economic growth = more inputs + better use of inputs.

More workers can increase production.

More capital can increase production.

More land, energy, and natural resources can increase production.

But there are limits to how far an economy can grow simply by adding inputs.

At some point, sustainable development requires better use of those inputs.

That means producing more value from the same amount of labor and capital.

This is where productivity enters the story.

Productivity growth can come from technology, better management, improved infrastructure, stronger competition, human-capital development, innovation, specialization, economies of scale, and better institutions.

Without productivity improvements, high growth becomes increasingly difficult to sustain.

This is one reason the five-percent question cannot be answered by GDP statistics alone.

A 5 percent growth rate generated by strong productivity gains has a different economic meaning from 5 percent growth generated primarily by expanding resource use.

The headline number is identical.

The underlying economy is not.

3.8. Investment: Quantity or Transformation?

Investment is another part of the equation.

Indonesia has invested heavily in infrastructure over the past decade. Roads, ports, airports, electricity networks, industrial estates, and digital infrastructure have expanded the country's productive and connective capacity.

But the economic impact of investment depends on quality.

An investment project can produce substantial economic returns if it lowers logistics costs, increases market access, improves productivity, attracts private investment, or enables new industrial activity.

The same amount of spending can produce weaker returns if projects are poorly selected, underutilized, delayed, or disconnected from productive economic ecosystems.

This distinction becomes particularly important during the Prabowo era because the government has articulated substantial development ambitions.

The policy challenge is therefore not simply:

How much should Indonesia invest?

It is:

Which investments raise Indonesia's future productive capacity?

That is a much harder question.

3.9. Consumption: Indonesia's Stabilizer

Indonesia's large domestic market is one of the country's structural strengths.

Household consumption has historically provided a major contribution to GDP and has helped stabilize the economy when external conditions deteriorate.

The 2025 growth performance again reflected the importance of domestic demand.

This creates a powerful economic buffer.

But consumption cannot carry the entire burden of development.

An economy cannot become significantly more productive simply because households consume more.

Consumption supports businesses, employment, and tax revenues. It is an essential component of economic activity.

But long-term transformation requires the productive capacity behind that consumption.

If household demand grows while productivity and productive investment remain weak, growth can eventually face limits.

The challenge is therefore to create a virtuous cycle:

PRODUCTIVITY → INCOME → CONSUMPTION → INVESTMENT → PRODUCTIVITY

rather than a cycle driven primarily by short-term demand.

This distinction becomes especially important when assessing whether growth is sustainable.

3.10. Exports and the External Engine

Exports provide another source of growth.

Indonesia has substantial natural-resource advantages, including mineral commodities, coal, palm oil, and other resource-based products. Downstream industrialization has sought to increase the value captured domestically from these resources.

The opportunity is significant.

But commodity dependence creates exposure to global prices, international demand, trade policy, and geopolitical developments.

A resource-rich economy can generate rapid export growth without necessarily developing a sufficiently diversified productivity base.

The strategic objective is therefore not simply to export more.

It is to increase the domestic value added associated with exports.

That means processing, technology, industrial capabilities, supplier networks, skills, research, logistics, and competitive firms.

Downstreaming becomes economically meaningful when it creates durable productive ecosystems rather than simply moving one stage of processing inside national borders.

The difference is crucial.

3.11. Growth and the Geography of Indonesia

Indonesia's national growth rate also hides significant geographic differences.

In 2025, the provinces on Java accounted for 56.93 percent of national economic output and grew by 5.30 percent (BPS-Statistics Indonesia, 2026b).

This concentration is not necessarily evidence of failure.

Java has population density, infrastructure, industrial clusters, universities, financial institutions, logistics networks, and large consumer markets that naturally support economic activity.

But concentration creates another question:

Can Indonesia raise national productivity while allowing more regions to become engines of higher-value growth?

The answer matters for both economics and social cohesion.

If productive opportunities remain heavily concentrated, regional migration and urbanization will continue to shape the economy. Cities may become more productive, but congestion, housing costs, transport pressures, and inequality can also intensify.

A geographically balanced development strategy therefore does not mean forcing every region to have the same economic structure.

It means enabling different regions to develop productive advantages appropriate to their resources, connectivity, human capital, and market opportunities.

3.12. The Middle-Income Growth Problem

Countries often face a difficult transition after the first stages of rapid development.

Low-income economies can grow quickly by shifting workers from very low-productivity activities into manufacturing, construction, services, and urban employment.

As an economy becomes richer, those easy productivity gains become harder to obtain.

The next stage requires innovation, advanced skills, better institutions, stronger competition, and more sophisticated production.

This is commonly described as the middle-income challenge.

The danger is not necessarily economic collapse.

It is stagnation.

An economy can continue growing at a moderate rate while failing to generate the productivity improvements required to move decisively into higher-income territory.

This is a different kind of vulnerability from the collapse framework developed in Chapter 2.

It is a vulnerability of insufficient transformation.

The economy functions.

GDP rises.

Businesses operate.

Banks lend.

Government collects taxes.

But the economy does not move rapidly enough up the productivity ladder.

That distinction is fundamental.

3.13. Is Five Percent Enough?

The answer depends on what question is being asked.

If the question is:

Is 5 percent growth consistent with economic stability?

The evidence indicates that it can be.

If the question is:

Does 5 percent growth mean Indonesia is collapsing?

No. Growth of 5 percent is fundamentally inconsistent with a simple diagnosis of generalized economic breakdown.

But if the question becomes:

Is 5 percent growth sufficient to achieve Indonesia's long-term development ambitions?

The answer cannot be determined from the growth rate alone.

It depends on productivity, demographics, investment, employment quality, human capital, inequality, fiscal capacity, and the duration over which the growth rate can be sustained.

This is where the title of the chapter becomes important.

Strong enough?

That is one question.

Fast enough?

That is another.

An economy can be strong enough to remain stable while not growing fast enough to achieve its desired transformation.

3.14. The Quality of Growth

A more complete growth framework therefore requires at least five questions.

1. How Fast Is the Economy Growing?

This is the traditional GDP question.

Indonesia's recent performance has remained around 5 percent, with 2025 growth reaching 5.11 percent.

2. What Is Driving the Growth?

Is growth being generated by household consumption, investment, government expenditure, exports, productivity, or a combination?

3. How Productive Is the Growth?

Are workers and firms producing more value per unit of input?

4. Who Benefits From the Growth?

Are real incomes rising broadly? Are better jobs being created? Are regional opportunities improving?

5. Can the Growth Be Sustained?

Can the economy maintain expansion without exhausting fiscal space, worsening external vulnerability, increasing environmental costs, or creating new structural imbalances?

These five questions transform the analysis.

They also prevent a common mistake:

equating growth with success.

Growth is necessary.

It is not sufficient.

3.15. The Prabowo Growth Challenge

The Prabowo administration therefore faces a growth challenge that is more demanding than simply preserving a 5 percent headline.

The first challenge is maintaining macroeconomic stability.

The second is protecting investment.

The third is increasing productivity.

The fourth is creating better jobs.

The fifth is strengthening the domestic revenue base and fiscal capacity required to finance development.

The sixth is ensuring that industrial policy produces competitive industries rather than permanent dependence on state support.

The seventh is improving human capital.

The eighth is reducing the structural barriers that prevent private firms from investing, innovating, and expanding.

The IMF's 2026 assessment describes Indonesia as resilient but emphasizes that structural reforms—including measures affecting trade integration, the business environment, and productivity—are important for a jobs-rich and sustainable growth path (International Monetary Fund, 2026).

This creates a useful distinction between stability policy and transformation policy.

Stability policy protects the economy from excessive volatility.

Transformation policy changes the economy's productive capacity.

Indonesia needs both.

3.16. Growth Without Transformation?

This is perhaps the most important warning in the five-percent debate.

An economy can become very good at maintaining 5 percent growth.

That is not necessarily the same as becoming very good at transforming itself.

If the same sectors continue to dominate, productivity remains weak, informal employment remains substantial, regional concentration persists, and investment does not generate sufficient technological upgrading, the economy may become stable without becoming sufficiently dynamic.

This is the difference between:

maintaining momentum

and

changing the trajectory.

The Prabowo era will be judged over time not only by whether growth remains positive, but by whether the structure supporting that growth changes.

3.17. A Growth Stress Test

The framework developed in Chapter 2 can now be applied to growth.

A useful growth stress test asks five questions:

3.18. Growth Stress Test

1. Output: Is GDP growth sustained without persistent contraction?

2. Productivity: Is output per worker increasing sufficiently to support rising real incomes?

3. Investment: Is capital formation expanding productive capacity?

4. Employment: Is growth generating productive and higher-quality employment?

5. Resilience: Can growth withstand external shocks without requiring increasingly large policy interventions?

These questions are more informative than the headline growth rate alone.

They also provide a bridge to the next chapters of this book.

Because eventually, growth must reach people.

3.19. The Household Test

A country can report 5 percent GDP growth while households ask a much simpler question:

Why does life still feel economically difficult?

That question cannot be dismissed as a misunderstanding of macroeconomics.

Households experience the economy through prices, wages, employment, housing, transportation, education, healthcare, debt, and purchasing power.

GDP is an aggregate measure.

Household welfare is a lived economic experience.

The relationship between the two is therefore one of the most important issues in assessing Indonesia's economic trajectory.

If GDP rises but real household income grows slowly, the political and social perception of economic progress may diverge from the national accounts.

That divergence matters.

The next chapter will therefore move from GDP to the household economy.

3.20. The Five-Percent Verdict

There is no single verdict to deliver from the number 5 percent.

The evidence points to something more nuanced.

Indonesia's growth rate demonstrates resilience.

The 5.11 percent expansion recorded in 2025 confirms that the economy continued to grow and that the starting premise of systemic collapse does not fit the aggregate output data (BPS-Statistics Indonesia, 2026b).

But the same number does not settle the deeper development question.

Five percent growth may be adequate for maintaining macroeconomic stability.

It may not be sufficient to accelerate Indonesia's movement toward high-income prosperity unless it is accompanied by stronger productivity, higher-quality investment, better jobs, stronger human capital, and broader participation in productive economic opportunities.

This is the central distinction:

Growth tells us how much the economy expands.

Productivity tells us how effectively it transforms.

And transformation is ultimately what determines whether a middle-income economy can become a high-income one.

3.21. The Next Question

Indonesia is not collapsing simply because its economy grows at around 5 percent.

But neither should 5 percent automatically be treated as proof that the economic model is working exactly as intended.

The more important question is what happens underneath the headline.

Who earns more?

Who gets better jobs?

Who becomes more productive?

Who is left behind?

And can the state create the conditions under which productivity gains become widespread rather than concentrated?

The next chapter moves directly into these questions.

Because an economy ultimately exists not only to produce GDP.

It exists to improve the economic possibilities available to people.

PART II — READING THE ECONOMY



Figure 2.2 — Economic Shock Transmission Channels
This figure illustrates how global and domestic shocks transmit through trade, financial, fiscal, and monetary channels to affect the real economy, and how feedback loops can amplify the impact.
Source: Author's analytical framework for this chapter, based on IMF (2023), World Bank (2023), BIS (2023), and related sources.

Figure 3.1 — THE GROWTH–PRODUCTIVITY–DEVELOPMENT FRAMEWORK

CHAPTER 4

PURCHASING POWER, JOBS & THE MIDDLE CLASS

When Growth Reaches the Household

Growth is visible in national accounts.

Economic pressure is often visible somewhere else:

at the household level.

A country can report positive GDP growth while households feel that economic progress is becoming harder to maintain.

The reasons are straightforward.

People do not experience GDP directly.

They experience prices.

They experience wages.

They experience employment.

They experience rent, housing, transportation, food, education, healthcare, debt, and the cost of raising a family.

They experience whether their children can find decent jobs.

They experience whether an unexpected expense can be absorbed without borrowing.

They experience whether their income rises faster than the cost of living.

This creates an important bridge between Chapter 3 and the chapters that follow.

Indonesia's economy grew by 5.11 percent in 2025.

The number was positive.

But the household question is different:

How much of that growth becomes better economic security for ordinary people?

That is the question this chapter examines.

4.1. From GDP to Lived Economics

Macroeconomic statistics are indispensable.

But national aggregates can conceal substantial differences between groups.

Two households can live in the same economy, experience the same inflation rate, and still face completely different economic realities.

One household may have two formal workers, stable salaries, health insurance, accumulated savings, and access to credit.

Another may depend on informal work, irregular income, and daily cash flow.

The first household may interpret a period of 5 percent growth as an opportunity.

The second may experience the same economy as a struggle to maintain purchasing power.

This does not mean that GDP statistics are misleading.

It means that GDP answers a different question.

GDP asks:

How much economic activity is being produced?

Household economics asks:

How is that economic activity affecting people's capacity to live, save, invest, and move upward?

A serious assessment of Indonesia therefore needs both perspectives.

4.2. Purchasing Power Is the First Test

The most immediate connection between growth and household welfare is purchasing power.

If nominal income rises by 5 percent while prices rise by 4 percent, real purchasing power increases only modestly.

If nominal income rises by 3 percent while prices rise by 5 percent, real purchasing power falls.

This is why wages cannot be interpreted without considering inflation.

The same nominal salary can represent very different living standards at different price levels.

Indonesia entered the Prabowo era with relatively contained headline inflation. That provided an important macroeconomic buffer.

But low headline inflation does not mean every household experiences prices in the same way.

Household expenditure patterns differ.

Food may represent a large share of expenditure for one family.

Housing may dominate another.

Transportation, education, healthcare, or debt payments may matter more for others.

The inflation rate is therefore an aggregate measure.

The household experience of inflation is more personal.

This distinction becomes increasingly important as incomes rise and households enter the middle class.

4.3. The Wage Question

If growth is to become broadly shared, wages must eventually reflect higher productivity.

This relationship is fundamental.

A productive economy should be capable of generating higher-value output.

Higher-value output can support higher wages.

Higher wages can strengthen household consumption.

Stronger consumption can support business revenue.

And stronger business revenue can support further investment.

The desired cycle is:

PRODUCTIVITY → WAGES → CONSUMPTION → INVESTMENT → PRODUCTIVITY

But this cycle is not automatic.

If productivity growth is weak, wages may stagnate.

If labor markets are highly informal, wage gains may not reach workers consistently.

If firms face weak demand or high uncertainty, they may hesitate to expand formal employment.

If skills do not match employer requirements, workers may remain in lower-productivity occupations even when they have higher educational qualifications.

The result can be an economy that creates jobs without creating enough good jobs.

That distinction is at the heart of Indonesia's middle-class challenge.

4.4. Employment Is Not the Same as Job Quality

One of the easiest ways to misunderstand the labor market is to focus exclusively on unemployment.

A low unemployment rate is important.

But it does not tell the whole story.

A person can be employed and still face economic insecurity.

A worker can have a job without stable hours.

A graduate can be employed in work that does not use his or her skills.

A self-employed worker can earn income while lacking social protection.

An informal worker can remain economically active but have little capacity to absorb a shock.

Employment therefore has at least two dimensions:

quantity

and

quality.

Quantity asks:

How many people have jobs?

Quality asks:

What kind of jobs are they?

For a middle-income economy attempting to move toward high-income status, the second question becomes increasingly important.

4.5. Indonesia's Labor Market: The Latest Signal

The latest labor-market evidence illustrates this distinction.

According to Statistics Indonesia, in May 2026 Indonesia had a labor force of approximately 155.41 million people and 148.19 million employed people. The unemployment rate was 4.65 percent. The average wage of employees was approximately IDR 3.39 million per month (BPS-Statistics Indonesia, 2026f).

These figures demonstrate continued labor-market absorption.

They do not indicate generalized employment collapse.

But they do not, by themselves, establish that Indonesia is generating enough high-quality employment to support sustained middle-class expansion.

That requires looking deeper into occupation, sector, formality, skills, productivity, and real wage trends.

This is where the labor-market story becomes more complicated.

4.6. The Good-Jobs Problem

The World Bank has emphasized that Indonesia continues to create employment, but a large share of new jobs is concentrated in lower-value-added activities.

That creates a paradox.

The economy can create jobs while simultaneously struggling to create enough jobs capable of supporting middle-class living standards.

This is not a contradiction.

It is a structural issue.

Suppose an economy adds one million jobs.

That sounds positive.

But if most of those jobs are low-productivity, informal, insecure, or poorly paid, their contribution to long-term household mobility may be limited.

The economy has absorbed workers.

It has not necessarily transformed their economic position.

The question is no longer only how to move people from unemployment into employment.

It is how to move workers from low-productivity employment into higher-productivity employment.

4.7. The Middle Class Is an Economic Engine

The middle class is more than a social category.

It is an economic mechanism.

Middle-class households generally have greater capacity to consume discretionary goods and services, invest in education, purchase housing, save, travel, use financial products, and support businesses beyond basic necessities.

This makes the middle class important for domestic demand.

BPS has estimated that the middle class and those approaching middle-class status represented approximately 66.35 percent of Indonesia's population in 2024 and accounted for 81.49 percent of household consumption (BPS-Statistics Indonesia, 2024).

The implication is important.

When middle-class purchasing power strengthens, the domestic market can become a powerful engine of growth.

When middle-class purchasing power weakens, the consequences extend beyond individual households.

Consumption can slow.

Businesses can face weaker demand.

Investment plans can be postponed.

Tax revenues can be affected indirectly through weaker economic activity.

The middle class therefore functions as a bridge between macroeconomic growth and domestic economic dynamism.

4.8. The Middle-Class Squeeze

The middle class can experience pressure even when the economy continues to grow.

This happens when income growth fails to keep pace with the combined cost of housing, education, transportation, healthcare, food, debt service, and other essential expenditures.

The problem is not necessarily absolute poverty.

It is the erosion of economic security.

A household can remain above the official poverty line while becoming increasingly vulnerable to shocks.

A medical emergency can consume savings.

A job loss can trigger debt.

A child entering university can substantially increase household expenditure.

A mortgage or rental increase can reduce discretionary consumption.

This is why middle-class vulnerability deserves separate attention from poverty.

Poverty asks:

Can a household meet minimum standards of living?

Middle-class vulnerability asks:

Can a household maintain economic security and continue to accumulate assets when confronted with shocks?

The two questions overlap.

They are not identical.

4.9. The Real-Wage Problem

The distinction between nominal and real wages becomes especially important here.

A nominal wage may rise while the worker becomes no better off in real terms.

The World Bank's recent analysis finds that real wages in Indonesia declined for medium- and high-skilled employment between 2018 and 2025, while lower-skilled occupations moved in the opposite direction. The report estimates that the median real wage declined by around 0.5 percent annually over that period (World Bank, 2026a).

This is a critical development signal.

The problem is not simply that wages are low.

It is that the labor market may not be rewarding skills and productivity strongly enough.

That creates a difficult incentive structure.

If education does not consistently translate into better employment outcomes, the return to education becomes less predictable.

If skilled workers are pushed toward informal employment, the connection between human-capital accumulation and middle-class advancement becomes weaker.

And if high-productivity sectors do not expand quickly enough, workers have fewer opportunities to move upward.

4.10. Education Without Economic Mobility?

Indonesia has made substantial progress in expanding access to education.

But education alone cannot guarantee upward mobility.

The labor market must be capable of absorbing educated workers into productive employment.

This creates a three-part chain:

EDUCATION → SKILLS → PRODUCTIVE EMPLOYMENT

If the second link is weak, education may not produce the expected economic return.

If the third link is weak, workers may possess skills but fail to find jobs that use them effectively.

The World Bank reports that the share of tertiary-educated workers in formal wage employment declined from 74.1 percent in 2018 to 67.8 percent in 2025 (World Bank, 2026a).

This does not mean that education has lost its value.

It means that education policy and labor-market policy must increasingly be considered together.

The economy needs not only educated workers.

It needs productive firms capable of employing them.

4.11. Informality and Economic Security

Informal employment is not automatically synonymous with poverty.

Many informal businesses are productive, entrepreneurial, and economically important.

Micro and small enterprises provide employment and services across Indonesia.

But informality can also limit access to social insurance, stable earnings, formal credit, training, and legal protections.

For workers attempting to move into the middle class, these limitations can matter.

A worker with a stable formal job may be able to obtain credit for housing.

A worker with irregular informal income may face greater difficulty.

A formal worker may receive employment-linked health or retirement benefits.

An informal worker may need to finance these risks independently.

The result is that two workers with similar monthly incomes can have very different levels of economic security.

This is why job quality must include more than wages.

It includes stability, productivity, social protection, working conditions, skill utilization, opportunities for advancement, and resilience against shocks.

4.12. The Household Balance Sheet

The household economy can be understood through a simple balance sheet.

On one side are:

Income + assets + savings + social protection.

On the other are:

Living costs + debt + financial shocks + uncertainty.

When income and assets grow faster than costs and liabilities, household resilience strengthens.

When costs and liabilities grow faster than income and assets, vulnerability increases.

This framework helps explain why the same GDP growth rate can produce different household experiences.

A household with rising real wages, growing savings, and manageable debt can experience economic expansion positively.

A household with stagnant real wages, rising housing costs, and high debt can experience the same macroeconomic environment as increasingly difficult.

The household balance sheet is therefore one of the hidden channels through which macroeconomic policy reaches society.

4.13. Consumption and the Middle-Class Feedback Loop

Indonesia's domestic-market strength depends heavily on household consumption.

But consumption itself depends on confidence.

A household that expects income to rise may purchase a home, vehicle, education, or durable goods.

A household uncertain about employment may postpone those decisions.

This produces an important feedback loop:

JOB SECURITY → INCOME CONFIDENCE → CONSUMPTION → BUSINESS REVENUE → INVESTMENT → JOB CREATION

When confidence is strong, the loop can reinforce growth.

When confidence weakens, households may increase precautionary savings or reduce discretionary spending.

That can slow demand.

This does not necessarily create a crisis.

But persistent weakness can reduce the momentum of an economy that relies heavily on domestic consumption.

The middle class is therefore both a beneficiary of growth and a potential transmission channel for economic weakness.

4.14. Poverty Is Falling—But That Is Not the Whole Story

Indonesia's official poverty rate has continued to decline.

The World Bank reported that the national poverty rate fell to 8.5 percent in March 2025, down from a year earlier. Yet it also noted that progress was uneven and that weak job quality and stagnant labor-market conditions continued to constrain household welfare, particularly in urban areas (World Bank, 2025).

This illustrates an important principle.

Poverty reduction and middle-class expansion are related, but they are not identical.

A country can reduce poverty while the middle class remains under pressure.

It can improve conditions for the poorest households while higher-income households experience slower real income growth.

It can reduce inequality while still facing weak productivity.

Economic development is therefore multidimensional.

A single welfare indicator cannot capture the entire process.

4.15. The Middle-Class Population Question

The long-term challenge becomes even clearer when considering the size and stability of the middle class.

The World Bank's recent analysis estimates that the share of middle-class workers declined from 14.5 percent in 2018 to 7.1 percent in 2025 under its middle-class worker definition (World Bank, 2026a).

This should not be interpreted simplistically as saying that Indonesia's entire middle class has disappeared.

The measurement is definition-specific.

Different institutions use different thresholds for defining the middle class.

But the direction of the evidence is important: a substantial number of households face difficulty converting education and employment into stable middle-class economic security.

This creates a structural concern.

If economic growth cannot generate enough jobs with middle-class earning potential, the expansion of GDP may not translate into a sufficiently broad expansion of economic security.

That is the real middle-class challenge.

4.16. Why This Matters for the Prabowo Era

The Prabowo administration inherits an economy with a large domestic market, substantial labor supply, expanding infrastructure, and significant industrial ambitions.

These are advantages.

But they create corresponding responsibilities.

If industrial policy succeeds in attracting investment but creates relatively few productive jobs, the household transmission mechanism may remain weak.

If infrastructure improves connectivity but wages do not rise with productivity, the welfare effect may be incomplete.

If education spending increases but skilled workers remain underemployed, human-capital investment may not achieve its full economic return.

If social assistance expands without improving pathways into productive employment, fiscal costs may rise without sufficiently strengthening household self-reliance.

None of these outcomes is predetermined.

They are policy questions.

4.17. Growth Must Reach the Paycheck

This is perhaps the simplest way to summarize the household challenge.

Growth must eventually reach the paycheck.

GDP growth becomes socially meaningful when it produces higher real incomes, more productive jobs, stronger household balance sheets, better access to social protection, greater economic mobility, and improved capacity to withstand shocks.

Without these transmission channels, GDP growth can remain statistically strong while its social impact becomes less convincing.

This does not mean GDP is unimportant.

It means GDP is the beginning of the story, not the end.

4.18. The Household Stress Test

The framework developed in previous chapters can now be extended to households.

A household-centered stress test should ask six questions.

1. Purchasing Power — Are real incomes increasing faster than the cost of essential consumption?

2. Employment Quality — Are new jobs stable, productive, adequately paid, and protected?

3. Income Mobility — Can workers move from low-productivity employment into higher-productivity occupations?

4. Middle-Class Security — Can households accumulate assets and maintain economic stability in the face of shocks?

5. Social Protection — Can households access effective protection against unemployment, illness, disability, old age, and other major risks?

6. Economic Opportunity — Can education and skills translate into productive employment and upward mobility?

These questions provide a more complete picture of whether growth is reaching households.

4.19. The Two-Sided Labor Market

Indonesia's labor market increasingly needs to be understood as two interconnected economies.

The first is the economy of survival and absorption.

It absorbs workers through agriculture, microbusinesses, informal services, construction, trade, transportation, and other activities.

Its strength is flexibility.

It can absorb labor quickly.

The second is the economy of productivity and advancement.

It includes higher-value manufacturing, modern services, technology, finance, professional services, advanced logistics, research, and other activities capable of generating higher productivity and wages.

Its strength is upward mobility.

Indonesia needs both.

The first prevents unemployment from becoming even more severe.

The second determines whether the economy can become substantially richer.

The policy challenge is therefore not to eliminate the first economy.

It is to create pathways from the first into the second.

4.20. From Jobs to Good Jobs

This distinction changes how employment policy should be evaluated.

A government can report millions of jobs created.

That is important.

But the next question should be:

What kind of jobs?

Are they formal or informal?

Are they productive or low-value?

Are they temporary or stable?

Do they use workers' skills?

Do they offer social protection?

Can workers progress?

Do wages rise with productivity?

Do firms invest in training?

These questions are not anti-business.

They are questions about the quality of economic transformation.

A productive private sector is one of the most important mechanisms through which growth becomes higher household income.

4.21. The Productivity-Wage Connection

There is a deeper economic principle underneath this discussion.

Long-term wage growth cannot be disconnected from productivity growth indefinitely.

If a worker produces substantially more value, there is greater potential for compensation to rise.

But productivity gains do not automatically become wage gains.

The distribution depends on labor-market institutions, bargaining power, competition, firm profitability, skills, technology, and the structure of production.

This means productivity policy and labor policy cannot be separated completely.

Improving productivity without improving access to productive employment can leave workers behind.

Improving wages without productivity gains can create cost pressures that undermine competitiveness.

The sustainable path lies in increasing the value created by workers and expanding the mechanisms through which that value becomes higher real income.

4.22. The Middle Class as a Strategic Variable

This is why the middle class should be treated not merely as a social outcome, but as a strategic economic variable.

A larger and economically secure middle class can strengthen domestic demand, support private investment, increase human-capital spending, expand financial inclusion, create entrepreneurship, increase tax capacity, and strengthen social stability.

But a vulnerable middle class can become a source of economic fragility.

Households under pressure may reduce consumption, postpone investment in education, avoid entrepreneurship, accumulate debt, or become highly sensitive to inflation and employment shocks.

The middle class is therefore both an engine and a barometer.

Its condition tells us something about whether economic growth is generating durable economic security.

4.23. What the Evidence Says

The evidence presents a mixed but coherent picture.

Indonesia continues to create jobs.

Unemployment remains far below the levels associated with a generalized employment crisis.

Poverty has continued to decline.

Macroeconomic stability remains important.

But the quality of employment remains a concern.

Real wage performance has been weak in important segments.

Higher-skilled workers face challenges in securing formal, productive employment.

Middle-class economic security has come under pressure.

And the transition from education to productive employment remains incomplete.

This is not the evidence of economic collapse.

It is evidence of a more subtle problem:

the economy is growing, but the transmission from growth to household prosperity is not yet strong enough across all segments of society.

That distinction matters enormously.

4.24. The Household Verdict

The household story therefore cannot be reduced to either optimism or pessimism.

Indonesia is not experiencing generalized labor-market collapse.

But neither does positive GDP growth automatically guarantee stronger household economic security.

The evidence points toward a transition problem.

The country has succeeded in generating economic activity.

The next challenge is to generate more productive activity.

It has succeeded in creating jobs.

The next challenge is to create more good jobs.

It has reduced poverty.

The next challenge is to expand and protect middle-class economic security.

It has expanded education.

The next challenge is to connect education more effectively to productive employment.

And it has maintained growth.

The next challenge is to ensure that growth produces rising real living standards.

4.25. The Economic Tsunami at Household Level

The metaphor of an economic tsunami becomes more useful at this level.

Economic pressure rarely arrives as a single event.

It accumulates.

A household may first experience higher food costs.

Then transportation costs rise.

Then a salary increase fails to keep pace.

Then a family member loses a job.

Then savings decline.

Then debt increases.

Each event may appear manageable.

Together, they can change the household's economic position.

The same principle applies at the national level.

Small pressures can accumulate across millions of households.

That does not mean a tsunami is inevitable.

It means that economic resilience must be evaluated not only at the level of banks, budgets, and GDP, but also at the level where people actually experience the economy.

4.26. The Next Question

Chapter 3 asked whether 5 percent growth is strong enough and fast enough.

Chapter 4 asks whether that growth reaches households.

The evidence suggests that Indonesia's central challenge is increasingly about the quality of economic transmission.

Growth must become productivity.

Productivity must become better jobs.

Better jobs must become higher real incomes.

Higher real incomes must become stronger household balance sheets.

And stronger household balance sheets must become a broader and more resilient middle class.

The chain is:

GROWTH → PRODUCTIVITY → JOBS → WAGES → PURCHASING POWER → MIDDLE-CLASS SECURITY

If the chain works, economic growth becomes development.

If the chain weakens, GDP can continue rising while household economic anxiety persists.

This is why the next question is not simply about workers.

It is about the productive structure that determines what workers can earn.

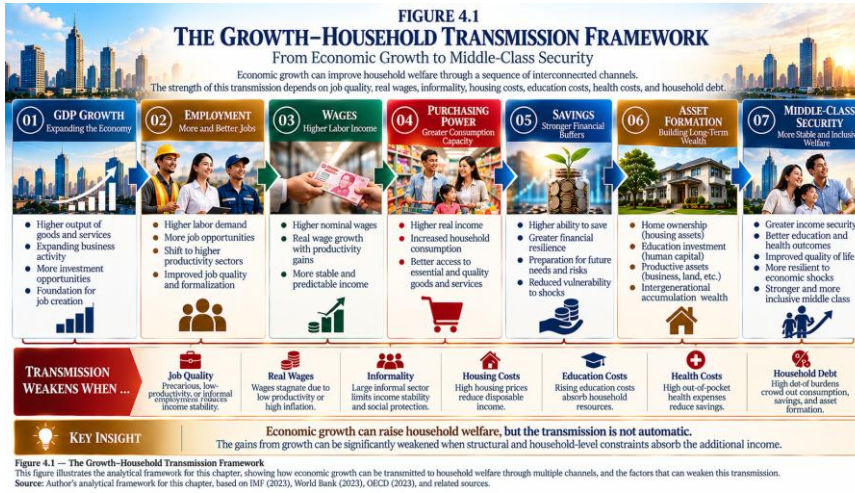


Figure 4.1 — The Growth–Household Transmission Framework
This figure illustrates the analytical framework for this chapter, showing how economic growth can be transmitted to household welfare through multiple channels, and the factors that can weaken this transmission.
Source: Author's analytical framework for this chapter, based on IMF (2023), World Bank (2023), OECD (2023), and related sources.

Figure 4.1 — THE GROWTH–HOUSEHOLD TRANSMISSION FRAMEWORK

CHAPTER 5

PRODUCTIVITY, HUMAN CAPITAL & REGIONAL GAPS

The Engine Beneath the Growth Number

5.1. Productivity Is the Question Beneath Growth

The previous chapters asked two connected questions. First, is Indonesia growing fast enough? Second, is that growth reaching households through purchasing power, employment, wages, and middle-class security?

Chapter 5 moves one level deeper.

The question is no longer simply how much Indonesia produces. It is how much value the economy can create with the people, capital, technology, institutions, and natural resources it already possesses—and how widely that capacity can be shared across regions and generations.

That is the productivity question.

Productivity is easy to overlook because it rarely arrives as a headline. GDP growth does. Inflation does. The exchange rate does. A new investment project does. But over long periods, productivity determines whether an economy can raise living standards without relying indefinitely on more workers, more land, more capital, or higher commodity prices.

This makes productivity central to the economic question posed by this book. Indonesia is not being tested only on whether it can avoid collapse. It is being tested on whether it can transform.

5.2. Productivity: The Hidden Engine

At its simplest, productivity asks how much output is generated from a given amount of input.

Labor productivity measures output per worker or per hour worked. Capital productivity asks how effectively investment creates output. Total factor productivity captures improvements that cannot be explained simply by adding more labor and capital.

The distinction matters because growth can come from two very different sources.

An economy can grow because it uses more inputs. More people enter the labor force. More factories are built. More roads are constructed. More machines are purchased. More land and natural resources are brought into production.

Or it can grow because the economy becomes better at combining those inputs.

The second process is harder to achieve—and more important for sustained prosperity.

A country that depends mainly on adding inputs eventually encounters limits. The working-age population cannot expand forever. Capital must be financed. Natural resources are finite. Infrastructure has diminishing returns if complementary institutions and skills do not improve.

Productivity therefore sits beneath the arithmetic of long-run development.

Growth = more inputs + better use of inputs.

The second component is the part that determines whether growth can remain strong as the economy becomes larger.

5.3. Indonesia's Productivity Challenge

Indonesia has achieved substantial economic transformation, but the productivity challenge remains significant. World Bank analysis has highlighted weaker productivity dynamics, including slower total factor productivity growth and declining labor productivity during parts of the past decade. In its 2024 Indonesia Economic Prospects, the World Bank reported that labor productivity fell from about US$7,530 per worker in 2015 to about US$5,336 in 2023 when measured in the report's comparable dollar terms. It also linked weaker potential growth to slower labor-input growth, human-capital constraints, and weaker productivity dynamics (World Bank, 2024).

These figures should not be read as evidence that the Indonesian economy has stopped developing. They point instead to a structural question: can the economy move from growth driven heavily by factor accumulation toward growth increasingly driven by productivity?

The answer matters for the country's high-income ambition.

Indonesia became an upper-middle-income economy in 2023. World Bank analysis has argued that reaching high-income status by 2045 will require faster and more productive growth, stronger job creation, and reforms that improve competition, business conditions, skills, and the diffusion of knowledge (World Bank, 2025).

The challenge is therefore not simply to grow.

It is to grow better.

5.4. The Mathematics of Prosperity

The mathematics of compounding makes productivity a national development issue rather than an abstract statistical concept.

At a constant 5 percent annual growth rate, an economy roughly doubles in a little over fourteen years. At 6 percent, the doubling period is shorter. The difference between one percentage point may appear modest in a single year, but over decades it creates a substantial divergence in output and income.

Yet the arithmetic becomes meaningful only when growth is sustainable.

If higher growth depends on unsustainable borrowing, temporary commodity prices, one-off construction cycles, or the rapid expansion of inputs without corresponding improvements in efficiency, the apparent acceleration may not persist.

Productivity changes the equation because it expands what the same economic system can produce.

A more productive worker can generate greater value. A more capable firm can produce better goods at lower cost. A better-connected city can match workers and firms more efficiently. A stronger education system can improve the quality of the labor force. Better regulation can reduce resources wasted on unnecessary transactions.

The long-run objective is therefore not simply a larger economy.

It is a more capable economy.

5.5. The 2025 Productivity Signal

The latest national labor-productivity data provide an important signal. BPS reported real GDP per worker growth of 3.75 percent in 2025, although the agency notes that the 2025 figures are very preliminary and that changes in the treatment of newly formed provinces affect some regional comparisons (BPS, 2026).

The national figure conceals considerable variation.

For example, BPS reported labor-productivity growth of 6.64 percent in the Riau Islands, 6.14 percent in Banten, 5.56 percent in Southeast Sulawesi, and 4.93 percent in West Java. Other provinces recorded much lower rates, including 0.16 percent in West Sumatra and negative growth in West Sulawesi. Several newly established provinces showed unusually large movements, reinforcing the need for caution when comparing regional data across years (BPS, 2026).

The lesson is not that one province is permanently productive and another permanently unproductive.

The lesson is that Indonesia does not have one productivity story.

It has many.

Regional productivity reflects industrial structure, infrastructure, human capital, urbanization, natural resources, firm capabilities, connectivity, and the statistical effects of economic restructuring. National policy therefore has to recognize both common constraints and regional differences.

5.6. The Productivity Gap Between Sectors

The regional divide is only part of the story. Indonesia also faces a large productivity gap across economic activities.

World Bank analysis in 2025 found that a large majority of workers were concentrated in activities with relatively low value added per worker. About 69 percent of workers were in activities generating less than IDR 8 million of value added per worker per month, while only

around 10 percent were in activities above IDR 24 million per worker per month (World Bank, 2025).

This distribution matters because an economy can contain highly productive sectors without making the majority of workers highly productive.

Extractive industries illustrate the point. Resource-intensive sectors can generate a large share of GDP with relatively few workers. That can raise national output while producing fewer employment opportunities than labor-intensive, higher-value manufacturing and modern services.

The issue is therefore not whether Indonesia has productive sectors.

It does.

The deeper issue is whether productivity gains can diffuse beyond a relatively narrow part of the economy.

That is the structural-transformation challenge.

5.7. Structural Transformation

Development is partly the movement of workers and capital from lower-productivity activities toward higher-productivity activities.

Historically, this process has involved shifts from subsistence agriculture toward manufacturing, from informal micro-enterprises toward more productive firms, and from routine services toward higher-value professional, digital, and knowledge-intensive activities.

But structural transformation does not happen automatically.

Workers need skills that match emerging jobs. Firms need access to finance, technology, infrastructure, and markets. Cities need housing and transport systems that allow people to move toward opportunity. Regulations must allow productive firms to expand. Competition must prevent inefficient firms from being protected indefinitely.

Without these conditions, workers can move geographically without moving economically.

They can leave farms for cities but remain in low-productivity informal services.

They can obtain education without finding jobs that use their skills.

They can gain digital access without gaining the capabilities required to turn connectivity into income.

Transformation therefore requires more than movement.

It requires movement into higher-value economic activity.

5.8. The Low-Productivity Trap

A low-productivity economy can become trapped by a self-reinforcing cycle.

Low productivity produces low wages. Low wages constrain household savings. Limited savings constrain investment in skills, health, and productive assets. Weak human capital limits firm productivity. Low firm productivity reduces the demand for high-skilled labor. The resulting shortage of productive jobs reinforces the original structure.

This is not a deterministic law. Economies can escape it.

But escape requires coordinated improvements.

The World Bank has emphasized the importance of better business conditions, competition, skills, labor-market information, lifelong learning, and digital capabilities in improving the quality of jobs and productivity in Indonesia (World Bank, 2025).

The policy challenge is to create a system in which productivity improvements reinforce one another rather than remain isolated successes.

5.9. Firms Matter More Than the Average

Productivity is ultimately created inside organizations.

National averages can hide enormous differences between firms operating in the same sector. Some firms adopt new technologies, train workers, improve management practices, integrate into export markets, and invest in research or process improvements. Others remain small, informal, and constrained by limited access to finance and knowledge.

This firm-level gap matters because productivity growth depends partly on the ability of productive firms to expand and less productive firms to improve, restructure, or exit.

The process is often described as reallocation.

Capital and labor move toward firms that can use them more effectively.

When reallocation works, productivity can rise even without a dramatic technological breakthrough. When reallocation is blocked, resources can remain locked in low-productivity uses.

That makes the business environment a productivity policy.

Permits, competition rules, access to finance, logistics, digital infrastructure, taxation, bankruptcy procedures, and labor-market institutions can all influence whether productive firms scale.

5.10. Competition as a Productivity Mechanism

Competition is not simply a consumer-protection principle. It can also be a productivity mechanism.

When firms face meaningful competition, they have stronger incentives to reduce costs, improve quality, innovate, and respond to changing consumer demand. When markets are insulated from competition, the incentives to improve can weaken.

World Bank research on Indonesia has identified market power and regulatory barriers among the structural constraints that can limit productivity and the diffusion of know-how (World Bank, 2025).

This does not imply that every regulation is harmful or that every large firm is inefficient.

The relevant question is more precise:

Does the institutional environment allow productive firms to enter, compete, grow, and innovate?

If the answer is yes, productivity gains can spread.

If the answer is no, the economy may continue to grow while leaving substantial productive potential unused.

5.11. Human Capital: The Other Side of Productivity

Productivity is not produced by machines alone.

A machine can be imported. A factory can be financed. Software can be purchased. But the ability to use technology effectively depends on people.

Human capital includes health, knowledge, skills, experience, and the capabilities that allow individuals to participate productively in the economy. The World Bank's 2026 Human Capital Report emphasizes that human capital is a foundation for growth and poverty reduction and that progress can slow when countries fail to convert education, health, and skills into productive opportunities (World Bank, 2026d).

This creates a simple chain:

Health → Learning → Skills → Employment → Productivity → Income.

Break one link and the return from the others can weaken.

A child who is healthy but receives poor foundational learning may not acquire the skills required for productive employment. A well-educated graduate may struggle if the labor market does not generate jobs matching those skills. A skilled worker may remain underproductive if firms lack the technology and management practices necessary to use that skill.

Human capital is therefore both an individual asset and a system-level capability.

5.12. Human Capital Is Not Just Education

Education matters, but years of schooling alone are not enough.

The relevant question is what people can actually do.

Can workers solve problems? Use digital tools? Communicate? Manage teams? Operate modern equipment? Analyze data? Adapt to new technologies? Move between occupations when industries change?

These capabilities determine whether education translates into productivity.

The distinction becomes increasingly important as technology changes the composition of work. Routine tasks can be automated or reorganized. New occupations emerge. Existing occupations acquire new digital components.

A productive education system must therefore support both foundational capabilities and continuous learning.

This is why the school-to-work transition matters.

If young people spend years in education but encounter weak pathways into productive employment, the economy loses part of the potential return on its human-capital investment.

The problem is not simply unemployment.

It is underutilization of capability.

5.13. The Skills Mismatch

Indonesia's labor market contains a persistent mismatch between the skills people possess and the skills productive firms need.

World Bank analysis has pointed to skills mismatches, weak labor-market information, and the need for lifelong learning and digital upskilling as part of a strategy for stronger productivity and better jobs (World Bank, 2025).

This matters because the cost of mismatch is paid by both sides.

Workers may accept jobs below their capabilities. Firms may struggle to recruit the skills they require. Training investments may produce weak returns. Productivity growth slows.

A more dynamic labor market requires better information.

Workers need clearer signals about which skills are in demand. Educational institutions need feedback from employers. Firms need incentives to train. Government needs labor-market data that can identify emerging shortages before they become structural constraints.

The objective is not to predict every future job.

It is to make the economy better at adapting when jobs change.

5.14. The Geography of Human Capital

Human capital is unevenly distributed across Indonesia because opportunity is unevenly distributed.

The geography of education, health, firms, infrastructure, universities, digital connectivity, and high-productivity jobs creates different economic possibilities across regions.

A talented young person in a major metropolitan area may have access to universities, professional networks, technology firms, financial services, and specialized employers that are unavailable in a remote region.

This creates a cumulative advantage.

Opportunity attracts talent. Talent attracts firms. Firms attract investment. Investment supports infrastructure. Infrastructure improves access. The cycle reinforces itself.

The opposite can also occur.

Regions with weak connectivity and limited high-productivity firms may lose their most mobile workers. The resulting shortage of skills can make it harder to attract productive investment.

Regional development policy therefore has to be understood partly as a human-capital policy.

5.15. Agglomeration: Why Cities Matter

Cities are not simply places where people live. They are systems for matching people, firms, infrastructure, knowledge, and markets.

Economic geography calls this agglomeration.

When productive activities cluster, firms can access specialized suppliers and workers. Workers can move between employers. Knowledge can spread through networks. Infrastructure can be used more intensively. New firms can emerge around existing capabilities.

But agglomeration also has costs.

Housing can become expensive. Congestion can reduce productivity. Pollution can increase. Infrastructure can become overloaded. Informal settlements can expand when formal housing supply is inadequate.

The policy challenge is therefore not simply to encourage urbanization.

It is to make urbanization productive and inclusive.

That requires transport, housing, sanitation, digital connectivity, public services, and land-use institutions that allow cities to absorb economic opportunity without pricing workers out of it.

5.16. Regional Gaps Are Not Only About Income

Regional inequality is often measured through income or GDP per capita.

Those measures are important, but incomplete.

Two regions with similar income levels can have very different productive foundations. One may have diversified manufacturing, universities, digital infrastructure, and competitive firms. Another may depend heavily on commodities and public spending.

The first may possess a broader base for future growth.

The second may be more exposed to external price cycles.

This is why regional analysis should examine not only output but also the underlying capacity to generate output.

A regional productivity dashboard should therefore include labor productivity, firm density, human-capital indicators, infrastructure quality, digital access, sectoral diversification, investment, and employment quality.

The objective is to identify where future capacity is being built—and where current output may conceal structural vulnerability.

5.17. The Resource-Rich Paradox

Natural resources can accelerate development.

They can also create a difficult policy paradox.

A resource-rich region may generate substantial GDP with relatively few workers because extraction is capital intensive. Fiscal revenues can increase. Investment can surge. Infrastructure can improve.

But resource wealth does not automatically create a broad ecosystem of productive jobs.

If local supplier networks remain weak, human-capital development is limited, and downstream processing generates little local capability, the economy may capture only part of the potential value chain.

This is why downstreaming is not simply a matter of processing commodities domestically.

The deeper question is whether downstreaming builds capabilities.

Does it create competitive firms? Develop skilled workers? Transfer technology? Build supplier networks? Increase domestic research and engineering capacity? Diversify exports?

If the answer is yes, natural resources can become a platform for structural transformation.

If not, the economy may remain dependent on extraction while appearing diversified on the surface.

5.18. From Extraction to Capability

The strategic objective should therefore be to convert resource endowments into capabilities.

Oil, gas, minerals, plantations, fisheries, and other natural assets are stocks of economic value. Capability is a flow of future productive potential.

A country that extracts a mineral can earn revenue.

A country that also develops processing technology, engineering services, skilled workers, domestic suppliers, and export-oriented manufacturing captures a broader development effect.

This distinction is central to the productivity question.

Natural resources can finance transformation.

But they cannot substitute for transformation.

For Indonesia, the challenge is to connect resource-based growth with human capital, manufacturing capability, services, technology, and competitive firms.

5.19. Digitalization and the Productivity Frontier

Digital technology changes the productivity frontier because it lowers the cost of information, coordination, payments, and market access.

For a small firm, digital payments can reduce transaction frictions. E-commerce can expand market reach. Cloud tools can reduce technology costs. Data systems can improve inventory management. Digital platforms can connect workers and customers.

But digitalization is not automatically productivity-enhancing.

Technology without skills can produce limited returns. Connectivity without reliable institutions can create new forms of exclusion. Digital adoption without organizational change can simply digitize inefficient processes.

The productivity effect therefore depends on complementary capabilities.

Infrastructure + Skills + Management + Competition + Trust.

When these elements reinforce one another, digitalization can accelerate productivity diffusion.

When they do not, the technology may remain concentrated among already-productive firms.

5.20. Artificial Intelligence and the New Productivity Question

Artificial intelligence introduces a new dimension to the productivity debate.

The World Bank's 2026 World Development Report argues that AI is transforming work, productivity, and economic opportunity, while emphasizing the importance of digital connectivity and skills for countries seeking to benefit from the technology (World Bank, 2026e).

For Indonesia, the key question is not whether AI will exist.

It is whether Indonesian workers and firms will be able to use it productively.

AI can complement workers who possess strong analytical and professional capabilities. It can also automate some routine tasks. The distribution of gains will therefore depend partly on skills, firm organization, access to computing and data, and the ability of institutions to adapt.

This creates both an opportunity and a risk.

If AI diffuses broadly, productivity can rise.

If it remains concentrated in a small group of firms and highly skilled workers, productivity gains may widen existing divides.

The policy challenge is to increase adoption while expanding the capabilities required to use the technology well.

5.21. Productivity and the Middle Class

The connection between productivity and the middle class is direct.

Productivity raises the value created by workers and firms. Higher value creation can support higher wages. Higher wages can strengthen household consumption, savings, and investment in education. A stronger middle class can then create demand for better products and services.

This creates a reinforcing chain:

Productivity → Income → Consumption → Investment → Productivity.

But the chain can break.

If productivity gains are concentrated among capital owners or a narrow group of workers, average GDP can rise without broad improvements in household security. If productivity increases while labor institutions and skills systems fail to support worker mobility, the distribution of gains may become uneven.

This is why Chapter 4's middle-class question and Chapter 5's productivity question are inseparable.

A productive economy is not merely one that produces more.

It is one that creates pathways for more people to participate in higher-value activity.

5.22. The Productivity–Fiscal Connection

Productivity also affects the state.

Higher productivity can increase incomes, profits, consumption, investment, and ultimately the tax base. A stronger productive economy can therefore give government greater capacity to finance public services and infrastructure.

The relationship can be represented as:

Productivity → Income → Consumption & Investment → Tax Base → Fiscal Capacity → Productivity.

This is one of the most important long-term economic loops in the book.

A country with weak productivity may struggle to raise revenue without increasing tax rates or relying on a narrow set of taxpayers and sectors.

A country with stronger productivity has a broader economic base from which public revenue can be generated.

Fiscal capacity is therefore partly an outcome of productive capacity.

5.23. The Productivity–Fiscal Trap

The reverse loop is equally important.

Low productivity can produce low incomes and a narrow tax base. A narrow tax base constrains public investment. Weak public investment can limit infrastructure, education, health, and digital capacity. Those constraints can reduce productivity further.

The result is a productivity–fiscal trap.

This does not mean government spending is always productive or that higher taxes automatically solve the problem.

Public spending has to create capabilities.

A poorly targeted subsidy can consume fiscal space without improving productivity. An inefficient infrastructure project can absorb capital without reducing logistics costs. Education spending can produce weak returns if learning outcomes remain poor.

The question is therefore not simply how much the state spends.

It is whether public resources expand future productive capacity.

5.24. Human Capital and Intergenerational Mobility

Productivity is also an intergenerational issue.

Children born into households with better health, education, nutrition, networks, and financial security often have greater access to productive opportunities. Children in economically insecure households may face constraints that reduce their ability to accumulate human capital.

This makes human capital policy part of the country's mobility system.

The objective is not equality of outcomes.

It is greater equality of opportunity to build productive capabilities.

That requires foundational learning, health, nutrition, quality schooling, skills development, and pathways into productive employment.

When those systems work, economic growth can become more self-reinforcing across generations.

When they fail, economic advantage can become increasingly inherited.

5.25. The Regional Human-Capital Divide

The same logic applies across regions.

A region with strong schools but few productive firms may export its educated workers.

A region with strong firms but weak local skills may import workers from elsewhere.

A region with neither may become dependent on public spending or low-productivity informal activity.

The policy challenge is therefore coordination.

Human-capital investment should be linked to regional economic strategies.

If a region is developing manufacturing, its education and training system should reflect manufacturing skills. If a region is becoming a tourism hub, skills in hospitality, digital marketing, logistics, and language become relevant. If a region is building an energy or mineral cluster, engineering, technical, environmental, and supply-chain capabilities matter.

This is the difference between generic human-capital policy and place-based capability building.

5.26. The Four-Layer Productivity Model

The evidence suggests that productivity should be understood through four interacting layers.

People.
Skills, health, education, experience, adaptability, and labor mobility.

Firms.
Technology, management, finance, innovation, competition, and the ability to scale.

Places.
Infrastructure, cities, connectivity, regional specialization, housing, and access to markets.

Rules.
Regulation, taxation, competition policy, institutions, property rights, public-sector capability, and the predictability of economic governance.

These layers are complementary.

A skilled worker in a low-productivity firm may not realize his or her potential. A productive firm in a poorly connected region may face high costs. A well-connected city with weak human capital may struggle to attract advanced industries. Excellent workers and firms can still be constrained by unpredictable rules.

Productivity is therefore a system property.

It cannot be created by a single ministry or a single reform.

5.27. A Productivity Stress Test

A useful national productivity stress test should ask seven questions.

First, Labor Productivity: Is output per worker rising sustainably?

Second, Firm Productivity: Are productive firms expanding and diffusing better practices?

Third, Human Capital: Are health, learning, skills, and experience improving?

Fourth, Technology: Are digital and emerging technologies spreading beyond leading firms?

Fifth, Regional Capacity: Are regions developing diversified and productive economic bases?

Sixth, Competition: Can new and productive firms enter, compete, and scale?

Seventh, Institutional Quality: Do rules support investment, innovation, and productive reallocation?

A weakness in one area does not prove economic failure.

But weaknesses across several layers can reduce potential growth and make the economy more vulnerable to shocks.

This is the difference between a cyclical slowdown and a structural productivity problem.

5.28. The Productivity Paradox

Indonesia can therefore face a paradox similar to the one identified in earlier chapters.

The economy can remain resilient while its transformation remains incomplete.

GDP can continue to grow around five percent.

Employment can continue to expand.

Investment can continue to arrive.

Digital adoption can continue to increase.

Yet productivity can still be insufficient to deliver the pace of convergence required for high-income status.

That is not collapse.

It is a transformation gap.

And a transformation gap can persist for years without producing a dramatic crisis. Its costs appear gradually—in slower wage growth, weaker firm upgrading, regional divergence, limited fiscal capacity, and missed opportunities for younger generations.

This is why productivity deserves attention before crisis becomes visible.

5.29. The High-Income Test

The high-income test is therefore more demanding than the growth test.

The growth test asks:

Is GDP increasing?

The productivity test asks:

Is the economy becoming more capable?

The human-capital test asks:

Are people becoming more capable of creating value?

The regional test asks:

Is capability spreading geographically?

The institutional test asks:

Can productive activity scale?

For Indonesia's 2045 ambition, these questions matter because a larger economy is not automatically a high-income economy.

High-income status requires sustained productivity, strong institutions, productive firms, human capital, and broad access to opportunity.

The path is therefore not simply:

Growth → High Income.

It is closer to:

Growth → Productivity → Better Jobs → Higher Incomes → Stronger Human Capital & Demand → Greater Fiscal Capacity → Higher Productivity.

5.30. From Regional Gaps to National Potential

Regional differences should not be viewed only as inequality to be reduced.

They are also unused potential.

A region with low productivity may contain workers, entrepreneurs, natural assets, or geographic advantages that have not yet been connected to productive markets.

The development question becomes:

What prevents potential from becoming productivity?

Sometimes the answer is infrastructure.

Sometimes skills.

Sometimes finance.

Sometimes market access.

Sometimes regulation.

Sometimes geography.

Often it is a combination.

This reframing matters because regional policy should not only redistribute income after production has occurred. It should also expand the capacity to produce.

That is the difference between compensating for regional gaps and transforming regional potential.

5.31. The Productivity Question for the Prabowo Era

For the Prabowo administration, productivity is one of the underlying tests of the economic agenda.

Industrial policy, downstreaming, infrastructure, food and energy programs, digitalization, human-capital investment, and efforts to mobilize private investment can all influence productivity.

But the policy test is not the size of the program.

It is the productive capability created by the program.

A successful investment should reduce costs, increase skills, strengthen firms, expand markets, improve resilience, or raise the value generated by workers and capital.

A successful industrial policy should create competitive capabilities rather than permanent dependence on protection.

A successful human-capital policy should improve learning and employability rather than simply increase years of schooling.

A successful regional policy should build productive ecosystems rather than only distribute spending.

This provides a neutral framework for evaluating the economic agenda: not by political branding, but by measurable changes in productive capacity.

5.32. The Deeper Meaning of Productivity

Productivity is often described as a technical economic variable.

It is more than that.

It is a measure of what an economy can do with what it has.

A country with the same population, land, capital, and natural resources can generate radically different living standards depending on how effectively those resources are combined.

That makes productivity a measure of national capability.

Human capital determines what people can do.

Firms determine how people and technology are organized.

Places determine how efficiently people and firms interact.

Rules determine the incentives within which those interactions occur.

The four layers reinforce one another.

People → Firms → Places → Rules → People.

When the system works, productivity rises.

When the system fragments, potential is lost.

5.33. The Next Question

Indonesia's long-term economic risk may therefore be less dramatic than the word “collapse” suggests.

The deeper risk is insufficient transformation.

An economy can remain stable while becoming too slow to close productivity gaps. It can maintain growth while wages lag behind

expectations. It can attract investment while domestic capabilities remain shallow. It can expand infrastructure while human capital fails to keep pace.

These are not signs of economic breakdown.

They are signs that the quality of growth matters as much as the quantity of growth.

The previous chapters moved from the national growth number to the household.

This chapter moved from the household to the productive system beneath it.

The next chapter moves to the state.

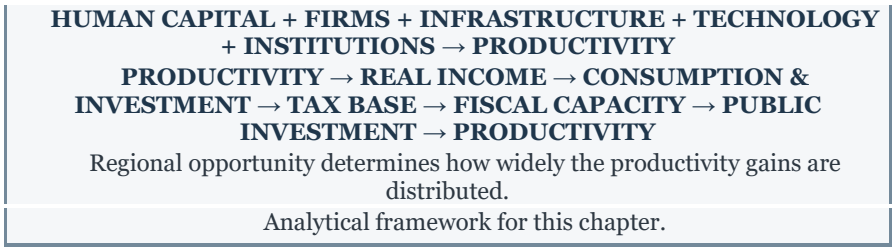
Growth creates resources.
Households create demand.
Productivity creates capacity.
But the state must finance the transformation.

That raises the next question:

How much can the Indonesian government spend, invest, and protect without exhausting its fiscal space?

PART III — THE FISCAL STORM

Figure 5.1 — THE PRODUCTIVITY–INCOME–FISCAL CAPACITY FRAMEWORK



Analytical framework for this chapter.

CHAPTER 6

THE STATE BUDGET UNDER PRESSURE

How Much Can the State Finance?

6.1. The State Behind the Economy

Growth creates resources.

Households create demand.

Productivity creates capacity.

But none of these processes operates independently of the state.

Governments build roads, ports, schools, hospitals, irrigation systems, digital infrastructure, and public institutions. They provide social protection when households are hit by shocks. They finance public goods that markets may underprovide. They collect taxes from economic activity and recycle part of those resources into services and investment.

In Indonesia, the central mechanism through which much of this activity is organized is the Anggaran Pendapatan dan Belanja Negara, or APBN.

The APBN is therefore more than a government spreadsheet.

It is a national allocation mechanism.

It determines how much the state collects, how much it spends, where resources are directed, how deficits are financed, and how much room remains to respond when the next shock arrives.

That makes the APBN central to the question of this book.

If Indonesia is not collapsing, the next question is not whether the government can spend.

It clearly can.

The more difficult question is:

How much can the state spend, invest, protect, and transform without exhausting its fiscal space?

That is the beginning of the fiscal storm.

6.2. The APBN as an Economic Shock Absorber

Fiscal policy has several functions at once.

It allocates resources.

It redistributes income.

It provides public goods.

It stabilizes the economy.

And it can influence long-term growth.

During a downturn, government spending can support demand when private consumption and investment weaken. During periods of inflationary pressure or overheating, fiscal policy can be calibrated to avoid adding excessive demand.

During a structural transformation, the state can finance infrastructure, education, health, research, and other investments that expand productive capacity.

This makes fiscal policy inherently multidimensional.

The government is not choosing between “spending” and “saving” in a household sense.

It is choosing how scarce public resources are allocated across competing objectives.

The difficulty is that every rupiah used for one purpose has an opportunity cost.

More subsidies can mean fewer resources for infrastructure.

More public-sector compensation can mean less room for capital expenditure.

More transfers can support regional services while reducing room for other priorities.

More interest payments can reduce the resources available for development programs.

Fiscal policy is therefore fundamentally a problem of trade-offs.

The quality of those trade-offs determines whether the APBN strengthens or weakens the economy over time.

6.3. Indonesia Entered the Prabowo Era with a Fiscal Inheritance

The Prabowo administration did not begin with an empty fiscal balance sheet.

It inherited a fiscal system shaped by the pandemic, the subsequent normalization of deficits, accumulated debt, changing commodity revenues, tax reforms, and a growing list of public priorities.

The pandemic years were extraordinary.

Indonesia's fiscal deficit reached 6.14 percent of GDP in 2020 and 4.57 percent in 2021 before falling to 2.35 percent in 2022 and 1.61 percent in 2023, according to the Ministry of Finance's APBN documentation. The 2024 deficit was recorded at about 2.30 percent of GDP (Ministry of Finance, 2025).

The return below the statutory three-percent ceiling was important.

But normalization did not mean that fiscal constraints disappeared.

The state had entered a period in which demands on the budget were increasing.

Infrastructure still required financing.

Human-capital investment remained necessary.

Social protection had to remain available.

Food and energy security had become strategic priorities.

Defense spending remained part of the national agenda.

And the government introduced or expanded programs requiring substantial public resources.

The fiscal question therefore changed.

It was no longer primarily:

How does Indonesia return to fiscal normality?

It became:

How does Indonesia use limited fiscal space to finance a larger transformation agenda?

6.4. The 2025 APBN: Expansion Within the Rule

The 2025 APBN was designed as a transition-year budget.

The original budget projected state revenues of approximately Rp3,005.1 trillion and state expenditure of approximately Rp3,621.3 trillion, producing a planned deficit of Rp616.2 trillion, or 2.53 percent of GDP (Ministry of Finance, 2025).

The structure is revealing.

The government planned to spend more than it collected.

That is not unusual.

A fiscal deficit is not automatically evidence of fiscal weakness. Deficits can finance productive public investment and support economic stabilization.

The important questions are:

Why is the government borrowing?

What is the money financing?

How large is the deficit?

How quickly is debt accumulating?

What is happening to the primary balance?

And can the government continue financing itself at reasonable cost?

These questions are more informative than the existence of a deficit alone.

Indonesia's fiscal framework provides an important guardrail: the statutory deficit ceiling remains 3 percent of GDP.

The ceiling does not eliminate fiscal risk.

But it creates an institutional boundary around fiscal expansion.

6.5. When the Budget Becomes More Expansive

The final 2025 outcome illustrates why a budget should not be evaluated only from its original plan.

According to the Ministry of Finance, 2025 state revenue reached approximately Rp2,756.3 trillion, while state expenditure reached approximately Rp3,451.4 trillion. The resulting deficit was Rp695.1 trillion, equivalent to 2.92 percent of GDP (Ministry of Finance, 2026).

The deficit therefore remained below the statutory ceiling, but it was materially larger than the original APBN target of 2.53 percent.

This distinction matters.

A budget can remain within a legal fiscal boundary while simultaneously experiencing increasing pressure.

That is precisely why fiscal analysis should avoid two opposite mistakes.

The first is to treat any deficit as evidence of crisis.

The second is to treat compliance with a deficit ceiling as proof that fiscal conditions are automatically comfortable.

Neither conclusion follows.

Fiscal health is multidimensional.

6.6. The Revenue Problem

Every spending ambition eventually meets the revenue constraint.

The state can finance expenditure through taxation, non-tax revenue, grants, asset transactions, or borrowing.

But borrowing is not a substitute for permanent revenue capacity.

Debt creates future obligations.

Interest must be paid.

Principal eventually has to be refinanced or repaid.

That means the long-run fiscal foundation ultimately depends on the productive economy's capacity to generate taxable income, profits, consumption, and transactions.

Indonesia's revenue challenge is therefore closely connected to the productivity challenge discussed in Chapter 5.

The relationship can be expressed simply:

Productivity → Income → Economic Activity → Tax Base → Fiscal Capacity.

If productivity rises, the potential tax base can broaden.

If productivity stagnates, the government faces a more difficult choice.

It can raise tax rates.

It can improve compliance.

It can reduce exemptions and leakages.

It can broaden the tax base.

Or it can borrow more.

Each option has consequences.

6.7. Tax Revenue and the Narrow Fiscal Base

Indonesia's government revenue remains relatively modest compared with the scale of the economy and the demands placed on public policy.

This does not necessarily mean that Indonesia taxes too little in every category.

It means that the relationship between economic activity and government revenue remains an important structural issue.

A narrow tax base creates vulnerability.

When commodity prices are strong, non-tax revenue can improve.

When commodity prices weaken, that support can fade.

When consumption is resilient, consumption-related tax receipts can help.

When household purchasing power weakens, revenue growth can become more difficult.

When corporate profits rise, income and corporate tax receipts can strengthen.

When profitability falls, revenue can soften.

The result is a fiscal system partly exposed to the economic cycle.

A more resilient fiscal system requires revenue sources that are broad, predictable, and administratively efficient.

The World Bank has emphasized revenue mobilization alongside better spending quality as important for preserving fiscal space and financing priority investments and social protection (World Bank, 2026a).

6.8. The Tax Administration Question

Fiscal reform is not only about tax rates.

It is also about administration.

A tax system can have theoretically adequate rates while collecting less than its potential because of informality, weak compliance, exemptions, limited information, or administrative inefficiencies.

Indonesia has therefore continued efforts to modernize tax administration.

The Ministry of Finance and international institutions have highlighted the importance of improving the tax system, including through digitalization and the Core Tax Administration System.

The IMF has emphasized revenue mobilization and tax-administration reforms as important components of strengthening Indonesia's fiscal capacity (IMF, 2026a).

This is particularly relevant to the productivity argument.

A modern economy requires a modern state.

The government needs information systems capable of identifying economic activity, reducing compliance costs, detecting inconsistencies, and providing taxpayers with predictable services.

Better administration can strengthen revenue without relying exclusively on higher statutory tax rates.

6.9. Spending is not the Enemy

A common mistake in fiscal debates is to treat government spending as inherently problematic.

That is too simplistic.

Public spending can create enormous economic value.

A road that lowers logistics costs can raise productivity.

A functioning school can build human capital.

A hospital can protect household balance sheets.

Reliable electricity can support firms.

Digital infrastructure can reduce transaction costs.

Social protection can prevent temporary shocks from becoming permanent losses in human capital.

The relevant question is therefore not:

Is government spending high?

It is:

What does government spending produce?

A rupiah spent on productive infrastructure is economically different from a rupiah spent on an ineffective program.

A well-targeted social transfer is different from a poorly targeted subsidy.

A high-quality education investment is different from spending that increases inputs without improving learning.

Fiscal analysis must therefore move from expenditure volume to expenditure quality.

6.10. The Composition of Spending

The APBN contains many categories of expenditure, but their economic effects are not identical.

Government salaries support public administration.

Interest payments fulfill existing obligations.

Subsidies influence prices and household costs.

Social protection protects vulnerable groups.

Transfers to regions support decentralized public services.

Capital expenditure can expand productive capacity.

Public investment can crowd in private investment when infrastructure reduces costs and uncertainty.

This does not mean capital expenditure is automatically superior.

A poorly designed capital project can generate low returns.

Likewise, social spending can generate high long-term returns if it protects nutrition, education, and human capital.

The correct framework is therefore not:

productive spending versus unproductive spending by category.

It is:

spending that produces sufficient economic and social value relative to its fiscal cost versus spending that does not.

That distinction becomes increasingly important as fiscal space narrows.

6.11. The Interest-Burden Problem

Debt does not become costly only when the principal becomes large.

Interest matters.

When debt rises, interest payments can absorb a growing share of government resources.

That creates a mechanical constraint.

Suppose revenue grows slowly while interest obligations rise.

The government must then choose among difficult alternatives:

reduce other spending,

increase revenue,

borrow further,

or allow deficits to widen.

None is costless.

The IMF's 2025 Article IV assessment projected Indonesia's general-government debt at around 41 percent of GDP in 2026 and

emphasized the importance of preserving fiscal space and maintaining credible fiscal rules (IMF, 2026a).

The number itself should not be interpreted in isolation.

Debt sustainability depends on the relationship between debt, interest rates, nominal growth, primary balances, maturity structure, currency composition, investor confidence, and the government's capacity to refinance.

The relevant question is therefore not:

Does Indonesia have debt?

Every modern government does.

The relevant question is:

Is the debt trajectory compatible with the economy's capacity to service it?

6.12. The Primary Balance

This is where the primary balance becomes important.

The primary balance measures government revenue minus expenditure excluding interest payments.

If the primary balance is negative, the government is spending more than it collects even before paying interest.

That does not automatically mean unsustainability.

But persistent primary deficits can make debt dynamics more difficult, particularly if interest costs are high relative to economic growth.

The IMF projected a general-government primary deficit of about 0.5 percent of GDP in 2025 and 0.6 percent in 2026 under its baseline projections (IMF, 2026a).

This illustrates an important principle.

Fiscal sustainability is not determined by the headline deficit alone.

It is a dynamic relationship between:

Growth + Interest Rates + Primary Balance + Debt.

When growth is strong and borrowing costs are contained, a given debt level may be easier to manage.

When growth weakens and financing costs rise, the same debt stock can become more burdensome.

6.13. Fiscal Space is a Stock of Options

Fiscal space is often described as if it were a single number.

It is better understood as a stock of options.

A government with fiscal space can respond to a crisis.

It can provide temporary transfers.

It can support essential services.

It can accelerate infrastructure investment.

It can stabilize affected sectors.

A government without fiscal space may still have legal authority to spend, but each additional intervention carries greater financing and credibility costs.

This is why fiscal space should be preserved before a crisis rather than created after one begins.

The World Bank's 2026 Indonesia Economic Prospects emphasized the importance of strengthening revenue mobilization, improving spending quality, and better targeting public support to preserve fiscal space for priority investments and social protection (World Bank, 2026a).

Fiscal space is therefore a form of resilience.

6.14. The 2026 Pressure Point

The fiscal story became more demanding in early 2026.

The World Bank reported that the preliminary 2025 deficit stood at about 2.9 percent of GDP, just below the statutory threshold. In the first five months of 2026, the fiscal deficit had reached 0.7 percent of GDP, while expenditure was growing substantially faster than revenue. The World Bank attributed part of the spending acceleration to the MBG program, energy-compensation payments, front-loaded expenditure, and rising subsidy pressures (World Bank, 2026a).

At the same time, revenues were improving.

Tax revenue increased strongly in the first five months of 2026, supported partly by improvements in the tax administration system and lower tax refunds. Non-tax revenue also increased (World Bank, 2026a).

This produces a more complicated picture than "fiscal deterioration."

Revenue was improving.

But expenditure was increasing faster.

The result was tighter fiscal space.

That distinction matters.

A government can have improving revenue and still face fiscal pressure if spending commitments grow even faster.

6.15. The Spending Multiplier Question

Government spending can stimulate the economy.

But the size of the effect depends on what the government spends, when it spends, and the conditions of the economy.

Infrastructure investment can generate demand during construction and productive capacity afterward.

Transfers can support consumption quickly.

Food programs can affect household welfare and demand.

Energy subsidies can lower measured consumer prices but can also consume substantial fiscal resources.

The economic effect therefore depends on the program's design.

A temporary, targeted intervention during weak demand can have a different effect from a permanent expenditure commitment.

This distinction becomes critical.

Temporary fiscal support can stabilize the economy.

Permanent expenditure creates a structural budget obligation.

A state budget becomes more constrained when temporary programs gradually become politically or institutionally difficult to reverse.

6.16. The Permanence Problem

One of the most important fiscal questions is whether new spending commitments are temporary or permanent.

A government may introduce a program during a period of economic stress.

If the program improves outcomes, it may be extended.

If beneficiaries become dependent on it, withdrawal becomes politically difficult.

Over time, what began as countercyclical policy can become structural expenditure.

This is not necessarily bad.

Some temporary programs should become permanent if they generate high social returns.

But permanence changes the fiscal equation.

A permanent program must have a permanent funding source.

Otherwise, the government is effectively borrowing against future fiscal capacity.

This is why fiscal policy requires not only a spending decision but also a financing strategy.

6.17. The APBN and the Transformation Agenda

The Prabowo-era fiscal challenge is particularly important because the government has a broad development agenda.

Food security.

Energy security.

Human capital.

Infrastructure.

Industrial development.

Social protection.

Digital transformation.

Defense.

Public health.

Nutrition.

Regional development.

These objectives can each have economic justification.

The problem is simultaneity.

The state cannot finance every priority at maximum scale simultaneously without facing trade-offs.

This creates the central fiscal question:

Which programs generate the largest increase in future national capability per rupiah of public resources?

That is a productivity question expressed through the budget.

6.18. From Budget Size to Budget Quality

The size of the APBN can attract attention because it provides a simple headline.

But fiscal capacity is not equivalent to budget size.

A larger budget can coexist with weak outcomes.

A smaller budget can produce stronger outcomes if resources are allocated efficiently and institutions perform well.

The relevant fiscal chain is:

Revenue → Allocation → Implementation → Output → Outcome → Future Capacity.

Each link matters.

Revenue without effective allocation is insufficient.

Allocation without implementation is insufficient.

Implementation without measurable outcomes is insufficient.

Outcomes without sustainability are insufficient.

The final test is whether today's fiscal resources improve tomorrow's economic capacity.

6.19. Fiscal Policy and Productivity

This brings Chapter 6 directly back to Chapter 5.

Productivity creates fiscal capacity.

But fiscal capacity can also create productivity.

Public investment in infrastructure can reduce business costs.

Education can raise worker capability.

Health spending can improve labor productivity.

Digital infrastructure can expand market access.

Research and innovation policy can increase technological capability.

Therefore:

Productivity → Fiscal Capacity → Public Investment → Productivity.

This is a positive fiscal-development loop.

But the opposite is also possible:

Low Productivity → Weak Revenue → Limited Fiscal Space → Underinvestment → Low Productivity.

This is the fiscal-productivity trap.

Indonesia's long-term challenge is to strengthen the first loop while avoiding the second.

6.20. The State Cannot Finance Everything

There is another implication.

The government does not have to finance every investment directly.

A productive fiscal strategy can use public resources to mobilize private capital.

The state can provide infrastructure.

It can improve regulation.

It can create credible project pipelines.

It can strengthen public-private partnerships.

It can reduce transaction costs.

It can improve competition.

It can provide targeted risk-sharing where justified.

The objective is not to replace private capital.

It is to create conditions in which private capital can finance productive activity.

The World Bank's recent Indonesia analysis has emphasized the role of private investment and business-enabling reforms in sustaining growth and improving productivity (World Bank, 2026a).

This matters because fiscal space is finite.

Private capital is not unlimited either.

But the combination can be more powerful than either alone.

6.21. Fiscal Risks Beyond the Deficit

The headline deficit does not capture every fiscal risk.

Governments also face contingent liabilities.

These can arise from guarantees, public enterprises, infrastructure projects, financial-sector exposures, and other commitments that may require government support under adverse conditions.

Quasi-fiscal activities can also complicate the picture.

The IMF has emphasized the importance of strong safeguards and oversight of quasi-fiscal operations while maintaining fiscal credibility (IMF, 2025).

This does not mean that every off-budget or state-linked activity is problematic.

It means that the fiscal authority needs a comprehensive view of potential obligations.

A government can appear fiscally comfortable under a narrow budget definition while carrying substantial risks elsewhere.

Transparency therefore becomes part of fiscal sustainability.

6.22. The Fiscal Credibility Channel

Fiscal policy affects the economy not only through spending and taxation.

It also affects expectations.

Investors care about whether the government can finance itself predictably.

Businesses care about whether taxes and regulations are stable.

Households care about inflation, employment, and future income.

Financial markets care about debt issuance, interest rates, and the credibility of fiscal institutions.

If fiscal credibility is strong, government borrowing can remain relatively predictable.

If credibility weakens, financing costs can rise.

Higher financing costs can then make fiscal management more difficult.

This creates another feedback loop:

Fiscal Credibility → Financing Conditions → Fiscal Cost → Fiscal Space.

The objective is therefore not simply to keep deficits below a legal ceiling.

It is to maintain confidence that fiscal policy remains sustainable and predictable.

6.23. The Fiscal Stress Test

The APBN can be evaluated through a seven-part fiscal stress test.

Revenue resilience.
Can government revenue withstand weaker growth or commodity prices?

Expenditure flexibility.
How much spending can be adjusted without damaging essential services?

Debt dynamics.
Is debt growing faster than the economy's capacity to support it?

Interest burden.
How much revenue is absorbed by debt-service costs?

Primary balance.
Is the government generating sufficient resources before interest payments?

Contingent liabilities.
What risks sit outside the headline deficit?

Shock capacity.
Can the government respond to a major external or domestic shock without breaching its fiscal guardrails?

A country can pass some tests and fail others.

That is why fiscal analysis should not produce a single simplistic label.

6.24. Stress is not Collapse

The evidence available through 2026 points to fiscal pressure, but pressure should not automatically be translated into fiscal collapse.

Indonesia's 2025 deficit remained below the statutory three-percent ceiling.

The World Bank described fiscal management as prudent while simultaneously warning that fiscal conditions were tight and that preserving fiscal space remained important (World Bank, 2026a).

The IMF similarly emphasized maintaining the fiscal rule, strengthening revenue mobilization, improving spending efficiency, and preserving room to respond to future shocks (IMF, 2026a).

The correct analytical conclusion is therefore more precise:

Indonesia's fiscal system is under pressure because policy ambitions, spending needs, revenue constraints, and the need to preserve fiscal space are increasingly interacting.

That is a fiscal-management challenge.

It is not, by itself, evidence of fiscal breakdown.

6.25. The Hardest Fiscal Choice

Eventually every government reaches the same constraint.

There are more desirable programs than available resources.

The difficult question is not whether a program sounds valuable.

Many do.

The question is whether the marginal benefit of additional spending is greater than the fiscal cost and the opportunity cost of not spending elsewhere.

This is where public policy becomes an exercise in prioritization.

The state must decide:

Which programs protect households?

Which programs raise productivity?

Which programs reduce future fiscal costs?

Which programs mobilize private investment?

Which programs should be temporary?

Which programs should be permanent?

Which programs can be decentralized?

Which programs can be delivered more efficiently?

And which programs should not be expanded until evidence shows that existing spending is producing results?

A credible fiscal strategy must be able to answer these questions.

6.26. The Fiscal Storm

The metaphor of a fiscal storm should therefore be used carefully.

A storm does not necessarily mean destruction.

It means changing conditions, stronger winds, greater uncertainty, and the need for navigation.

Indonesia's fiscal environment contains several such forces.

Revenue remains structurally constrained.

Spending demands are expanding.

Interest obligations matter.

Development ambitions are large.

Global financing conditions can change.

Commodity prices can move.

Exchange-rate conditions can alter financing costs.

Unexpected shocks can arrive.

At the same time, Indonesia retains important buffers and institutional guardrails.

The fiscal challenge is therefore not simply survival.

It is navigation.

Can the state maintain credibility while financing development?

Can it expand priority programs without allowing permanent commitments to outrun permanent revenues?

Can it improve the quality of spending?

Can it mobilize private capital?

Can it preserve enough fiscal space to respond when the next shock arrives?

These questions determine whether the fiscal storm remains manageable.

6.27. What the APBN Must Ultimately Deliver

The final test of fiscal policy is not the size of the budget.

It is what the budget leaves behind.

Better infrastructure.

Better human capital.

Better health.

More productive firms.

Higher-quality jobs.

Stronger household resilience.

Greater regional connectivity.

A broader tax base.

Higher productivity.

More fiscal capacity.

The ideal fiscal system therefore creates a positive cycle:

Public Resources → Productive Investment → Higher Productivity → Higher Incomes → Broader Tax Base → Greater Fiscal Capacity.

The dangerous cycle is the reverse:

Weak Productivity → Weak Revenue → More Borrowing → Higher Interest Burden → Less Development Spending → Weaker Productivity.

The distance between these two trajectories is the real fiscal question.

6.28. The State Budget Under Pressure

The Indonesian state is not fiscally powerless.

Nor is it fiscally unlimited.

That distinction is essential.

The APBN remains a powerful instrument for stabilization, redistribution, public investment, and development.

But every additional commitment consumes part of the state's future room for maneuver.

The 2025 outcome demonstrated this tension clearly: revenue reached Rp2,756.3 trillion, expenditure Rp3,451.4 trillion, and the deficit reached Rp695.1 trillion, or 2.92 percent of GDP (Ministry of Finance, 2026).

By early 2026, the World Bank was already highlighting the tension between stronger revenue and faster expenditure growth (World Bank, 2026a).

The question is therefore no longer whether Indonesia has fiscal space.

It does.

The question is how quickly that space is being used, how effectively it is being converted into productive capacity, and how much remains available when conditions become less favorable.

That is the essence of fiscal resilience.

And it leads to a deeper question.

If fiscal space is finite, debt is not free, and revenue cannot expand indefinitely, what happens when the government must finance an ambitious development agenda while the economy faces competing demands from households, businesses, regions, and global markets?

The answer takes us from the annual budget to the country's broader debt and deficit dynamics.

6.29. The Next Question

The fiscal story does not end with the deficit.

A deficit is a flow.

Debt is the accumulated stock.

The two are connected, but they are not the same thing.

A government can run a deficit without an immediate crisis.

But persistent deficits add to debt.

Debt creates interest obligations.

Interest obligations influence future budgets.

And future budgets determine how much room the state has to respond to the next shock.

The next chapter therefore asks the question that follows naturally from the APBN:

How much debt can Indonesia carry before fiscal space becomes materially constrained?

Figure 6.1 — THE FISCAL PRESSURE–STATE CAPACITY FRAMEWORK

REVENUE → FISCAL SPACE → PUBLIC SPENDING → SERVICES & INVESTMENT → PRODUCTIVITY → GROWTH → REVENUE

PRESSURE CHANNEL: rigid spending + interest costs + subsidies + shocks + contingent liabilities → narrower fiscal space

The fiscal test is not only how much the state spends, but whether spending expands future productive and revenue capacity.

Analytical framework for this chapter.

CHAPTER 7

DEBT, DEFICIT & FISCAL SPACE

How Much Debt Can Indonesia Carry?

7.1. The Deficit Is a Flow. Debt Is a Stock.

Chapter 6 ended with a simple distinction: the APBN is powerful, but it is not unlimited.

That limitation becomes clearer when the annual deficit is translated into the accumulated stock of public debt.

A deficit is a flow. It measures how much government expenditure exceeds government revenue during a given period.

Debt is a stock. It represents the accumulation of past borrowing that remains outstanding.

The relationship is straightforward:

Deficit → Debt Stock → Interest Burden → Fiscal Space → Shock Capacity.

This chain is at the center of fiscal sustainability.

A country can run a deficit without entering a crisis. It can even increase borrowing to finance productive investment and improve future growth.

But debt creates obligations.

Interest has to be paid.

Maturing securities have to be refinanced or repaid.

Future budgets inherit today's financing decisions.

The question is therefore not whether Indonesia has debt.

It does.

The question is whether the evolution of debt remains compatible with economic growth, interest costs, revenue capacity, primary balances, and investor confidence.

7.2. Debt Is Not the Same as Fiscal Failure

Public discussion often treats debt as a binary condition: low debt means safety, high debt means danger.

Economic analysis is more complicated.

Two countries can have the same debt-to-GDP ratio and face very different fiscal conditions. One may have strong institutions, long debt maturities, a deep domestic investor base, stable nominal growth, and a broad tax base. The other may have weak revenue, high refinancing needs, short maturities, foreign-currency exposure, and fragile market access.

Debt therefore has to be interpreted in context.

Indonesia's fiscal framework provides two important numerical anchors: a statutory deficit ceiling of 3 percent of GDP and a public-debt ceiling of 60 percent of GDP. The IMF considers these rules important anchors for fiscal credibility and policy space (IMF, 2026a).

The existence of a ceiling does not mean that all debt below the ceiling is automatically comfortable.

Nor does crossing a threshold automatically mean that an economy has collapsed.

The purpose of fiscal rules is to constrain risk before it becomes a crisis.

7.3. The Arithmetic of Debt Sustainability

The basic debt equation can be expressed conceptually as:

Debt tomorrow = Debt today + Primary deficit + Interest cost – Growth effect.

In ratio terms, the dynamics depend heavily on the relationship between the interest rate paid on government debt and the nominal growth rate of the economy.

When nominal economic growth is stronger than the effective interest rate, existing debt can become easier to stabilize relative to GDP, provided primary deficits remain controlled.

When interest rates remain above nominal growth for an extended period, debt stabilization becomes more demanding.

This is why debt sustainability cannot be assessed from the debt ratio alone.

It requires a view of:

economic growth,

interest rates,

inflation,

primary balances,

revenue,

expenditure,

maturity structure,

and refinancing conditions.

The arithmetic is mechanical even when the policy choices are political.

7.4. Indonesia's Debt Position

Indonesia entered the 2020s with a significant increase in public borrowing as the government responded to the pandemic.

The fiscal deficit rose sharply during the pandemic period before returning below the three-percent rule.

The IMF's 2026 Article IV assessment put general-government debt at about 40.2 percent of GDP in 2024 and projected it at about 41.3 percent in 2026, with a gradual increase thereafter under its baseline. The World Bank similarly projected public debt to rise gradually toward roughly 42 percent of GDP by 2027 (IMF, 2026; World Bank, 2025).

These levels remain below Indonesia's 60-percent statutory debt ceiling.

That is an important fact.

But it is not the end of the analysis.

The IMF also noted that Indonesia's borrowing costs and debt-service-to-tax ratio are relatively high compared with peers and that

the interest bill represents a substantial share of gross financing needs, reducing fiscal space (IMF, 2026a).

The message is therefore two-sided:

Indonesia's debt burden remains within its formal fiscal guardrails.

But the cost of servicing and refinancing that debt still matters.

7.5. The Pandemic Changed the Starting Point

The pandemic provides the most important recent explanation for the change in Indonesia's fiscal position.

In 2020, extraordinary health and economic measures required a major fiscal response. The deficit reached more than six percent of GDP.

That response was not unusual in the context of a global emergency.

What matters for the post-pandemic period is normalization.

Indonesia successfully returned its fiscal deficit below three percent of GDP. But the stock of debt accumulated during the extraordinary period did not disappear when the annual deficit narrowed.

This is the difference between a flow and a stock.

Returning the deficit to a lower level stabilizes the rate at which debt is accumulating.

It does not automatically return the debt stock to its pre-pandemic level.

That distinction is essential for understanding today's fiscal position.

7.6. The 2025–2026 Fiscal Path

The fiscal path entering 2026 remained expansionary but within the established rule framework.

The IMF estimated the 2025 general-government deficit at about 2.8 percent of GDP and projected around 2.9 percent for 2026 under a more conservative revenue and growth scenario than the government's approved budget. The approved 2026 budget targeted a deficit of 2.7 percent of GDP (IMF, 2026a).

This narrow gap between 2.7, 2.8, and 2.9 percent may appear technical.

It is not.

When a fiscal rule is set at three percent, small changes in revenue or expenditure can materially reduce the remaining room available for unexpected shocks.

That remaining room is fiscal space.

The closer the deficit moves toward the ceiling, the less room exists for a new emergency response unless the government can quickly raise revenue, reduce spending, or accept higher borrowing costs.

7.7. Fiscal Space Is the Real Asset

Fiscal space is sometimes misunderstood as the ability to borrow more.

That is only one part of the concept.

Fiscal space is the government's capacity to provide additional support without undermining debt sustainability or market confidence.

It is therefore an option value.

A government with fiscal space can respond when a natural disaster occurs, when a global recession hits, when commodity prices collapse, or when a financial shock threatens households and firms.

A government with little fiscal space may still respond.

But the response becomes more expensive.

Borrowing costs may rise.

Debt may accumulate faster.

Other programs may have to be cut.

Taxes may have to increase.

The central fiscal objective is therefore not to maximize borrowing capacity.

It is to preserve enough room to act when action becomes necessary.

7.8. The Primary Balance Matters

The primary balance provides another way to examine fiscal sustainability.

It measures revenue minus expenditure before interest payments.

A primary deficit means the government is spending more than it collects before accounting for interest.

A primary surplus means the government is generating resources before interest payments.

Indonesia's recent fiscal position has included primary deficits after the pandemic. The IMF projected a general-government primary deficit of about 0.5 percent of GDP in 2025 and 0.6 percent in 2026 (IMF, 2026a).

Again, the number should not be interpreted mechanically.

A primary deficit can be appropriate when the economy needs temporary support or when high-return public investment is being financed.

The concern arises when primary deficits become persistent while growth is insufficient to offset their effect on debt.

That is when debt dynamics become progressively harder to manage.

7.9. Interest Is the Silent Fiscal Cost

Interest payments differ from many other forms of expenditure.

They do not directly build a road.

They do not educate a child.

They do not provide a health service.

They fulfill an obligation created by earlier borrowing.

That does not make interest expenditure unnecessary. It makes it a reminder that today's fiscal choices become tomorrow's budget commitments.

As debt rises, the interest burden can rise.

If interest rates rise at the same time, the pressure can become stronger.

This creates a fiscal feedback loop:

Higher Debt → Higher Interest Exposure → Less Flexible Spending → Less Fiscal Space.

The IMF has highlighted Indonesia's debt-service-to-tax ratio and borrowing costs as areas that deserve attention even though overall sovereign debt risks remain relatively low (IMF, 2026a).

This is why the cost of debt matters as much as the quantity of debt.

7.10. Domestic Financing Is a Buffer—and a Constraint

Indonesia finances a large share of its public borrowing domestically.

A deep domestic financial market can be an advantage.

It reduces dependence on foreign-currency borrowing and can make refinancing more predictable.

A broad domestic investor base can also strengthen the government's access to funding during periods of global volatility.

But domestic financing is not costless.

Government borrowing competes for financial resources with private borrowers.

If public financing needs become very large, financing conditions for businesses can be affected.

The challenge is therefore to maintain a balance:

Enough government borrowing to finance legitimate fiscal needs.

Enough financial capacity remaining for private investment.

This is one reason fiscal policy and monetary policy cannot be analyzed completely separately.

7.11. The Refinancing Question

Debt sustainability is partly a question of maturity.

A government that must refinance a large volume of debt every year is exposed to changes in interest rates and market sentiment.

A longer maturity structure can reduce immediate refinancing pressure, although it may come with higher upfront interest costs.

A diversified investor base can reduce concentration risk.

A credible debt-management strategy can reduce uncertainty.

The important variable is not simply the total debt stock.

It is also the structure of that debt.

How much matures next year?

At what interest rate?

Held by whom?

In what currency?

Under what market conditions?

These questions become particularly important when global interest rates rise or capital flows become volatile.

7.12. The Currency Dimension

Indonesia has another source of protection in its debt structure: the government has increasingly relied on domestic-currency financing.

This reduces the direct balance-sheet risk associated with a sharp depreciation of the rupiah.

Foreign-currency debt does not automatically create a crisis.

But if a large share of government obligations is denominated in foreign currency, depreciation can increase the domestic-currency value of those obligations.

Domestic-currency borrowing therefore provides an important buffer.

But it does not eliminate market risk.

Domestic investors still respond to inflation, interest rates, economic expectations, and confidence.

Currency resilience and fiscal credibility remain interconnected.

7.13. Gross Financing Needs

Debt sustainability also depends on gross financing needs.

A government does not borrow only to finance a new deficit.

It also borrows to refinance maturing debt.

This means a country can have a moderate deficit while still needing substantial gross financing.

The IMF estimates Indonesia's public gross financing needs at around five to six percent of GDP under its baseline, while noting that interest costs represent a significant portion of those needs (IMF, 2026a).

The World Bank projected gross financing needs to rise toward around seven percent of GDP by 2027 as deficits and debt repayments increase (World Bank, 2025).

This is an important distinction.

The deficit tells us how much additional debt may be required.

Gross financing needs tell us how much financing the government must access during the year.

Market access therefore matters.

7.14. Debt and Growth Are Connected

Debt is easier to manage when the economy grows.

That sounds obvious, but it has a powerful implication.

The strongest way to improve debt sustainability is not always to cut expenditure.

It can also be to raise productive growth.

Higher productivity increases incomes.

Higher incomes expand the tax base.

Higher tax revenue improves fiscal capacity.

Higher fiscal capacity reduces dependence on borrowing.

The relationship is:

Productivity → Revenue Capacity → Debt Sustainability.

This is why the fiscal story cannot be separated from the productivity story of Chapter 5.

A government trying to stabilize debt while allowing productivity to stagnate may face an increasingly difficult task.

A government that raises productivity can improve debt dynamics without relying exclusively on austerity.

7.15. The Revenue Constraint

Debt sustainability ultimately meets the revenue constraint.

If government revenue remains weak relative to the economy's needs, financing development entirely through borrowing becomes increasingly difficult.

The solution is not necessarily higher tax rates.

It may involve broader tax bases, better compliance, fewer inefficient exemptions, stronger administration, better digital systems, and formalization of economic activity.

The IMF has emphasized domestic revenue mobilization as an important way to create fiscal space and support high-quality spending in Indonesia (IMF, 2026a).

This is why Chapter 8 follows naturally.

Debt is partly a consequence of the gap between what the state wants to do and what the state can sustainably finance.

Revenue reform addresses that gap at its source.

7.16. Debt and Public Investment

Borrowing can be economically justified when it finances investments that increase future productive capacity.

Consider infrastructure.

If a new transport corridor reduces logistics costs, increases trade, and raises productivity, the future economic base may become larger because of the investment.

The same principle applies to human capital.

If public spending improves learning, health, and workforce capabilities, future incomes may rise.

Debt used for productive investment can therefore have a different economic logic from debt used primarily to finance recurring consumption.

But even productive investment must pass a cost-benefit test.

A project that generates insufficient economic returns can weaken debt sustainability regardless of how attractive its label sounds.

Borrowing is therefore not inherently good or bad.

Its economic value depends partly on what it produces.

7.17. The Risk of Quasi-Fiscal Expansion

Not all public-sector risks appear directly in the central government deficit.

State-owned enterprises, guarantees, public financial institutions, and other government-linked entities can create contingent liabilities.

These obligations may remain invisible during normal conditions and become relevant only when an institution encounters financial stress.

The IMF has specifically highlighted the importance of managing quasi-fiscal activities and contingent liabilities in Indonesia (IMF, 2026a).

This issue becomes particularly relevant when public investment is increasingly conducted through state-linked entities.

The objective is not to prevent such activity.

It is to ensure that risks are visible, governed, and consistent with the government's broader fiscal framework.

Fiscal transparency is therefore part of debt sustainability.

7.18. Danantara and the Fiscal Perimeter

The creation and expansion of Danantara adds another dimension to the discussion because some public priorities may be financed through state-owned enterprises and investment structures outside the conventional budget.

The IMF has noted that Danantara could support development objectives but could also increase quasi-fiscal risks if investments are highly leveraged, underperform, or generate explicit or contingent public liabilities (IMF, 2026a).

This is an area where careful distinction is essential.

An investment made by a state-owned entity is not automatically government debt.

But if the government ultimately bears the risk of that investment, the economic exposure can become relevant to the public balance sheet.

The fiscal perimeter must therefore be broad enough to capture material risks without treating every state-linked investment as an immediate sovereign liability.

7.19. The 60-Percent Ceiling

Indonesia's statutory public-debt ceiling is 60 percent of GDP.

The current debt ratio remains substantially below that threshold.

This provides an important buffer.

But a ceiling should not be interpreted as a target.

A country should not aim to approach its legal maximum simply because the law permits it.

The purpose of a ceiling is to establish an upper guardrail against excessive accumulation.

Fiscal management should instead seek a debt path consistent with sustainable financing costs, credible institutions, adequate shock capacity, and long-term development.

The distance between the current debt ratio and the legal ceiling is therefore a buffer—not a spending invitation.

7.20. The Three-Percent Rule

The same logic applies to the deficit ceiling.

Indonesia's three-percent rule is a fiscal anchor.

It provides a simple signal to markets and policymakers that annual deficits should remain contained.

The rule also creates discipline when governments face pressure to expand spending.

But the rule is not a substitute for fiscal strategy.

A deficit just below three percent can still be inefficient if spending produces little value.

A temporary deficit slightly above a rule during an extraordinary emergency could be economically different from a persistent breach caused by structural imbalance.

The objective is therefore both compliance and quality.

Fiscal rules protect the boundary.

Fiscal institutions determine what happens inside it.

7.21. Fiscal Credibility

Debt sustainability depends partly on credibility.

Investors need confidence that the government will continue to manage its obligations.

Households need confidence that fiscal policy will not generate destabilizing inflation or abrupt tax changes.

Businesses need predictable taxation and public investment.

Financial institutions need confidence in sovereign debt.

Credibility reduces uncertainty.

Lower uncertainty can reduce the risk premium embedded in financing costs.

That can improve debt dynamics.

This produces another feedback loop:

Fiscal Credibility → Lower Risk Premium → Better Financing Conditions → Greater Fiscal Space.

The opposite can also occur.

A loss of credibility can increase borrowing costs, which increases interest expenditure, which reduces fiscal space, which can further weaken confidence.

Fiscal credibility is therefore an economic asset.

7.22. The Debt Stress Test

A practical debt stress test should ask eight questions.

Debt level. Is the debt ratio rising faster than the economy's capacity?

Deficit path. Is the deficit stabilizing or persistently widening?

Primary balance. Can the government generate sufficient resources before interest payments?

Interest-growth differential. Are borrowing costs consistently above nominal economic growth?

Interest burden. How much tax revenue is absorbed by debt service?

Gross financing needs. How much debt must be issued or refinanced each year?

Contingent liabilities. What risks could migrate onto the public balance sheet?

Shock capacity. How much room remains for a major unexpected event?

These indicators should be read together.

No single number determines fiscal sustainability.

7.23. A Scenario, Not a Prediction

Debt analysis is inherently forward-looking, which makes scenario analysis more useful than deterministic claims.

Consider three broad scenarios.

In a favorable scenario, productivity improves, nominal growth remains healthy, revenue mobilization strengthens, and financing costs remain contained. Debt can stabilize even while the government finances priority investment.

In a baseline-pressure scenario, growth remains around its medium-term trend, deficits stay close to the fiscal rule, and debt rises gradually. Fiscal space becomes somewhat tighter but remains usable.

In an adverse scenario, growth weakens, interest rates rise, revenue underperforms, and contingent liabilities materialize. The deficit can widen and debt dynamics can deteriorate quickly.

These are analytical scenarios, not forecasts.

Their purpose is to show why fiscal buffers matter before a shock arrives.

7.24. Stress Is Not Crisis

The available evidence does not support treating Indonesia's current debt position as a debt crisis.

The IMF assesses Indonesia as having relatively low sovereign debt risks, while emphasizing that borrowing costs, debt-service burdens, fiscal rules, and contingent liabilities require continued attention (IMF, 2026a).

The World Bank likewise projects a gradual increase in public debt rather than an abrupt debt explosion (World Bank, 2025).

This distinction matters.

A country can experience tighter fiscal space without experiencing fiscal collapse.

Indeed, fiscal management is partly about recognizing pressure early enough to prevent pressure from becoming crisis.

The relevant question is therefore not:

“Has Indonesia reached the point of collapse?”

It is:

“Is Indonesia preserving enough fiscal space to remain resilient if conditions become materially worse?”

7.25. The Debt–Growth Trade-Off

There is a temptation to frame the choice as debt versus growth.

That is too simple.

Some borrowing can support growth.

Some spending can raise productivity.

Some fiscal consolidation can strengthen confidence.

Some expenditure cuts can weaken growth if they reduce high-return investment or household protection.

The objective is therefore not minimum debt.

It is sustainable debt combined with productive public spending.

This requires sequencing.

Protect high-return investments.

Improve revenue.

Reduce inefficient spending.

Manage financing risks.

Preserve buffers.

Allow automatic stabilizers to work when needed.

The best fiscal position is not necessarily the smallest government.

It is the position that leaves the state capable of acting without creating unsustainable obligations.

7.26. The Fiscal Capacity Loop

The most important connection between Chapters 5, 6, and 7 can now be expressed as a single loop.

Productivity creates income.

Income creates a broader tax base.

The tax base creates fiscal capacity.

Fiscal capacity allows productive public investment.

Productive public investment can raise productivity.

And higher productivity improves the ability to service debt.

The positive loop is:

Productivity → Revenue → Fiscal Capacity → Productive Investment → Productivity.

The negative loop is:

Low Productivity → Weak Revenue → Higher Borrowing → Higher Interest Burden → Less Fiscal Space → Lower Investment → Low Productivity.

The fiscal question is therefore inseparable from the development question.

7.27. How Much Debt Can Indonesia Carry?

There is no single universal debt ratio at which an economy suddenly becomes safe or unsafe.

Debt capacity depends on institutions, growth, interest rates, revenue, financing structure, investor confidence, and the credibility of fiscal policy.

For Indonesia, the current evidence points to a debt position that remains within established fiscal guardrails, while fiscal space is becoming more valuable as spending ambitions expand and financing needs rise.

The IMF's assessment is instructive: sovereign debt risks remain relatively low, but continued adherence to fiscal rules and stronger revenue mobilization are important for preserving policy space (IMF, 2026a).

That is the correct analytical balance.

Indonesia is not defined by its debt ratio alone.

Nor should the debt ratio be ignored.

Debt is a resource when it finances productive transformation and remains sustainable.

Debt becomes a constraint when financing costs, weak revenue, low growth, or contingent liabilities progressively reduce the government's room to act.

7.28. The Next Question

The debt question leads directly to the revenue question.

Deficits can be managed.

Debt can be refinanced.

Spending can be prioritized.

But ultimately, fiscal capacity requires a durable revenue base.

If Indonesia wants to finance infrastructure, human capital, social protection, industrial transformation, regional development, and strategic programs while preserving fiscal space, the state needs stronger and more resilient revenue capacity.

That means asking a difficult question.

Is Indonesia collecting enough revenue from an economy of its current size—and is the tax system designed well enough to support the transformation ahead?

The answer cannot be found by looking only at tax rates.

It requires examining the tax base, compliance, administration, informality, exemptions, consumption, corporate income, property, digital activity, and the relationship between economic growth and state revenue.

The next chapter therefore moves from debt to the source of fiscal capacity itself.

Figure 7.1 — THE DEBT–DEFICIT–FISCAL SPACE FRAMEWORK

PRIMARY BALANCE + INTEREST COST + GROWTH + FINANCING CONDITIONS → DEBT DYNAMICS
DEBT SUSTAINABILITY → MARKET CONFIDENCE → BORROWING COST → FISCAL SPACE → PUBLIC INVESTMENT
The key question is whether borrowing finances productive capacity while preserving credible fiscal rules and refinancing resilience.

Analytical framework for this chapter.

CHAPTER 8

REVENUE & TAX REFORM

Building the Fiscal Capacity to Finance Transformation

8.1. The Revenue Question

A government can borrow.

It can reprioritize spending.

It can postpone projects.

It can use fiscal buffers.

But none of these options can substitute indefinitely for one fundamental requirement:

A state needs a durable revenue base.

Chapter 6 examined the APBN as the mechanism through which the Indonesian state allocates resources.

Chapter 7 examined debt, deficits, and fiscal space.

This chapter moves to the source beneath both.

Revenue.

The question is not simply whether Indonesians pay taxes.

They do.

The deeper question is whether Indonesia's tax system can generate enough predictable revenue from a growing economy to finance public services, infrastructure, human capital, social protection, and strategic investment while preserving fiscal credibility.

That is a much harder question.

A country can have a large economy and a relatively small tax base.

It can have high statutory tax rates in selected areas while collecting modest revenue overall.

It can introduce sophisticated digital systems while leaving substantial economic activity outside the effective tax net.

It can increase enforcement while damaging compliance if taxpayers perceive the system as unfair or unpredictable.

Tax reform is therefore not simply about collecting more.

It is about building a fiscal system that is **broad, credible, efficient, administratively capable, and compatible with economic growth.**

That is the revenue challenge.

8.2. Revenue is the Foundation of Fiscal Capacity

The relationship between economic growth and fiscal capacity is straightforward.

Economic activity generates income.

Income generates transactions and profits.

Transactions and profits create potential tax bases.

Tax collection converts part of that economic activity into public resources.

Public resources finance infrastructure, human capital, social protection, and institutions.

Those investments can then raise productivity.

The cycle is:

Economic Activity → Tax Base → Revenue → Public Investment → Productivity → Economic Activity.

A weak link can weaken the entire system.

If economic activity is informal, the tax base becomes difficult to observe.

If compliance is weak, potential revenue is not converted into actual revenue.

If administration is inefficient, collection costs rise.

If public spending is ineffective, taxpayers may become less willing to comply.

If productivity is weak, the underlying tax base grows slowly.

Tax policy is therefore part of a much larger economic system.

8.3. Indonesia'S Revenue Constraint

The IMF has identified Indonesia's relatively low tax-to-GDP ratio as a structural constraint. Its 2026 Article IV assessment put the ratio at around 10 percent of GDP and emphasized that raising revenue is important for accommodating development spending while remaining within fiscal rules (IMF, 2026a).

The number matters because the state has increasingly ambitious responsibilities.

Indonesia wants to improve infrastructure.

It wants stronger human capital.

It needs social protection.

It seeks industrial upgrading.

It faces food and energy-security challenges.

It must maintain public administration.

It needs fiscal room for future shocks.

All of these require resources.

A relatively narrow revenue base makes the trade-offs harder.

This does not automatically mean that Indonesia must dramatically increase tax rates.

It means the country needs to examine **why the relationship between the size of the economy and the amount of revenue collected remains relatively limited.**

That is a structural question.

8.4. The Tax Ratio is a Signal, not a Verdict

The tax ratio is one of the most commonly cited indicators of fiscal capacity.

It is useful.

But it should not become an economic verdict by itself.

A tax ratio depends on the structure of the economy.

Countries with large informal sectors often collect less relative to GDP.

Commodity exporters may experience large fluctuations.

Countries with extensive social-security systems may collect different forms of compulsory revenue.

Different accounting conventions can also affect international comparisons.

The appropriate use of the tax ratio is therefore diagnostic.

It asks:

How much of national economic activity is being converted into government revenue?

Is the ratio stable?

What explains changes?

Which sectors contribute?

Which taxpayers are underrepresented?

How much of the gap reflects policy choices, and how much reflects administration?

The number opens the investigation.

It does not end it.

8.5. The 2025 Revenue Reality

The 2025 APBN provides a useful case study.

Total state revenue reached approximately **Rp2,756.3 trillion**, while tax revenue reached approximately **Rp1,917.6 trillion**. Tax revenue therefore reached 87.6 percent of the APBN target. Customs and excise revenue reached approximately Rp300.3 trillion, or 99.6 percent of its target (Ministry of Finance, 2026).

This composition is revealing.

Indonesia does not rely on one single source of public revenue.

It combines tax revenue, customs and excise, and non-tax state revenue.

That diversification provides some resilience.

But tax revenue remains central because it is more directly connected to the underlying domestic economy.

Non-tax revenue can be influenced by natural resources, state assets, administrative fees, and other factors.

These sources can be important.

But they do not eliminate the need for a broad and durable tax base.

8.6. Revenue Volatility

Revenue can move for reasons that have little to do with tax administration.

Commodity prices matter.

Corporate profitability matters.

Imports matter.

Household consumption matters.

Exchange rates matter.

Economic growth matters.

A commodity boom can temporarily strengthen government revenue.

A commodity downturn can weaken it.

This creates a fundamental distinction:

temporary revenue strength is not the same as structural fiscal capacity.

A government should therefore be cautious about treating a favorable commodity cycle as permanent fiscal space.

Windfall revenue can be used to reduce debt, build buffers, finance high-return investment, or support temporary programs.

Using temporary revenue to finance permanent expenditure creates a different problem.

The revenue disappears.

The expenditure remains.

That is one of the oldest fiscal mistakes in economic history.

8.7. Taxation and Economic Structure

Indonesia's tax challenge is partly a reflection of its economic structure.

The economy contains large modern corporations.

It also contains millions of smaller businesses.

It contains formal employees.

It also contains informal workers.

It contains sophisticated financial activity.

It also contains cash-based transactions.

It contains globally integrated firms.

It also contains local economic activity that is difficult for the state to observe.

This creates an uneven tax landscape.

The objective of reform is not to treat every taxpayer identically.

It is to build a system capable of identifying different risk profiles and applying appropriate compliance strategies.

Large corporations require sophisticated transfer-pricing and international-tax oversight.

High-wealth individuals require effective information and asset reporting.

Small businesses need simple compliance mechanisms.

Informal firms need pathways toward formalization.

The shadow economy requires better data and enforcement.

Tax administration therefore needs to become more intelligent, not merely more aggressive.

8.8. The Informality Problem

Informality is one of the most difficult issues in revenue mobilization.

An informal enterprise may not maintain complete financial records.

Its transactions may occur in cash.

Its workers may not be registered formally.

Its income may fluctuate substantially.

Its administrative capacity may be limited.

Traditional tax administration can struggle under these conditions.

But informality is not simply a tax problem.

It is also a productivity problem.

Informal firms often have limited access to finance, technology, training, formal markets, and legal protections.

This creates a powerful policy connection:

Formalization → Better Access → Higher Productivity → Higher Income → Broader Tax Base.

The objective should therefore not be to push every small economic actor immediately into complex compliance.

The objective is to make formalization economically worthwhile.

8.9. The Taxpayer'S Perspective

Tax systems are often discussed from the government's perspective.

But compliance also depends on the taxpayer's experience.

A taxpayer asks:

Is the rule understandable?

Is registration easy?

Can payment be completed digitally?

Will the administration treat taxpayers consistently?

Can errors be corrected?

Are audits based on transparent risk criteria?

Are penalties proportionate?

Does government spending appear credible?

These questions influence voluntary compliance.

Tax compliance is partly an enforcement problem.

It is also a trust problem.

A system that combines clear rules, convenient administration, credible enforcement, and visible public value can create stronger incentives for voluntary compliance.

A system perceived as arbitrary can generate avoidance, resistance, or informality.

8.10. Coretax and the Digital State

Indonesia's Coretax system represents an important component of this transformation.

The Directorate General of Taxes describes Coretax as the modernization of tax administration, integrating core processes including taxpayer registration, tax returns, payments, audit, and collection. Its implementation began on **January 1, 2025** (Directorate General of Taxes, 2025).

The significance of Coretax is therefore larger than replacing an old computer system.

The deeper objective is information.

A modern tax authority needs to understand economic activity.

Who earns income?

Who owns assets?

Which transactions are connected?

Which firms are growing?

Where are inconsistencies?

Which taxpayers represent high compliance risk?

Which taxpayers simply need assistance?

Digital administration can improve the state's ability to answer these questions.

But technology alone does not guarantee higher revenue.

The system must generate reliable data, integrate information, reduce errors, and translate information into effective compliance strategies.

8.11. From Mass Audits to Risk-Based Compliance

Traditional tax enforcement can rely heavily on broad or periodic audits.

A modern system can become more targeted.

The IMF has specifically emphasized compliance-risk management, third-party data, government-database integration, digitalization through Coretax, and broader taxpayer coverage as important elements of Indonesia's revenue strategy (IMF, 2026a).

The principle is straightforward.

Not every taxpayer presents the same level of risk.

A small taxpayer making an administrative error is not equivalent to a sophisticated taxpayer deliberately concealing substantial income.

Risk-based administration allows tax authorities to allocate investigative resources where potential revenue and compliance risks are greatest.

This can improve both efficiency and taxpayer experience.

The state becomes more precise.

Compliance becomes less dependent on indiscriminate intervention.

This is an institutional productivity gain.

8.12. The Shadow Economy

One of the largest potential sources of additional revenue lies not necessarily in increasing rates but in reducing the gap between economic activity and reported economic activity.

This is the shadow economy.

It can include undeclared income, underreported transactions, unregistered businesses, illegal trade, and other activities that escape formal measurement or taxation.

The challenge is significant because the shadow economy is not always easy to distinguish from ordinary informality.

Some activities are survival-based.

Others involve deliberate evasion.

Policy must distinguish between them.

A productive approach combines:

better information,

simpler registration,

digital payments,

financial-data integration,

risk-based enforcement,

and credible penalties for deliberate evasion.

The goal is not simply to collect more.

It is to make the formal economy increasingly attractive and deliberate evasion increasingly difficult.

8.13. Taxation and the Middle Class

Tax reform also has a distributional dimension.

Middle-class households are both taxpayers and consumers.

They pay income taxes where applicable.

They pay consumption taxes.

They pay property-related charges and other local taxes.

They also depend on public services.

This creates a fiscal contract.

Households contribute.

The state provides public goods and protection.

When taxes rise without visible improvements in public services, the perceived burden can increase.

When public services improve, the same tax payment can be perceived differently.

This does not mean taxpayers should receive a direct individual return for every rupiah paid.

Public finance is collective.

But the broader relationship matters.

A credible tax system requires citizens to see taxation as part of a functioning social contract rather than simply a financial extraction mechanism.

8.14. Consumption Taxes and the Broad Base

Consumption taxes have an important advantage.

They can reach a broad range of economic transactions.

But they also require careful design.

A broad consumption tax can generate substantial revenue because consumption is widespread.

At the same time, low-income households can spend a larger share of their income on consumption than higher-income households.

This creates distributional concerns.

The policy response is not necessarily to abandon consumption taxation.

It can involve exemptions or zero-rating for essential goods where justified, targeted transfers, social protection, or other mechanisms that protect vulnerable households.

The key principle is:

Revenue mobilization and distributional protection should be designed together.

Tax policy cannot be evaluated only by how much revenue it collects.

It must also be evaluated by who ultimately bears the burden.

8.15. Corporate Taxation and Investment

Corporate taxation creates another trade-off.

Higher effective taxation can increase revenue.

But excessively burdensome or unpredictable taxation can influence investment decisions.

The relevant question is therefore not simply:

How high should corporate taxes be?

It is:

How can Indonesia collect a fair share of corporate income while maintaining incentives for productive investment?

This becomes particularly important in a global economy where capital can move across borders.

Tax competition is real.

But so is international cooperation.

Indonesia must prevent aggressive tax avoidance while maintaining a competitive and predictable investment environment.

The objective is a system in which firms compete on productivity rather than primarily on their ability to exploit differences in tax treatment.

8.16. Tax Expenditures

Tax expenditures are another part of the fiscal equation.

Governments often provide exemptions, deductions, credits, reduced rates, or other incentives to achieve economic or social objectives.

Some are justified.

They can support investment, innovation, housing, employment, or strategic industries.

But every tax incentive has a fiscal cost.

Revenue forgone today must be justified by an expected benefit.

The relevant question is therefore:

What economic outcome is being purchased by the revenue the state chooses not to collect?

If an incentive creates substantial additional investment, jobs, technology transfer, or productivity, the cost may be justified.

If it simply rewards activity that would have happened anyway, its fiscal return may be weak.

Tax expenditures should therefore be evaluated like public spending.

They are spending through the tax system.

8.17. The Wealth Question

As economies become more complex, tax systems must also address wealth.

Income can be taxed when it is earned.

But wealth can accumulate through property, financial assets, businesses, capital gains, and inheritance.

Tax administration therefore needs better information about ownership and asset structures.

The IMF has highlighted the importance of tailored compliance strategies for high-wealth individuals alongside large business taxpayers and the broader shadow economy (IMF, 2026a).

This does not imply that every wealthy person is evading taxes.

It means that the tax authority needs the capability to distinguish compliant taxpayers from high-risk cases.

Information becomes the foundation.

Without reliable information, enforcement becomes arbitrary.

With reliable information, enforcement can become more targeted.

8.18. The Regional Revenue Dimension

Indonesia's fiscal system is not only national.

Local governments also collect revenue.

Regional taxes and retributions contribute to local fiscal capacity, while transfers from the central government remain important.

The national fiscal system therefore has two connected layers.

Central revenue → National public goods and transfers.

Regional revenue → Local public services and development.

This creates an important decentralization question.

How much should regions finance themselves?

How much should be transferred from the center?

How should differences in regional tax bases be compensated?

A wealthy metropolitan region may have a much stronger tax base than a remote region.

If local governments rely almost entirely on their own revenue, regional service quality can diverge sharply.

If transfers dominate completely, incentives for local revenue mobilization can weaken.

The solution requires balance.

8.19. Tax Reform and Regional Autonomy

Indonesia's decentralization framework creates an important opportunity.

Regional governments can improve their own fiscal capacity through better administration, stronger local economic activity, and more effective collection.

But regional taxes must also be designed carefully.

Excessive local taxation can increase business costs and discourage investment.

Poorly designed local charges can create fragmentation.

Well-designed local revenue systems can improve accountability because citizens can more clearly connect taxes to local services.

This creates a second fiscal contract:

Local Taxation → Local Services → Local Accountability.

The quality of this relationship matters for Indonesia's broader fiscal architecture.

8.20. Revenue Mobilization and Productivity

Revenue reform should not be designed independently of productivity policy.

A tax system can unintentionally discourage investment, entrepreneurship, or formalization.

Conversely, a well-designed tax system can support productivity.

For example:

Simpler compliance can reduce administrative costs.

Digital filing can reduce transaction time.

Predictable taxation can reduce uncertainty.

Targeted incentives can support productive investment.

Better enforcement can reduce unfair competition from deliberate evasion.

Formalization can improve access to finance.

The objective is therefore not simply to maximize tax collection.

It is to maximize **sustainable revenue compatible with productive economic activity.**

That distinction is crucial.

8.21. The Fiscal Contract

At its deepest level, taxation is a relationship between citizens and the state.

Citizens provide resources.

The state provides collective goods.

This relationship can be described as a fiscal contract.

A strong fiscal contract requires at least four elements:

Capacity.
The state can collect revenue effectively.

Fairness.
The burden is distributed according to credible principles.

Transparency.
Citizens can see how public resources are used.

Performance.
Public spending produces services and outcomes.

Weakness in any one of these can weaken trust.

Tax reform is therefore institutional reform.

It is not merely a technical exercise in adjusting rates.

8.22. Revenue without Growth is not Enough

There is another danger.

A government can attempt to increase revenue through higher taxation while the underlying economy remains weak.

That can create pressure on firms and households.

If taxes rise faster than productivity, investment and consumption can be affected.

The sustainable solution is therefore a combination:

Broader Base + Better Compliance + Higher Productivity.

This allows revenue to rise because the economy itself becomes larger and more productive.

The strongest fiscal system is not one that extracts the maximum amount from a stagnant economy.

It is one that collects a sustainable share of a growing and productive economy.

8.23. The Tax Reform Sequence

A credible reform strategy can therefore be understood as a sequence.

First: Simplify.

Make compliance easier.

Second: Digitize.

Improve information and reduce administrative friction.

Third: Integrate.

Connect government and third-party data within appropriate legal and privacy safeguards.

Fourth: Differentiate risk.

Focus enforcement resources where potential non-compliance is greatest.

Fifth: Broaden the base.

Reduce unnecessary gaps and improve formalization.

Sixth: Evaluate incentives.

Test whether tax expenditures produce sufficient economic returns.

Seventh: Strengthen trust.

Demonstrate that additional revenue supports credible public outcomes.

The sequence matters.

A government that begins with enforcement without improving administration can generate resistance.

A government that digitizes without integrating data may create a new interface without a new capability.

A government that raises rates without broadening the base can place disproportionate pressure on existing taxpayers.

Reform must therefore be systemic.

8.24. The 2026 Revenue Opportunity

The early 2026 data provide evidence that revenue performance can improve.

As of March 31, 2026, state revenue had reached approximately **Rp574.9 trillion**, up 10.5 percent year-on-year. Tax revenue reached approximately **Rp394.8 trillion**, up 20.7 percent year-on-year, according to the Ministry of Finance's APBN update (Ministry of Finance, 2026).

This is encouraging as a revenue signal.

But one quarter does not establish a structural trend.

The appropriate question is whether improvements in tax administration, compliance, economic activity, and the tax base can generate sustained revenue gains.

That distinction is important.

A strong quarter is a result.

A stronger tax system is a capability.

Indonesia needs the second.

8.25. Coretax: Technology or Institutional Reform?

Coretax should therefore be evaluated not simply as an IT project.

Its success ultimately depends on whether it changes the capacity of the tax administration.

Can it improve taxpayer registration?

Can it improve filing quality?

Can it identify compliance risks?

Can it integrate relevant information?

Can it reduce processing time?

Can it improve audit selection?

Can it reduce leakage?

Can it make compliance easier?

Can it generate more predictable interactions between taxpayers and the state?

If the answer to these questions is yes, Coretax becomes an institutional productivity investment.

The technology is the infrastructure.

The real reform is the capability built on top of it.

8.26. The Risk of Digital Taxation

Digitalization also creates risks.

A complex digital system can generate compliance difficulties if users do not understand it.

Integration errors can affect taxpayer records.

Technical failures can delay filing or payment.

Poor communication can create uncertainty.

Digital enforcement can become excessive if automated signals are treated as proof rather than risk indicators.

A modern tax administration therefore needs both technology and human judgment.

Digital systems should identify patterns.

Officials must interpret them.

Taxpayers need channels to correct errors.

Appeals and dispute-resolution mechanisms remain essential.

A digital state should become more precise—not simply more powerful.

8.27. Revenue and Social Legitimacy

Tax reform becomes durable when citizens believe that the system is legitimate.

Legitimacy does not require universal satisfaction.

Taxes are rarely popular.

It requires a perception that the system follows understandable rules, applies them consistently, and supports public purposes that citizens recognize as legitimate.

This makes expenditure quality part of tax reform.

If the state collects more but public services do not improve, the political economy of compliance can weaken.

If additional revenue is visibly translated into better education, health, infrastructure, social protection, and public administration, the fiscal contract can strengthen.

Revenue and spending are therefore two sides of the same institutional relationship.

8.28. The Revenue Stress Test

Indonesia's revenue system can be evaluated through eight questions.

Tax-base breadth.
How much of economic activity is effectively inside the tax system?

Compliance.
Are taxpayers reporting and paying according to the rules?

Administration.
Can the state identify and manage compliance risks efficiently?

Digital capability.
Is technology improving information and taxpayer services?

Economic structure.
Is revenue overly dependent on volatile sectors?

Incentives.
Do tax expenditures generate sufficient economic returns?

Distribution.
Is the burden compatible with social and economic objectives?

Trust.
Do taxpayers perceive the system as credible and predictable?

A revenue system does not become strong simply because one of these indicators improves.

It becomes strong when the system performs across all eight.

8.29. The Revenue Paradox

Indonesia faces a fiscal paradox.

The country needs more public investment to raise productivity.

But raising investment requires fiscal capacity.

Increasing fiscal capacity requires stronger revenue.

Increasing revenue sustainably requires a more productive and formal economy.

The system therefore has to improve from both directions.

The state must become better at collecting.

The economy must become better at producing.

This produces the central fiscal loop:

Productivity → Tax Base → Revenue → Public Investment → Productivity.

Breaking the loop at either end creates difficulty.

Strengthening both ends creates resilience.

8.30. Tax Reform is Economic Reform

Tax reform is often presented as a narrow fiscal issue.

It is broader.

A better tax system can influence:

investment,

formalization,

business creation,

firm growth,

household behavior,

regional development,

public-service quality,

and state capacity.

That is why tax policy should be integrated with the broader economic transformation agenda.

A country cannot build a high-productivity economy with a weak state.

But a state cannot sustain ambitious development with a weak revenue system.

The two must evolve together.

8.31. What Should a Stronger Revenue System Look Like?

A stronger Indonesian revenue system would not necessarily be defined by the highest possible tax rate.

It would be defined by five characteristics.

Broad.
More economic activity participates in the formal tax system.

Predictable.
Businesses and households can plan around clear rules.

Digital.
Administration uses information technology effectively.

Targeted.
Enforcement focuses on material compliance risks.

Productivity-compatible.
Taxation raises sustainable revenue without unnecessarily suppressing investment and economic upgrading.

This is a more demanding objective than simply raising collection.

It requires institutional capability.

8.32. The Revenue-to-Resilience Chain

The connection between this chapter and the previous two can now be expressed as one chain:

Revenue → Deficit Management → Debt Sustainability → Fiscal Space → Shock Capacity.

But there is another chain beneath it:

Productivity → Income → Tax Base → Revenue.

And a third:

Revenue → Public Investment → Human Capital & Infrastructure → Productivity.

Together they create the fiscal resilience system.

A country with strong productivity but weak revenue cannot fully convert private economic strength into public capacity.

A country with strong revenue but weak productivity can collect resources today while weakening the economic base tomorrow.

Sustainable development requires both.

8.33. The Fiscal Storm Revisited

The fiscal storm is therefore not simply about debt.

It is about the interaction between spending ambitions and revenue capacity.

Indonesia's challenge is not that the state has no resources.

It is that the state must decide how much it can mobilize without weakening the economy that generates those resources.

The storm contains several forces:

a relatively low tax-to-GDP ratio,

large development needs,

expanding social commitments,

debt-service obligations,

volatile commodity revenues,

a large informal economy,

regional fiscal differences,

and rising expectations of public services.

At the same time, Indonesia possesses opportunities:

digital tax administration,

broader economic formalization,

stronger compliance systems,

better use of third-party data,

productive growth,

and improved expenditure quality.

The fiscal future will depend partly on whether these opportunities can outweigh the structural constraints.

8.34. The Revenue Question for the Prabowo Era

For the Prabowo administration, the revenue question is ultimately a question of policy credibility.

Can the government finance its priorities without continuously expanding debt?

Can it improve revenue without unnecessarily suppressing growth?

Can it broaden the tax base without overburdening households and firms already inside the system?

Can it use digitalization to improve compliance?

Can it strengthen the relationship between taxation and public-service performance?

Can it convert higher revenue into higher productivity?

These questions should be judged through evidence.

Tax reform should therefore be evaluated not by political rhetoric but by measurable outcomes:

higher compliance,

broader formalization,

lower administrative costs,

more predictable revenue,

stronger tax capacity,

and improved public-sector performance.

8.35. The Taxpayer is Part of the Economic System

There is a final conceptual point.

Taxpayers are not external to the economy.

They are the economy.

Workers, households, entrepreneurs, corporations, investors, and consumers generate the economic activity from which public revenue is collected.

A tax system that treats taxpayers only as sources of money misses this relationship.

The better approach recognizes a feedback loop:

Citizens and Firms → Economic Activity → Taxes → Public Goods → Productivity → Citizens and Firms.

The state and the private economy are therefore not separate systems.

They are connected through fiscal institutions.

8.36. The Revenue Stress Test

The final test for Indonesia's tax system is not whether it can collect more in a single year.

It is whether it can sustainably increase fiscal capacity while supporting economic transformation.

A resilient revenue system should be able to withstand:

a commodity downturn,

slower consumption,

weaker corporate profits,

global financial volatility,

changes in technology,

and structural changes in employment.

It should also be able to capture upside when productivity and incomes rise.

That requires elasticity.

Revenue should grow as the economy grows.

But it should not collapse whenever one sector weakens.

This is the essence of a broad tax base.

8.37. The Deeper Meaning of Tax Reform

Tax reform is ultimately about the capacity of a society to finance its collective ambitions.

A country cannot provide advanced public services without resources.

It cannot build infrastructure without resources.

It cannot maintain social protection without resources.

It cannot respond effectively to shocks without fiscal buffers.

It cannot finance human-capital transformation without sustained investment.

And it cannot preserve fiscal space indefinitely through borrowing.

Revenue is therefore not merely an accounting item.

It is the financial foundation of state capacity.

But revenue alone is not enough.

The state must also spend effectively.

The economy must become more productive.

Institutions must become more credible.

And citizens must be able to see the connection between contribution and public value.

That is the fiscal contract.

8.38. From Fiscal Pressure to Fiscal Capacity

The first three chapters of the fiscal part of this book now form a sequence.

Chapter 6 asked:
How much can the state spend?

Chapter 7 asked:
How much can the state borrow?

Chapter 8 asks:
How much can the state sustainably collect?

The three questions are inseparable.

Spending creates public capacity.

Borrowing creates temporary fiscal capacity.

Revenue creates recurring fiscal capacity.

The strongest fiscal system is therefore one in which borrowing supports transformation while revenue gradually strengthens enough to sustain the resulting commitments.

The objective is not zero debt.

It is sustainable public capacity.

8.39. The End of the Fiscal Storm

The metaphor of the fiscal storm now becomes clearer.

The storm is not a single event.

It is the pressure created when a growing economy asks the state to do more while the state's recurring revenue base remains limited.

The solution is not simply to spend less.

It is not simply to tax more.

It is not simply to borrow more.

It is to improve the entire system.

Grow the economy.

Broaden the tax base.

Improve compliance.

Modernize administration.

Prioritize spending.

Protect fiscal space.

Invest in productivity.

The objective is a fiscal system capable of supporting transformation without becoming a constraint on transformation.

8.40. The Next Question

The fiscal chapters have now moved from budget to debt and from debt to revenue.

But fiscal policy does not exist in isolation.

Government decisions interact with industrial policy.

They interact with state-owned enterprises.

They interact with investment.

They interact with the allocation of capital.

They interact with the government's broader economic architecture.

The next question therefore moves beyond the APBN.

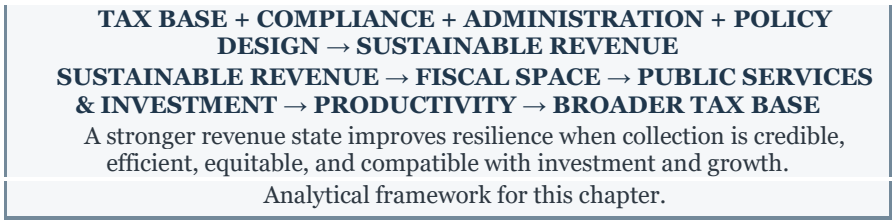
If the state is mobilizing public resources, investment vehicles, industrial policy, and state-owned enterprises at the same time, what exactly is the economic architecture being built?

And how does that architecture shape Indonesia's growth model?

That takes us from the fiscal storm to the heart of the Prabowo-era economic agenda.

PART IV — PRABOWO'S ECONOMIC AGENDA

Figure 8.1 — THE REVENUE–FISCAL CAPACITY–RESILIENCE FRAMEWORK



Analytical framework for this chapter.

CHAPTER 9

PRABOWO'S ECONOMIC ARCHITECTURE

The New Economic Architecture

9.1. The Economy After the Fiscal Storm

Chapters 6 through 8 examined the fiscal state from three connected angles: what the government spends, how it finances deficits and debt, and how it raises revenue. The sequence matters. A state can expand expenditure, borrow to finance it, or strengthen revenue, but each choice changes the space available for the others. Fiscal policy is therefore not a collection of separate decisions. It is an architecture.

The transition to Part IV shifts the question. If the fiscal system is the financial skeleton of the state, what economic strategy is that skeleton being asked to support?

Under President Prabowo Subianto, Indonesia has entered a new phase of economic policy. The administration's development framework is anchored in Asta Cita and operationalized through the 2025–2029 National Medium-Term Development Plan (RPJMN). The plan links high economic growth with poverty reduction, human-capital improvement, national resilience, industrial development, and greater economic sovereignty. Bappenas identifies economic growth, poverty reduction, and human-capital development as central objectives, while the RPJMN sets a path toward growth of up to 8 percent by 2029 (Bappenas, 2024, 2025, 2026).

9.2. From Presidential Program to Economic System

An economic agenda becomes meaningful only when it can be translated into institutions, budgets, incentives, investment decisions, and measurable outcomes.

This distinction is important. A presidential program is a statement of intent. An economic architecture is the system through which that intent is implemented.

The Prabowo administration's framework combines several policy directions that have appeared repeatedly in official planning and budget documents: food and energy security, industrialization and downstreaming, infrastructure, human-capital development, social protection, digital transformation, stronger domestic investment, and greater mobilization of state-owned assets and private capital. The 2025 APBN was explicitly framed as supporting Asta Cita, while the 2026 budget architecture continued to emphasize food, energy, human capital, health, villages, cooperatives and MSMEs, defense, and economic transformation (Ministry of Finance, 2025a, 2025b).

The analytical question is not whether these objectives are individually desirable. Many address long-standing constraints. The more difficult question is whether they can operate as a coherent economic system.

A coherent architecture must answer at least five questions.

First, where will growth come from?

Second, how will investment be financed?

Third, how will productivity rise?

Fourth, how will households participate in and benefit from that growth?

Fifth, how will the state preserve fiscal and institutional capacity while pursuing a larger development role?

These questions connect directly to the previous chapters. Growth requires productivity. Productivity requires investment, skills, infrastructure, competition, and institutional quality. Investment requires financing. Financing requires fiscal capacity and credible institutions. And growth must ultimately reach households through employment, wages, business opportunities, and public services.

The architecture therefore cannot be judged by the number of programs it contains. Its deeper test is whether the programs reinforce one another.

9.3. Asta Cita as the Strategic Framework

Asta Cita provides the political and strategic framework for the administration's five-year development agenda. The 2025–2029 RPJMN translates that framework into national priorities, targets, programs, and development planning. Bappenas describes the RPJMN as the bridge between the President's vision and the longer-term 2025–2045 development plan (Bappenas, 2024, 2025).

Economically, the framework contains several interconnected ambitions.

One is greater self-reliance in strategic sectors, including food and energy. Another is industrialization and downstreaming, intended to increase domestic value added from natural resources. A third is investment in human capital through education, health, nutrition, and skills. A fourth is infrastructure and regional development. A fifth is strengthening domestic enterprises, cooperatives, and MSMEs. A sixth is improving economic resilience in a world characterized by geopolitical fragmentation, supply-chain disruption, and changing trade patterns.

The government has also articulated an ambition for faster economic growth. Bappenas has stated that the RPJMN targets economic growth reaching 8 percent by 2029 (Bappenas, 2025, 2026). This is a policy objective rather than an established economic outcome.

That distinction should remain central throughout this book.

A target describes where policymakers want the economy to go. It does not demonstrate that the economy can get there.

The gap between target and outcome is where implementation capacity becomes decisive.

9.4. The Eight-Percent Question

An 8 percent growth target changes the scale of the policy challenge.

At roughly 5 percent growth, Indonesia can maintain a relatively familiar development pattern: household consumption remains an important stabilizer, investment expands gradually, commodity exports provide foreign exchange, and public policy seeks incremental productivity improvements.

At 8 percent, the arithmetic becomes more demanding.

Higher growth requires substantially more productive investment, faster productivity gains, stronger export performance, greater human-capital accumulation, or some combination of all four. It also requires that infrastructure, energy supply, logistics, financial intermediation, and institutions expand sufficiently to support the additional activity.

The official strategy identifies manufacturing, construction, and tourism among the sectors expected to contribute to higher growth, while consumption, investment, and exports are identified as important expenditure-side drivers (Bappenas, 2025).

This creates a useful analytical framework:

Growth = Consumption + Investment + Government Demand + Net Exports.

But the accounting identity does not explain the quality of growth. An economy can raise demand temporarily without raising its productive capacity at the same rate.

For sustained higher growth, the more important relationship is:

Productivity → Income → Demand → Investment → Productivity.

If productivity rises, firms can produce more value per worker and per unit of capital. Higher productivity can support higher real incomes. Higher incomes support demand. Demand can justify new investment. New investment can raise productive capacity again.

The reverse loop is equally possible:

Weak productivity → weak wage growth → weak household demand → weak private investment → weak productivity.

The architecture of the Prabowo era therefore faces a fundamental test: can policy shift Indonesia from a primarily demand-supported growth model toward a productivity-supported growth model while preserving macroeconomic stability?

9.5. The State as Coordinator, Investor, and Enabler

The role of the state is broader than simply spending money.

A modern development state performs several functions simultaneously. It provides public goods, sets rules, corrects market failures, coordinates strategic investments, manages risks, and sometimes invests directly through public institutions or state-owned enterprises.

The challenge is that these functions can overlap.

When the state becomes a major investor, it must still preserve clear rules for competition and capital allocation. When it supports strategic industries, it must distinguish between temporary learning support and permanent protection. When it provides incentives, it must evaluate whether the social and economic returns justify the fiscal cost. When it mobilizes state-owned assets, it must ensure that commercial objectives do not weaken public accountability.

The administration's own economic communications increasingly emphasize coordination across government, state-owned enterprises, and private capital. In February 2026, the Coordinating Ministry for Economic Affairs described an "Indonesia Incorporated" approach centered on collaboration, legal certainty, and investment confidence (Coordinating Ministry for Economic Affairs, 2026).

This suggests an architecture in which government is not expected to finance transformation alone.

That principle is important because Chapter 6 established a basic fiscal constraint: the state cannot finance every development objective directly from the APBN.

The implication is not that the state should retreat.

It is that the state must become better at mobilizing capital rather than simply substituting for it.

9.6. Industrial Policy and Downstreaming

Industrial policy is one of the most visible elements of Indonesia's economic strategy.

The underlying logic is straightforward. Indonesia possesses large natural-resource endowments, but exporting raw or minimally processed commodities can limit domestic value added, industrial learning, technology transfer, and job creation. Downstreaming seeks

to move production into processing and manufacturing activities that capture more value within the country.

The economic case is strongest when downstreaming produces genuine productivity gains: new technology, better infrastructure, skilled employment, supplier development, export diversification, and stronger domestic capabilities.

But downstreaming is not automatically synonymous with industrial transformation.

A processing plant can increase domestic output without creating a broad industrial ecosystem. A protected industry can survive without becoming internationally competitive. An investment can raise capital expenditure without producing enough productivity improvement to justify its economic cost.

The relevant question is therefore not simply:

How much downstream investment occurred?

It is:

How much additional productive capacity, technology, employment quality, export capability, and domestic value creation resulted?

This distinction matters because industrial policy operates under a trade-off between strategic patience and economic discipline.

New industries often require time to learn. But indefinite protection can weaken incentives to become efficient.

The strongest architecture would therefore connect industrial support to measurable performance: productivity, export competitiveness, technology adoption, supplier development, skilled employment, and eventually reduced dependence on fiscal or regulatory protection.

9.7. Food and Energy Security

Food and energy occupy a special position in the Prabowo administration's economic architecture because both influence household welfare and national resilience.

Food prices affect real purchasing power. Energy prices affect production costs, transportation, inflation, and industrial

competitiveness. Import dependence can create exposure to global price movements and geopolitical disruptions.

The government's 2026 budget framework explicitly places food and energy sovereignty among its central themes. It includes measures aimed at food productivity, price stability, energy production, energy security, and transition toward cleaner energy (Ministry of Finance, 2025b).

The economic logic is not merely about self-sufficiency.

Complete self-sufficiency in every product is neither necessary nor automatically efficient. International trade exists precisely because countries differ in resource endowments, productivity, technology, and comparative advantage.

The more useful concept is strategic resilience.

A resilient food system can absorb global shocks without imposing disproportionate costs on households. A resilient energy system can provide reliable and affordable energy while supporting industrial development and managing environmental constraints.

This creates another policy balance:

Security without excessive inefficiency.

Resilience without permanent isolation.

Domestic capacity without abandoning productive international exchange.

The distinction will become increasingly important in Chapter 12, where global fragmentation and trade will be examined directly.

9.8. Human Capital as Economic Infrastructure

Economic architecture is often described in terms of factories, roads, ports, power plants, and financial institutions. Yet human capital may be the infrastructure with the highest long-term return.

Education, nutrition, health, skills, and work experience determine how effectively an economy can use physical capital and technology.

The RPJMN explicitly places human-resource quality among its major development objectives. Government programs also include nutrition, health, education, vocational development, and social

protection as components of the broader development strategy (Bappenas, 2024; Ministry of Finance, 2025a).

The connection to Chapter 5 is direct.

Productivity cannot rise sustainably if workers lack the skills required by expanding sectors. Nor can industrial policy generate broad-based prosperity if the labor force remains concentrated in low-productivity activities.

The economic chain is:

Health → Learning → Skills → Employment → Productivity → Income.

Breaking any link weakens the entire system.

This is why human-capital spending should not be treated simply as social expenditure. It can also be productive investment.

But the same discipline applies here as elsewhere. More spending does not automatically create more human capital. Outcomes depend on quality, targeting, institutional capacity, teacher and health-worker effectiveness, infrastructure, access, and alignment with labor-market demand.

The central question is therefore not only how much Indonesia spends on people, but whether the spending increases capabilities that households and firms can actually use.

9.9. Danantara and the Mobilization of State Capital

The creation of Danantara adds another institutional layer to Indonesia's economic architecture.

Danantara Indonesia was launched in February 2025 as an institution intended to manage and optimize state assets and support strategic investment. Its official materials describe a role in industrial development, strategic sectors, and the transformation of state-owned enterprises (Danantara Indonesia, 2025, 2026).

The significance of such an institution is potentially large because Indonesia has a substantial state-owned enterprise sector and a large pool of public assets.

The economic proposition is that better management of these assets could increase returns, consolidate fragmented activities, mobilize investment, and support strategic industrial priorities.

But the proposition carries an equally important governance question.

State capital can be productive capital only when capital allocation is disciplined.

The key variables are therefore not simply the size of assets under management. They include governance, transparency, investment mandates, risk management, return measurement, portfolio discipline, conflict-of-interest safeguards, and clarity about the boundary between commercial and policy objectives.

Danantara's development should consequently be assessed through observable outcomes rather than institutional scale alone.

Useful measures include the productivity of managed assets, returns adjusted for risk, incremental private investment mobilized, successful restructuring of state-owned enterprises, export and industrial outcomes, and the fiscal implications of investment decisions.

In 2026, Danantara and the Qatar Investment Authority were also associated with a proposed USD 4 billion joint investment fund focused on areas including downstream industrialization, renewable energy, and healthcare (Danantara Indonesia, 2025).

Such partnerships illustrate a broader principle: the new architecture seeks to use state institutions as platforms for mobilizing additional capital rather than relying exclusively on the state budget.

9.10. The Private Sector Question

No government can create sustained high productivity through public investment alone.

Private firms determine a large share of investment, employment, innovation, technology adoption, and export competitiveness. A development strategy therefore depends on whether firms have incentives to invest and improve.

This makes the business environment part of the economic architecture.

Regulatory predictability matters because investment decisions are forward-looking. Competition matters because firms facing competitive pressure have stronger incentives to innovate and reduce costs. Access to finance matters because productive firms cannot expand without capital. Infrastructure matters because logistics and energy costs affect competitiveness. Skills matter because technology cannot be adopted effectively without capable workers.

The government has increasingly emphasized investment confidence, legal certainty, and collaboration with the private sector. In its 2026 economic outlook messaging, the Coordinating Ministry for Economic Affairs identified Indonesia Incorporated, legal certainty, and economic optimism as pillars of investment policy (Coordinating Ministry for Economic Affairs, 2026).

The analytical issue is whether these principles are translated into predictable implementation.

A policy framework can be ambitious on paper while uncertain in practice. Conversely, institutional improvements that appear less dramatic can have large effects on investment behavior.

The economic architecture therefore extends beyond headline programs. It includes the everyday rules faced by millions of firms.

9.11. The Middle Class as the Transmission Mechanism

Chapter 4 established a critical point: national growth becomes economically meaningful for households only when it reaches purchasing power, employment quality, and economic security.

This makes the middle class a transmission mechanism between macroeconomic growth and social stability.

A growing middle class creates demand for housing, education, healthcare, transportation, financial services, tourism, technology, and consumer goods. It also expands the domestic market for firms.

But a middle class under income pressure can become a source of economic fragility.

If real wages stagnate while housing, education, healthcare, and other essential costs rise, households may reduce discretionary

spending, postpone investment in skills, increase borrowing, or become more vulnerable to shocks.

This means that the success of the new economic architecture cannot be evaluated only through GDP, investment, or industrial output.

It must also be evaluated through household transmission:

Growth → Jobs → Wages → Purchasing Power → Middle-Class Security.

A policy can raise national output while producing weaker household transmission than expected.

That is not necessarily evidence of policy failure. Economic effects are distributed unevenly across sectors, regions, firms, and households.

But it is evidence that the transmission mechanism requires attention.

9.12. Regional Transformation

Indonesia's geography makes economic architecture a spatial question.

The country does not have one labor market, one productivity level, or one development structure. Java remains the largest contributor to national output, while resource-rich regions can have very different production structures from manufacturing and service centers.

A national strategy must therefore combine national coordination with regional specialization.

Industrial development in one province can create demand for logistics, energy, finance, and suppliers elsewhere. Infrastructure can reduce regional transaction costs. Digital connectivity can widen access to markets and services. Human-capital investment can allow regions to move beyond resource extraction.

But regional transformation cannot be achieved simply by distributing projects geographically.

The relevant question is whether investment creates durable economic ecosystems.

A new industrial zone matters more if it generates supplier networks, skills, exports, technology diffusion, and local business formation.

A new road matters more if it lowers logistics costs and expands market access.

A new university or training center matters more if graduates acquire skills demanded by productive employers.

Regional policy therefore needs to move from project distribution toward productivity ecosystems.

9.13. The Fiscal Constraint Returns

At this point, the architecture meets the fiscal reality established in Part III.

Every major economic objective requires resources.

Food security requires infrastructure, logistics, research, and financing.

Energy security requires investment.

Human capital requires sustained spending.

Industrialization requires infrastructure and sometimes targeted incentives.

Regional transformation requires public capital.

Social protection requires fiscal capacity.

Strategic state investment requires capital and governance.

The state cannot pursue all of these objectives at maximum scale simultaneously without trade-offs.

This is why Chapters 6, 7, and 8 are not background chapters. They are the financial constraints within which the Prabowo economic architecture must operate.

The basic equation is:

Policy Ambition → Financing Requirement → Fiscal Capacity → Economic Return.

If the expected economic return is high enough, investment can strengthen future fiscal capacity through higher growth, employment, and revenue.

If returns are weak, the same spending can increase fiscal pressure without sufficiently expanding productive capacity.

This is the central fiscal-productivity loop:

Productivity → Revenue → Fiscal Space → Productive Investment → Productivity.

A successful economic architecture strengthens the loop.

An unsuccessful one can create the opposite:

Low Productivity → Weak Revenue → Limited Fiscal Space → Underinvestment → Low Productivity.

9.14. The Institutional Capacity Test

Economic architecture is ultimately an institutional capacity problem.

Indonesia does not lack policy ideas. The more difficult question is whether institutions can coordinate, execute, monitor, evaluate, and adjust them.

Large programs require procurement systems. Industrial policy requires technical agencies. Human-capital programs require local implementation capacity. Infrastructure requires land, regulation, financing, and maintenance. State-asset management requires governance. Tax reform requires administrative systems. Investment policy requires legal certainty.

Coordination becomes especially important when multiple programs interact.

For example, industrialization requires energy. Energy requires infrastructure. Infrastructure requires financing. Financing requires fiscal and financial institutions. Industrialization also requires skills, logistics, and market access.

If ministries operate in isolation, each program may appear successful while the overall system remains inefficient.

The architecture therefore requires horizontal coordination as much as vertical authority.

This is one reason the RPJMN's alignment across ministries, agencies, and subnational governments matters. Bappenas has emphasized that national and regional planning should be aligned with the RPJMN (Bappenas, 2024, 2025).

Implementation capacity is thus not an administrative footnote. It is an economic variable.

9.15. The Governance Test

The larger the state's economic role becomes, the more important governance becomes.

This is not an ideological statement. It is a capital-allocation principle.

When governments control more resources, institutional quality determines whether those resources are allocated according to transparent economic and social criteria.

Three governance questions are particularly important.

First, can outcomes be measured?

Second, can poor-performing programs be corrected or terminated?

Third, can decision-makers be held accountable for the use of public resources?

These questions matter for APBN programs, state-owned enterprises, industrial incentives, infrastructure, and state investment institutions alike.

A development architecture that cannot learn from results can become expensive even when its original objectives are reasonable.

The strongest systems therefore create feedback loops.

Policy → Implementation → Measurement → Evaluation → Adjustment.

Without the measurement and evaluation stages, policy can become a sequence of commitments rather than a learning system.

This is particularly relevant to the Prabowo era because the administration has set a broad and ambitious portfolio of economic objectives. The wider the agenda, the more important prioritization and evaluation become.

9.16. A Portfolio, not a Single Bet

The Prabowo economic architecture should not be understood as one policy.

It is better understood as a portfolio of bets.

Some bets are designed to improve resilience: food, energy, health, and strategic capacity.

Some are designed to raise productivity: infrastructure, human capital, technology, and industrial upgrading.

Some are designed to mobilize capital: state-asset reform, Danantara, public-private partnerships, and investment policy.

Some are designed to protect households: social protection, nutrition, healthcare, and employment programs.

Some are designed to increase fiscal capacity: tax administration and revenue reform.

The advantage of a portfolio approach is diversification. Not every policy must produce the same type of return.

The risk is fragmentation.

If programs compete for resources, duplicate functions, or lack clear performance criteria, the portfolio becomes a collection of initiatives rather than an integrated strategy.

The central management problem is therefore sequencing.

Which reforms must come first?

Which investments unlock others?

Which programs can be scaled?

Which should remain targeted?

Which should be redesigned when evidence changes?

Economic architecture is, in this sense, partly an exercise in sequencing.

9.17. The Five Dependencies

Five dependencies connect the major components of the new economic architecture.

First, growth depends on productivity.

Second, productivity depends on investment, skills, infrastructure, competition, and institutions.

Third, investment depends on financing and confidence.

Fourth, financing depends on fiscal capacity, financial-market depth, and private capital mobilization.

Fifth, political and economic sustainability depends on whether households experience tangible improvements in income, opportunity, and security.

These dependencies create a system rather than a checklist.

A weakness in one layer can propagate through the others.

Weak tax collection limits productive public investment.

Weak public investment can limit productivity.

Weak productivity can limit wage growth.

Weak wage growth can weaken household demand.

Weak demand can reduce private investment.

The resulting cycle can make it harder to achieve the original growth objective.

The opposite is also possible.

Better institutions can attract investment.

Investment can raise productivity.

Productivity can raise wages.

Higher incomes can strengthen demand.

Stronger demand can support business investment.

Growth can broaden the tax base.

The economic architecture should therefore be judged by the strength of its positive feedback loops.

9.18. Stress Test: Can the Architecture Deliver?

A useful stress test can be built around seven questions.

1. Growth: Can the strategy raise productive capacity rather than only aggregate demand?

2. Productivity: Can investment and industrial policy increase output per worker and per unit of capital?

3. Employment: Can growth create productive and reasonably well-paid jobs?

4. Fiscal capacity: Can the state finance priorities without weakening fiscal resilience?

5. Private capital: Can public initiatives mobilize rather than displace productive private investment?

6. Governance: Can institutions measure results, manage risks, and correct underperformance?

7. Household transmission: Can national growth translate into stronger purchasing power and economic security?

These questions are deliberately different from asking whether the strategy is politically attractive.

They are economic tests.

A policy architecture can be ambitious and still fail an implementation test. It can also contain individual programs that perform well even if the broader strategy encounters constraints.

The evidence available by 2026 does not justify treating the Prabowo economic architecture as either a guaranteed transformation or an inevitable failure. The more defensible approach is to monitor the mechanisms through which the architecture is expected to work.

9.19. What Would Count as Success?

Success should be defined in measurable economic terms.

A successful architecture would not necessarily mean that every official target is reached exactly on schedule. Economic outcomes are influenced by global conditions, commodity prices, geopolitical shocks, financial markets, weather, and domestic events.

A more useful scorecard would include:

Higher productivity.

Higher-quality employment.

Stronger real household incomes.

More competitive exports.

Greater domestic value added.

More efficient public investment.

Stronger fiscal capacity.

Better human-capital outcomes.

More effective state-owned enterprises.

Higher private investment.

Stronger regional productivity.

Greater resilience to external shocks.

These indicators complement GDP growth.

Growth remains essential. But growth without productivity can be fragile. Productivity without household transmission can be socially incomplete. Investment without returns can weaken fiscal capacity. Fiscal stability without development investment can preserve the present while sacrificing the future.

Economic architecture is therefore about balance.

It seeks to convert public resources, private capital, natural resources, human capability, and institutional capacity into sustained improvements in productive potential.

9.20. The Deeper Question: What Kind of Economy?

The most important question about the Prabowo era is not simply how fast Indonesia grows.

It is what kind of economy that growth creates.

Will Indonesia remain heavily dependent on commodity cycles, or build broader industrial and service capabilities?

Will productivity gains be concentrated among large firms, or diffuse across smaller enterprises?

Will growth create better jobs, or primarily absorb workers into low-productivity activities?

Will state capital crowd in private investment, or compete with it?

Will industrial policy build competitive capabilities, or prolong inefficient protection?

Will food and energy policy improve resilience without imposing excessive economic costs?

Will fiscal policy finance productive transformation while preserving room for future shocks?

Will human-capital investment generate skills that match the economy of the future?

These questions cannot be answered by political rhetoric alone.

They require evidence.

That is why the economic architecture must remain testable.

The purpose of analysis is not to assume success or failure in advance. It is to identify the mechanisms, indicators, risks, and feedback loops that will reveal which direction the economy is actually taking.

9.21. From Architecture to Execution

The transition from Part III to Part IV is therefore complete.

Part III asked how much fiscal room Indonesia has.

Part IV asks what Indonesia intends to do with that room.

Chapter 9 has described the architecture: Asta Cita and the RPJMN as the strategic framework; higher growth as the central ambition; productivity and human capital as foundational requirements; industrialization and downstreaming as transformation mechanisms; food and energy security as resilience objectives; Danantara and state-owned assets as capital-mobilization instruments; private

investment as a necessary partner; and household welfare as the ultimate transmission test.

The next chapters will examine individual pillars of this architecture more closely.

Chapter 10 will examine industrial policy and downstreaming. The question will not simply be whether Indonesia should process more of its resources domestically. It will be whether downstreaming can generate durable productivity, competitive industry, technology transfer, quality employment, and export capability.

Chapter 11 will then examine Danantara, state-owned enterprises, and state capital: how a larger state investment role can potentially mobilize capital and industrial capacity, and what governance and fiscal questions follow from that expansion.

The economic tsunami metaphor returns here in a different form.

A tsunami is not merely a wave of spending or investment. It is a force that moves through a system.

The Prabowo economic architecture should therefore be judged by how its policies move through the Indonesian economic system: from institutions to investment, from investment to productivity, from productivity to jobs and wages, from growth to revenue, and from public policy to household welfare.

The architecture is now visible.

The harder question is whether it can execute.

Figure 9.1 — THE PRABOWO ECONOMIC ARCHITECTURE

Strategic framework: Asta Cita / RPJMN → Growth and Resilience → Industrialization & Downstreaming; Human Capital; Food & Energy Security; Infrastructure & Regional Transformation; State Capital & Danantara; Private Investment → Productivity → Jobs & Wages → Household Welfare → Revenue & Fiscal Capacity → Sustainable Investment.

CHAPTER 10

INDUSTRIAL POLICY & DOWNSTREAMING

Can Indonesia Turn Natural Resources into Productivity?

10.1. The Promise of Value Added

Indonesia has something many economies spend decades trying to build: abundant natural resources, a large domestic market, a strategic geographic position, and a growing industrial base. The question is whether these assets can be converted into a broader and more productive economic structure.

That is the promise behind downstreaming.

The basic idea is simple. Instead of exporting commodities in raw or minimally processed form, Indonesia seeks to process more of them domestically, capture more value inside the country, build industrial capabilities, create jobs, and strengthen its position in global value chains. The 2025–2029 RPJMN explicitly places continued downstreaming and resource-based industrial development among national priorities, with the stated objective of increasing domestic value added and creating better employment opportunities (Bappenas, 2025).

But downstreaming is not an economic destination. It is an instrument.

A country can process more minerals and still remain dependent on imported technology, foreign capital, imported machinery, and low-value industrial activities. It can increase the number of smelters without building a deep supplier ecosystem. It can raise export value while leaving productivity gains narrowly concentrated.

The central question of this chapter is therefore more demanding than whether downstreaming is happening.

It is whether downstreaming can become industrial transformation.

That distinction will determine whether Indonesia's resource endowment becomes a foundation for higher productivity or simply a larger processing capacity.

10.2. From Commodity Exporter to Industrial Economy

For decades, Indonesia's development has been influenced by the economic weight of commodities. Oil and gas, coal, palm oil, minerals, and other resource-based products have generated exports, investment, fiscal revenues, and regional economic activity.

The strength of this model is obvious: natural resources can generate foreign exchange and investment relatively quickly.

Its vulnerability is equally clear: commodity prices fluctuate, resource extraction can be capital-intensive, and value creation may remain concentrated in upstream activities.

Industrialization seeks to change that structure.

The objective is not to abandon commodities. It is to build more economic activity around them.

The conceptual transition is:

Resource → Processing → Manufacturing → Technology → Services → Global Value Chain.

The farther an economy can move along this chain, the greater its potential for learning, diversification, skilled employment, and productivity growth.

Yet movement along the value chain is neither automatic nor linear. Processing a commodity is only one step. The deeper transformation occurs when processing creates capabilities that can be used to produce increasingly sophisticated goods and services.

Bappenas has explicitly linked industrialization with the creation of domestic value added and the development of modern services. Its current planning documents also extend the logic of downstreaming beyond mining into agriculture, plantations, fisheries, and other commodities (Bappenas, 2024, 2025, 2026).

The strategic question is therefore no longer simply how to process more.

It is how to learn more from processing.

10.3. The Nickel Experiment

Nickel is the clearest example of Indonesia's downstreaming strategy.

Indonesia introduced restrictions on raw nickel ore exports beginning in 2014, followed by increasingly stringent domestic-processing requirements. The policy sought to encourage smelting, refining, and later stages of the nickel value chain inside Indonesia.

The results have been economically significant. The World Bank notes that Indonesia's policy shifted exports away from raw nickel ore toward processed products such as ferronickel and nickel pig iron. The country has also attracted substantial investment into nickel processing and related industrial activity (World Bank, 2026a).

This is important evidence that industrial policy can alter the location of processing activity.

But the second question is more difficult: what happened beyond the first processing stage?

A transformation becomes deeper when processing generates supplier industries, engineering capabilities, technology diffusion, skilled jobs, research capacity, export diversification, and domestic firms capable of competing internationally.

The World Bank's 2026 regional economic update also highlights a tension surrounding Indonesia's approach: export restrictions can support domestic value addition but may conflict with multilateral trade commitments. The WTO dispute over Indonesia's nickel ore export ban remains unresolved following Indonesia's appeal (World Bank, 2026a).

The nickel experience therefore provides neither a simple success story nor a simple failure story.

It is a live industrial-policy experiment.

Its significance lies precisely in the lessons it offers about how resource policy can—and cannot—translate into broader industrial capability.

10.4. The Value-Added Test

Value added is the first test of downstreaming.

But value added must be interpreted carefully.

An increase in export value does not necessarily mean that domestic value added has increased by the same amount. A processing facility may rely heavily on imported machinery, technology, intermediate inputs, foreign services, and foreign capital. The domestic share of the final export can therefore differ substantially from its gross export value.

A stronger assessment asks:

How much domestic income was created?

How many productive jobs were created?

How much domestic technology was developed?

How many local suppliers entered the value chain?

How much productivity increased?

How much export capability became more sophisticated?

These measures move the discussion from gross output toward economic transformation.

The distinction is especially important for Indonesia because the country is trying to move from resource abundance toward higher-income status. Higher-income economies generally require more than extraction. They require firms capable of learning, innovating, scaling, and competing across increasingly complex markets.

Downstreaming should therefore be evaluated through a broader value-added chain:

Natural Resource → Domestic Processing → Supplier Development → Technology → Skilled Employment → Export Capability → Productivity.

If the chain stops at processing, the transformation is incomplete.

10.5. The Productivity Test

Chapter 5 established productivity as the hidden engine of long-term prosperity. Chapter 9 then placed productivity at the center of the Prabowo economic architecture.

Industrial policy must therefore pass a productivity test.

A new factory can raise output. But does it raise output per worker?

A new smelter can increase processing capacity. But does it create technological learning?

A new industrial estate can attract investment. But does it generate supplier networks?

A downstream industry can increase exports. But does it become competitive without permanent policy support?

These questions matter because capital accumulation alone cannot guarantee sustained productivity growth.

The strongest industrial policy combines capital with learning.

That means encouraging firms to adopt better technologies, develop local engineering capabilities, improve management, train workers, integrate suppliers, and compete in increasingly demanding markets.

Bappenas Working Papers in 2026 similarly emphasized that the effectiveness of downstreaming depends on industrial linkages, national technological capability, regulatory consistency, and integration with the transition toward lower-carbon production. Without these elements, downstreaming can become an expansion of processing capacity without sufficient structural transformation (Nugroho & Widyastuti, 2026).

The productivity test therefore asks not how large the industrial project is, but what capabilities remain after the project is built.

10.6. Beyond Nickel: Diversifying the Downstreaming Agenda

A national industrial strategy cannot depend on one mineral.

The government has increasingly expanded downstreaming into other commodities. The RPJMN includes broader resource-based industrialization, while Bappenas has developed road maps for commodities such as coconut and has highlighted palm oil, coffee, cocoa, fisheries, salt, and other sectors as potential areas for value-added development (Bappenas, 2025, 2026).

This diversification matters for two reasons.

First, Indonesia's natural-resource endowment is broad. Second, different commodities require different industrial strategies.

Mineral downstreaming often involves large-scale capital-intensive facilities, energy systems, ports, and industrial estates.

Agricultural downstreaming depends more heavily on productivity at the farm level, quality standards, cold chains, storage, logistics, processing technology, branding, and farmer organization.

Fisheries require sustainable resource management, cold-chain infrastructure, processing, certification, and market access.

Forestry requires traceability and sustainable production.

The same word—downstreaming—therefore describes very different economic mechanisms.

A serious industrial policy must avoid applying a single template to every commodity.

The relevant question is always:

What is the binding constraint in this value chain?

Sometimes it is processing capacity.

Sometimes it is farm productivity.

Sometimes it is logistics.

Sometimes it is technology.

Sometimes it is certification.

Sometimes it is access to finance.

Industrial transformation begins by identifying the constraint rather than assuming that a factory is the answer.

10.7. Industrial Ecosystems, not Isolated Plants

An industrial plant is an asset.

An industrial ecosystem is an economic system.

The difference is crucial.

A successful industrial ecosystem contains producers, suppliers, logistics firms, financial institutions, skilled workers, research

institutions, testing laboratories, infrastructure providers, and export channels.

The ecosystem creates spillovers.

A large processing facility can generate demand for local engineering firms. Those firms can develop capabilities. Workers can acquire skills. Universities can adapt curricula. Suppliers can improve standards. Financial institutions can learn to evaluate industrial projects. New firms can enter the market.

This is how an initial investment becomes a platform for broader productivity.

The opposite can also occur.

An isolated industrial project can import most inputs, employ relatively few workers, export intermediate products, and generate limited local linkages.

The physical investment may be large while the domestic transformation is modest.

This is why industrial policy should track linkages as seriously as investment value.

Useful indicators include the share of domestic inputs, number and quality of local suppliers, local research and development, worker training, technology transfer, domestic ownership and capability, export diversification, and productivity growth.

Bappenas has recently emphasized precisely this ecosystem perspective in its work on coconut and plantation downstreaming, linking productivity, investment, and industrial development rather than treating processing as a standalone activity (Bappenas, 2026).

10.8. The Energy Constraint

Industrialization consumes energy.

This creates one of the most important constraints on Indonesia's downstreaming strategy.

Smelting, refining, chemical processing, steel production, and other heavy industries can require large and reliable supplies of electricity and fuel. If energy costs are high or supply is unreliable, industrial competitiveness suffers.

Indonesia therefore faces a dual requirement.

It must expand industrial energy supply while managing the environmental and carbon implications of that expansion.

The issue is not simply how much energy is available. It is the combination of price, reliability, infrastructure, technology, and emissions intensity.

An industrial strategy that creates low-cost but highly carbon-intensive production may face increasing challenges in global markets as climate-related trade measures and buyer standards evolve.

Conversely, a strategy that imposes excessively high energy costs before alternative technologies are commercially viable could weaken industrial competitiveness.

The economic challenge is therefore to reduce the carbon intensity of industrial growth while maintaining reliable and competitive energy.

This connects Chapter 10 directly to Chapter 14, where energy, food, and strategic vulnerability will be examined in a broader context.

Industrial policy cannot be separated from energy policy.

10.9. The Infrastructure and Logistics Test

Downstreaming also depends on geography.

Indonesia's resources are dispersed across an archipelago, while major markets and industrial centers are unevenly distributed.

A processing plant near a mine may reduce the need to transport raw material, but finished products still need to reach ports, domestic customers, or international markets.

Roads, ports, electricity grids, water systems, telecommunications, and industrial estates therefore form part of the industrial policy itself.

The economic value of infrastructure should be evaluated through the constraints it removes.

A port is valuable when it lowers shipping time and cost.

A road is valuable when it connects producers to markets.

A power system is valuable when it provides reliable energy at competitive cost.

A digital network is valuable when it improves coordination, market access, and productivity.

This is why the infrastructure agenda should be integrated with industrial clusters rather than developed as a separate list of projects.

The objective is not infrastructure for its own sake.

It is lower transaction costs and higher productive capacity.

10.10. The Skills and Employment Test

Industrialization changes the demand for labor.

Some downstream industries are highly capital-intensive and may create fewer direct jobs than their investment size suggests. Others can generate extensive employment through supplier networks, processing, logistics, maintenance, services, and manufacturing.

This makes job quality more important than job counts alone.

Indonesia needs employment that raises productivity and wages over time.

The ideal transmission is:

Industrial Investment → Skills → Productivity → Wages → Household Security.

If workers remain concentrated in low-skill activities while the most sophisticated functions are performed elsewhere, domestic value capture remains limited.

Industrial policy should therefore include skills policy from the beginning.

Technical and vocational education, engineering skills, maintenance capabilities, digital skills, management training, and workplace learning all become part of industrial competitiveness.

This also creates an opportunity for regional development.

Industrial clusters can become training ecosystems if firms, vocational institutions, universities, and local governments coordinate.

The goal should be to ensure that Indonesian workers do not simply work inside downstream industries.

They should increasingly move upward within them.

10.11. The Foreign Investment Question

Foreign investment is an important part of Indonesia's industrialization strategy.

Large-scale industrial projects often require capital, technology, managerial capabilities, and access to global markets that domestic firms cannot immediately provide at sufficient scale.

The relevant question is therefore not whether foreign investment should be present.

It is what Indonesia learns and captures from it.

Foreign direct investment can generate positive spillovers through supplier development, worker training, technology transfer, demonstration effects, and access to international value chains.

But spillovers are not automatic.

They depend on local capabilities, competition, labor mobility, supplier readiness, intellectual-property arrangements, infrastructure, and the quality of institutions.

Industrial policy should therefore seek complementarity rather than simple ownership substitution.

The objective is to make foreign investment a bridge into higher capabilities.

That requires domestic firms capable of becoming suppliers, workers capable of learning advanced processes, universities capable of supporting research, and regulators capable of maintaining predictable rules.

Foreign capital can accelerate industrialization.

Domestic capability determines how much of the acceleration remains in the economy.

10.12. Competition and the Risk of Protected Inefficiency

Industrial policy inevitably creates a tension between support and competition.

New industries may need temporary support because learning takes time and initial costs can be high.

But protection can become permanent.

When that happens, firms may have less incentive to reduce costs, innovate, improve quality, or compete internationally.

This is the classic risk of industrial policy: a temporary instrument becomes a permanent entitlement.

The solution is not to abandon industrial policy.

It is to design discipline into it.

Support can be linked to measurable milestones.

Protection can be reviewed periodically.

Incentives can be conditional on investment, exports, technology adoption, productivity, training, or supplier development.

Poor-performing programs can be redesigned or terminated.

The principle is simple:

Industrial policy should create capabilities that eventually survive competition.

If an industry requires permanent protection to remain viable, policymakers should examine whether the social return justifies the continuing cost.

The purpose of industrial policy is transformation, not insulation.

10.13. Trade Rules and Strategic Autonomy

Indonesia's downstreaming strategy operates within a global trading system.

This creates a tension between strategic autonomy and international obligations.

The World Bank's 2026 East Asia and Pacific Economic Update notes that Indonesia's export restrictions on minerals have raised questions under WTO rules, including the WTO panel ruling concerning the nickel ore export ban. Indonesia appealed the ruling, and the dispute remains unresolved because the WTO Appellate Body is not currently functioning (World Bank, 2026a).

This matters because industrial policy does not operate in a legal vacuum.

Trade restrictions can change domestic incentives, but they can also trigger disputes, retaliation, or uncertainty for investors and trading partners.

Strategic autonomy therefore requires more than restricting exports.

It requires building capabilities that remain competitive under a range of trade conditions.

The strongest industrial strategy would seek to make Indonesian products competitive because of productivity, quality, logistics, technology, and scale—not because foreign buyers have no alternative.

This is a more durable form of economic sovereignty.

It is sovereignty through capability.

10.14. The Environmental Constraint

Industrialization can create environmental costs.

Mining, smelting, refining, plantations, and heavy manufacturing can affect land, water, air quality, biodiversity, and greenhouse-gas emissions.

These costs are not peripheral to economic analysis.

They can become economic costs through health impacts, cleanup requirements, stranded assets, regulatory disputes, financing constraints, and changing international market standards.

The World Bank has noted that some downstreaming activities, particularly mineral processing, can be energy-intensive and environmentally demanding (World Bank, 2024, 2026).

This does not mean industrialization should stop.

It means industrial policy must incorporate environmental productivity.

The relevant question becomes:

Can Indonesia increase value added while reducing the environmental cost per unit of output?

That requires cleaner energy, better industrial technology, water management, waste treatment, environmental monitoring, land rehabilitation, and credible enforcement.

Green industrial capability can itself become a competitive advantage.

As global supply chains increasingly evaluate carbon intensity and environmental standards, cleaner production may influence market access and investment decisions.

Environmental policy is therefore not simply a constraint on industrial policy.

It can become part of industrial upgrading.

10.15. Fiscal Incentives and the Cost of Industrial Policy

Industrial policy often requires incentives.

Tax holidays, import facilities, infrastructure support, subsidized financing, special economic zones, training programs, and other instruments can reduce the cost of investment.

But every incentive has an opportunity cost.

A tax expenditure is revenue not collected.

A subsidized loan is a fiscal or financial risk.

Public infrastructure dedicated to one cluster may reduce resources available elsewhere.

This returns us to Chapter 8.

Revenue capacity is limited. Fiscal space is limited. Therefore industrial incentives must be evaluated against measurable economic returns.

The relevant calculation is not simply:

How much investment did the incentive attract?

It is:

What additional investment, productivity, employment, exports, technology, and revenue did the incentive create compared with what would have happened without it?

This is the logic of additionality.

If an investment would have occurred anyway, a large subsidy may transfer public resources without changing the outcome materially.

Industrial policy becomes stronger when incentives are transparent, targeted, time-bound, evaluated, and connected to performance.

10.16. Regional Value Capture

One of the most important political-economy questions in resource-based industrialization is where the benefits accrue.

Resource-producing regions may bear environmental and infrastructure costs while much of the processing, finance, technology, and ownership value is captured elsewhere.

A more inclusive downstreaming strategy therefore needs regional value capture.

That can involve local employment, supplier development, infrastructure, revenue-sharing arrangements, skills programs, and stronger participation of local enterprises.

Bappenas has emphasized this issue in its recent work on integrated coconut industrial areas, where the objective includes ensuring that more value is captured in producing regions while reducing logistics costs (Bappenas, 2026).

Regional value capture also matters for national cohesion.

Industrial transformation becomes more sustainable when producing regions see tangible improvements in income, infrastructure, services, and opportunity.

The goal is not to force every stage of every value chain into the producing region.

The goal is to ensure that resource-rich regions are not left with extraction while higher-value capabilities accumulate elsewhere.

10.17. The Small-Firm Question

Industrialization is often associated with large firms.

But long-term economic transformation also depends on small and medium enterprises.

Large industrial projects can create opportunities for smaller firms in logistics, maintenance, food services, packaging, engineering, construction, digital services, and specialized manufacturing.

These linkages can turn industrial investment into broad-based productivity growth.

Without them, industrialization may remain an enclave.

The challenge is that small firms often face constraints in finance, quality standards, technology, management, certification, and market information.

Industrial policy should therefore include supplier-upgrading programs.

The objective is not to protect small firms from competition indefinitely.

It is to help capable firms meet the standards required to enter productive value chains.

This is another point where skills, finance, digitalization, and industrial policy converge.

A downstream industry becomes more transformative when thousands of firms can participate around it rather than when one large facility dominates the ecosystem.

10.18. The Technology Test

Technology determines how much learning an industrial project creates.

A country can own a factory without owning the knowledge required to design, improve, and reproduce its technology.

The long-term objective should therefore be technological capability.

This includes engineering, research and development, process optimization, industrial software, automation, materials science, quality control, and management systems.

Technology transfer is strongest when local firms and workers have the capability to absorb it.

This means that industrial policy and innovation policy cannot be separated.

Universities, research institutes, firms, vocational schools, and government agencies need mechanisms for collaboration.

The objective is not simply to import the newest machine.

It is to build the capability to use, adapt, improve, and eventually develop technology.

That is how capital becomes knowledge.

And knowledge becomes productivity.

10.19. A Downstreaming Stress Test

The downstreaming strategy can be evaluated through eight questions.

1. Value added: Is domestic value added increasing rather than only gross export value?

2. Productivity: Is output per worker and per unit of capital rising?

3. Linkages: Are domestic supplier networks becoming deeper?

4. Technology: Is Indonesia acquiring capabilities rather than only importing equipment?

5. Employment: Are jobs becoming more productive and better paid?

6. Competitiveness: Can industries compete with declining dependence on protection?

7. Resilience: Can the industrial system withstand commodity, trade, energy, and geopolitical shocks?

8. Sustainability: Can value added rise while environmental costs per unit of output fall?

These questions produce a more demanding scorecard than investment announcements.

They also help distinguish between three possible outcomes.

The first is processing expansion: more factories, more capacity, but limited capability diffusion.

The second is industrial deepening: more suppliers, skills, technology, and competitive firms.

The third is structural transformation: industrial capabilities spill into new sectors, exports diversify, productivity rises, and the economy becomes less dependent on resource cycles.

Indonesia's strategic objective is the third.

The evidence available by 2026 shows meaningful expansion of downstream activity, especially in minerals and base metals, but the deeper transformation remains an ongoing process rather than a completed outcome (World Bank, 2026; Bappenas, 2026).

10.20. From Downstreaming to Upstream Capability

There is a paradox at the heart of downstreaming.

To move downstream successfully, Indonesia must also strengthen parts of the upstream.

Agricultural processing requires productive farmers.

Mineral processing requires reliable mining operations, geological knowledge, engineering, and energy.

Manufacturing requires machinery, components, logistics, finance, and skilled labor.

Therefore the value chain is circular rather than one-directional.

Upstream productivity supports downstream competitiveness.

Downstream demand can, in turn, create incentives for upstream upgrading.

The policy objective should be to strengthen the entire chain.

This is particularly important for agriculture. Bappenas has emphasized that downstreaming coconut cannot succeed simply by building processing facilities because much of the plantation base is

aging and productivity constraints begin at the farm level (Bappenas, 2026).

The lesson is broad.

Industrial transformation begins before the factory gate.

10.21. Can Indonesia Turn Resources into Productivity?

The answer cannot yet be reduced to yes or no.

Indonesia has demonstrated that policy can change the structure of commodity exports and attract major investment into downstream processing. Nickel is the clearest example. The government is now extending the downstreaming agenda across minerals, agriculture, plantations, fisheries, and other resource-based sectors.

That is significant.

But industrial transformation is a higher threshold.

The decisive evidence will be visible in productivity, technology, supplier networks, employment quality, export sophistication, regional value capture, fiscal returns, and environmental performance.

If downstreaming creates these capabilities, Indonesia's natural resources can become a platform for structural transformation.

If downstreaming remains concentrated in capital-intensive processing with limited domestic capability diffusion, the economy may gain value without achieving the full productivity transformation required for high-income development.

The distinction is not academic.

It determines whether resource abundance becomes a bridge to a more diversified economy or a deeper dependence on resource-linked industrial cycles.

The Prabowo economic architecture therefore faces a specific industrial question:

Can Indonesia use downstreaming to move from owning resources to mastering capabilities?

That is the real test of industrial policy.

10.22. Bridge to Chapter 11

Chapter 9 presented the economic architecture.

Chapter 10 has examined one of its central mechanisms: industrial policy and downstreaming.

The logic is now clearer.

Natural resources can provide the initial advantage.

Downstreaming can create processing capacity.

Processing can attract investment.

Investment can generate industrial ecosystems.

Industrial ecosystems can create skills and technology.

Skills and technology can raise productivity.

Productivity can create better jobs, stronger incomes, broader tax bases, and greater resilience.

But every link must work.

The next chapter examines another institution at the center of this architecture: Danantara and Indonesia's state-owned enterprise system.

The question changes from how Indonesia processes resources to how Indonesia allocates and mobilizes capital.

If Chapter 10 asks whether natural resources can become productivity, Chapter 11 asks whether state capital can become productive capital.

The two questions are connected.

Industrial transformation requires capital.

Capital requires governance.

And governance determines whether investment becomes an asset—or merely an expenditure.

Figure 10.1 — THE DOWNSTREAMING-TO-PRODUCTIVITY CHAIN

Natural Resources → Domestic Processing → Supplier Development → Technology & Skills → Competitive Industry → Productive Employment → Export Capability → Productivity → Household Income → Fiscal Capacity → Further Investment.

CHAPTER 11

DANANTARA, STATE ASSETS & THE INVESTMENT STATE

Can State Capital Become Productive Capital?

11.1. The Rise of the Investment State

If Chapter 10 asked whether Indonesia can turn natural resources into productive industrial capability, Chapter 11 asks a related question from the capital side: can the state turn public assets into productive capital?

This question has become more important with the creation of Danantara Indonesia.

Launched in February 2025 and established through Law No. 1 of 2025, Danantara was designed as a strategic state investment management institution with a mandate connected to the management and optimization of government investments and state-owned enterprise assets. Its institutional framework was subsequently amended through Law No. 16 of 2025 and implementing regulations (Danantara Indonesia, 2026).

The significance of Danantara is larger than the creation of another state institution.

It represents a change in how Indonesia intends to organize state capital.

Instead of treating state-owned enterprises primarily as individual companies, the new architecture places them within a more centralized investment and operational holding structure. Danantara's stated mandate includes managing dividends, capital participation, investment holdings, operational holdings, and strategic policies covering finance, investment, risk management, compliance, and ESG (Danantara Indonesia, 2026).

The underlying proposition is straightforward:

Better-managed state assets → better capital allocation → higher returns → more investment capacity → stronger economic transformation.

But the reverse is also possible:

Poor capital allocation → weak returns → greater leverage or contingent liabilities → reduced fiscal space → weaker resilience.

That is why Danantara should be analyzed neither as a guaranteed engine of growth nor as an automatic fiscal threat.

It is an institutional experiment whose economic consequences depend on governance, investment discipline, transparency, risk management, and measurable returns.

11.2. From SOES to a State Investment Architecture

Indonesia has long relied on state-owned enterprises to provide infrastructure, energy, transportation, finance, telecommunications, and strategic goods and services.

The challenge has been fragmentation.

Large SOE portfolios can contain companies with very different objectives, capital structures, governance arrangements, and performance profiles. Some operate in commercial markets. Others carry public-service obligations. Some require restructuring. Others generate substantial dividends.

Danantara seeks to create a more integrated architecture.

Its official framework distinguishes between investment and operational holdings and gives the institution authority over important aspects of state-owned enterprise capital allocation, including dividend management and capital participation (Danantara Indonesia, 2026).

The economic rationale is portfolio management.

A portfolio approach can potentially identify where capital is underutilized, where businesses should be consolidated, where investment should be increased, where assets should be divested, and where companies require operational restructuring.

But portfolio management creates a new requirement: the center must know enough about each asset to allocate capital intelligently.

Centralization can reduce duplication.

It can also centralize mistakes.

The institutional design therefore matters as much as the asset base.

11.3. The Scale Question

The scale of Danantara has attracted international attention.

The World Bank described Danantara in 2025 as combining traditional sovereign wealth fund functions with a broad domestic development mandate, with assets under management estimated at roughly US$900 billion at that time. Danantara itself has subsequently described its broader ecosystem as a platform for managing, optimizing, and growing Indonesia's strategic assets (World Bank, 2025; Danantara Indonesia, 2026).

Large scale creates opportunity.

A large asset pool can support diversification, long-term investment, portfolio optimization, and strategic co-investment. It can also provide Indonesia with a platform for partnering with global investors.

But scale is not performance.

An asset is economically valuable only when it generates an adequate risk-adjusted return or delivers a clearly defined public benefit whose cost and financing are transparent.

The important question is therefore not:

How large is Danantara?

It is:

How effectively does Danantara allocate capital?

That distinction should remain central as the institution develops.

11.4. State Assets Are not Free Money

A common misunderstanding of state investment is that government-owned assets represent money that can simply be redeployed without cost.

They cannot.

Every asset has an opportunity cost.

A profitable SOE can distribute dividends to the state budget, retain earnings for expansion, or transfer value through another investment structure. Each choice changes the financial position of the state.

The World Bank noted that the transfer of SOE dividends to Danantara reduced revenue flowing directly into the state budget and could initially increase the fiscal deficit, while improved SOE governance and investment performance could potentially generate stronger future returns (World Bank, 2025).

The IMF made a similar observation in its 2025 Article IV assessment. It estimated that the shift of SOE dividends to Danantara contributed to a wider fiscal deficit in 2025 and emphasized the importance of managing contingent liabilities and quasi-fiscal risks (IMF, 2025).

This creates an essential accounting principle:

Transferred assets are not newly created national wealth.

They are reorganized claims on existing national wealth.

The economic benefit comes only if the reorganization produces better returns, better services, higher productivity, or other measurable gains.

11.5. The Dividend Trade-Off

SOE dividends are a useful example of the trade-off.

When a state-owned company pays a dividend to the government, the APBN receives revenue that can finance public spending, reduce borrowing needs, or strengthen fiscal space.

When that dividend is retained within an investment institution, the government forgoes immediate budget revenue in exchange for the possibility of higher future returns.

Neither choice is automatically superior.

The relevant comparison is between the return on reinvested capital and the fiscal value of receiving the dividend today.

If retained earnings are invested in high-return projects, the long-term benefit may exceed the short-term dividend.

If capital is allocated to low-return projects, the state may sacrifice fiscal capacity without creating sufficient economic value.

This is essentially a capital-allocation equation:

Retained Capital → Expected Return → Risk → Alternative Use of Funds.

The quality of Danantara will therefore be partly revealed through the opportunity cost of capital.

Every rupiah retained for investment should have a reason.

11.6. The Investment State

Danantara points toward a broader model of economic governance: the investment state.

In an investment state, government does more than regulate markets and finance public goods. It also seeks to mobilize, manage, and allocate capital toward long-term strategic objectives.

This model can be useful when markets underinvest in projects with long horizons, large coordination requirements, or significant externalities.

Infrastructure, energy systems, industrial upgrading, strategic technology, and food security can all involve investments whose returns are uncertain or delayed.

But the investment state carries a fundamental discipline requirement.

Public capital must not become politically allocated capital by default.

The distinction between public purpose and political allocation is therefore critical.

A strategic project may have a legitimate national-development rationale. But that rationale should be translated into an investment thesis, risk assessment, expected return, measurable outcomes, and a clear governance structure.

This is what converts state ownership into economic management.

11.7. Commercial Logic and Public Purpose

Danantara operates at the intersection of two objectives.

The first is commercial: generate sustainable returns and improve the performance of state assets.

The second is developmental: support national priorities such as industrialization, downstreaming, infrastructure, energy, food security, and strategic sectors.

These objectives can reinforce one another.

A profitable investment in a productive industrial ecosystem can generate both financial and economic returns.

But they can also conflict.

A project may have high social value but low commercial return.

Another project may have high commercial return but limited strategic importance.

A third may be strategically important but carry substantial risk.

The solution is not to pretend that every project has the same objective.

The institution needs clear classification.

Commercial investments should be evaluated commercially.

Developmental investments should disclose their public-policy rationale and economic cost.

Public-service obligations should be separately identified and transparently compensated where appropriate.

This separation helps prevent cross-subsidization from obscuring performance.

11.8. Governance is the Core Asset

For a state investment institution, governance is itself a form of capital.

Strong governance lowers the probability that capital will be misallocated, conflicts of interest will go unmanaged, or risks will accumulate unnoticed.

Danantara's formal framework includes policies on accounting and finance, investment, procurement, information technology, human resources, risk management, internal oversight, legal compliance, and ESG (Danantara Indonesia, 2026).

Danantara also announced a governance reset and broader review of SOE accounting policies, asset quality, governance, and integrated risk management in 2026 (Danantara Indonesia, 2026).

These institutional steps matter because large asset portfolios create information problems.

Decision-makers need reliable financial statements.

They need consistent asset valuation.

They need risk-adjusted performance measures.

They need independent oversight.

They need clear approval thresholds.

They need mechanisms for detecting underperformance.

And they need the ability to exit investments.

Without these functions, a large portfolio can become difficult to manage precisely because of its size.

11.9. Transparency and the Reporting Problem

Investment institutions operate partly on trust.

Investors, taxpayers, legislators, and citizens need to understand what assets are owned, how they are valued, where capital is invested, what returns are generated, and what risks are being carried.

This makes financial reporting especially important.

In May 2026, Danantara stated that it was consolidating and finalizing audited financial statements for SOE entities within its management scope and emphasized its commitment to transparency, accountability, and financial disclosure under the applicable legal framework (Danantara Indonesia, 2026).

For a large state investment institution, transparency should eventually extend beyond aggregate asset size.

A mature reporting framework would allow external observers to assess:

Portfolio composition.

Investment performance.

Risk-adjusted returns.

Leverage.

Liquidity.

Related-party exposures.

Contingent liabilities.

Dividend policy.

Public-policy investments.

Administrative costs.

And realized versus unrealized gains.

The more transparent the reporting, the easier it becomes to distinguish economic value creation from accounting revaluation or asset transfers.

11.10. The Leverage Question

Leverage can magnify investment returns.

It can also magnify losses.

This is especially important when a state investment institution has access to borrowing, guarantees, or other forms of financial support.

The legal framework for Danantara includes authority relating to borrowing and guarantees subject to specified approvals (Danantara Indonesia, 2026).

The IMF has highlighted the possibility that leveraged investments could expand quasi-fiscal activity and increase contingent liabilities if projects underperform or accumulate debt obligations (IMF, 2025).

This is not an argument against leverage.

Debt can be appropriate when an asset generates predictable cash flows sufficient to service it.

The relevant question is whether the risk-return profile remains sustainable under adverse conditions.

A proper investment framework therefore needs:

Debt limits.

Liquidity requirements.

Currency-risk management.

Interest-rate stress tests.

Project-level cash-flow analysis.

Guarantee limits.

Concentration limits.

And transparent treatment of contingent liabilities.

The objective is not zero risk.

It is controlled risk.

11.11. The Quasi-Fiscal Boundary

One of the most important questions surrounding Danantara is where investment activity ends and fiscal policy begins.

A government can pursue public objectives through the APBN.

It can also pursue them through SOEs, investment institutions, guarantees, directed lending, or other state-linked entities.

When these channels overlap, the fiscal perimeter can become difficult to see.

This is the problem of quasi-fiscal activity.

A project may appear outside the budget while ultimately creating a financial obligation for the public sector.

The IMF therefore emphasized that Danantara-related contingent liabilities and quasi-fiscal risks should be managed carefully (IMF, 2025).

The analytical solution is transparency.

If a project has a public-policy objective, that objective should be identifiable.

If the project receives an implicit or explicit government guarantee, the exposure should be measurable.

If a commercial entity is expected to carry a policy burden, the cost should be recognized.

The principle is simple:

Off-budget does not mean cost-free.

11.12. SOE Reform and the Portfolio Logic

Danantara's role also involves changing the structure of the SOE portfolio.

The government has discussed substantial rationalization of the SOE ecosystem. The IMF reported plans to reduce the number of SOEs significantly while improving operational efficiency (IMF, 2025).

Portfolio rationalization can take several forms:

Merger.

Consolidation.

Restructuring.

Divestment.

Liquidation.

Operational improvement.

Capital reallocation.

Each has a different economic purpose.

A merger may reduce duplication.

A divestment may release capital.

A restructuring may improve productivity.

A liquidation may stop continuing losses.

A new capital injection may accelerate a high-return business.

The key is that portfolio decisions should be based on economic logic rather than the symbolic importance of individual companies.

A state-owned company should not be protected merely because it is large.

Nor should an asset be sold merely because it is underperforming temporarily.

The relevant question is whether its social and economic value exceeds the opportunity cost of retaining capital in its current form.

11.13. From Ownership to Performance

Ownership is not the same as control over outcomes.

The state may own a company while the company remains inefficient.

Conversely, a professionally managed state-owned enterprise can perform competitively while serving legitimate strategic objectives.

This makes performance measurement central.

Useful indicators include:

Return on invested capital.

Return on equity.

Cash-flow generation.

Productivity per employee.

Capital turnover.

Debt-service capacity.

Dividend contribution.

Market competitiveness.

Export performance.

Technology adoption.

Supplier development.

And quality of public-service delivery where relevant.

Different SOEs will require different metrics.

A commercial bank should not be evaluated like a toll-road operator.

A public utility should not be evaluated exactly like an export manufacturer.

But every institution needs a clear performance framework.

This is how ownership becomes accountable capital.

11.14. Crowding in Private Capital

One of the strongest arguments for a state investment institution is its potential to crowd in private capital.

Suppose a strategic project requires US$1 billion.

The state does not necessarily need to finance the entire amount.

It can provide anchor capital, improve project preparation, reduce information asymmetry, establish infrastructure, or partner with institutional investors.

If every dollar of state capital attracts several dollars of private capital into productive projects, the development impact can exceed the size of the initial public investment.

This is the leverage that matters most:

Public Capital → Private Capital → Productive Investment → Jobs and Productivity.

The objective is therefore not to maximize the state's share of every project.

It is to maximize productive investment mobilized per unit of public capital.

That requires credible project preparation, bankable structures, transparent risk allocation, and clear exit strategies.

A successful investment state does not crowd out markets.

It makes productive markets larger.

11.15. Global Partnerships

State investment institutions can also provide a platform for international partnerships.

Danantara has publicly emphasized partnerships with global investors and long-term investment across strategic sectors. Its stated ecosystem includes investment management, SOE transformation, and development-oriented financing functions (Danantara Indonesia, 2026).

The attraction for international investors is scale.

The attraction for Indonesia is access to capital, technology, expertise, and global networks.

But partnerships should be evaluated by what they contribute beyond money.

Does the partnership bring technology?

Does it open export markets?

Does it improve management?

Does it create domestic supplier opportunities?

Does it strengthen financing conditions?

Does it reduce project risk?

Does it improve Indonesian capability?

A large foreign investment announcement can be economically meaningful.

But the deeper question remains:

What capability remains in Indonesia after the capital has been deployed?

11.16. The Risk of Concentration

Large investment institutions face a structural risk: concentration.

If too much capital flows into a small number of sectors, companies, commodities, or projects, a single shock can affect the entire portfolio.

Indonesia's resource-linked economy makes this especially relevant.

A portfolio heavily exposed to nickel, energy, infrastructure, or domestic financial institutions may perform strongly under certain conditions and poorly under others.

Diversification therefore matters.

But diversification should not become an excuse for investing without expertise.

A portfolio should be diversified where risk reduction is valuable and concentrated where strategic capability creates an investment advantage.

The challenge is to combine strategic focus with portfolio resilience.

This is another reason why investment mandates and risk limits matter.

11.17. The Political-Economy Test

Any large state investment institution operates in a political environment.

Capital allocation decisions can create winners and losers.

This is unavoidable.

The institutional question is whether economic criteria remain visible when those decisions are made.

A robust investment system therefore needs:

Transparent mandates.

Professional investment committees.

Independent risk functions.

Clear conflict-of-interest rules.

Auditable decision processes.

Public reporting.

Legislative oversight where required.

And credible sanctions for misconduct.

These mechanisms do not eliminate political influence.

They make the boundary between policy and investment more observable.

That distinction is essential because the economic cost of misallocation can accumulate slowly.

A poor investment decision may not produce an immediate crisis.

It may instead generate years of weak returns, refinancing needs, and lost opportunities.

Investment governance is therefore a long-term economic policy.

11.18. The Fiscal Return Question

Danantara's ultimate relevance to public finance will partly be measured through the fiscal consequences of its portfolio.

There are several possible channels.

Higher SOE profitability can increase dividends.

Higher investment returns can increase public wealth.

More productive companies can expand tax bases.

Private capital mobilization can reduce the amount of public financing required.

Better SOE management can reduce future capital injections.

But the opposite channels must also be monitored.

Lower dividends can reduce current revenue.

Poor investments can destroy capital.

Leverage can increase contingent liabilities.

Weak SOEs can require support.

The fiscal return therefore cannot be reduced to dividend income.

It is a broader equation:

Public Asset Value → Investment Return + Productivity + Tax Base + Reduced Fiscal Risk.

This is why Danantara belongs in the fiscal discussion as well as the investment discussion.

11.19. The Development Return Question

Financial return is only one dimension of development.

Some strategic investments may generate broader economic effects.

An energy project may reduce production costs.

A logistics project may shorten supply chains.

A digital infrastructure project may increase productivity.

A food-security investment may reduce exposure to supply shocks.

An industrial project may create technology spillovers.

These effects can matter even when the direct financial return is moderate.

But they should be measured rather than assumed.

A development investment should have a theory of change:

Investment → Capability → Productivity → Economic Benefit.

The stronger the causal chain, the easier it becomes to justify the investment.

The weaker the chain, the greater the risk that strategic language becomes a substitute for economic analysis.

11.20. Danantara and Downstreaming

Chapter 10 showed that industrial downstreaming requires capital.

Danantara potentially provides a mechanism through which state capital can participate in that transformation.

Its official investment framework identifies strategic sectors that include downstream natural-resource industries, advanced manufacturing, renewable energy, digital infrastructure, strategic upstream sectors, and food security (Danantara Indonesia, 2026).

This creates a direct connection between the two chapters.

Chapter 10 asks whether downstreaming can produce productivity.

Chapter 11 asks whether state capital can finance that productivity efficiently.

The answer depends on investment discipline.

Danantara should not become a mechanism for financing every industrial project simply because the project is labeled strategic.

Instead, it can potentially serve as a capital allocator that identifies projects with credible economic returns and mobilizes additional private and international capital.

That would transform state capital from a passive ownership claim into an active investment platform.

11.21. The Data and Valuation Problem

State-asset management depends on information quality.

A portfolio cannot be managed intelligently if assets are poorly valued, financial statements are inconsistent, liabilities are hidden, or performance data arrive late.

This is particularly important in a large SOE ecosystem where assets can include infrastructure, land, subsidiaries, financial investments, intellectual property, concessions, and long-term contracts.

Valuation is therefore not a technical side issue.

It affects capital allocation.

If an asset is overvalued, investment decisions may appear more attractive than they really are.

If an asset is undervalued, opportunities may be missed.

If liabilities are incompletely recognized, returns can be overstated.

Danantara's 2026 governance reset and consolidation work is therefore economically significant because asset quality and accounting information form the foundation of investment decisions (Danantara Indonesia, 2026).

Better data create better capital allocation.

Better capital allocation creates better returns.

11.22. The Investment State Stress Test

The investment-state model can be tested through ten questions.

1. Governance: Are investment decisions transparent, accountable, and professionally managed?

2. Returns: Are assets generating competitive risk-adjusted returns?

3. Fiscal impact: Is the model strengthening rather than weakening fiscal resilience?

4. Leverage: Are borrowing and guarantees controlled?

5. Contingent liabilities: Are public-sector exposures measured and disclosed?

6. Private capital: Does state investment crowd in additional productive capital?

7. Productivity: Do investments raise productive capacity?

8. Strategic value: Do investments strengthen capabilities that markets may underprovide?

9. Household transmission: Do investments ultimately improve jobs, incomes, services, or resilience?

10. Exit discipline: Can the institution reduce or exit investments when the economic thesis no longer holds?

These tests are intentionally broader than financial performance.

The investment state exists because public capital is expected to achieve more than a private portfolio.

But that additional objective increases the need for transparency, not decreases it.

11.23. What Would Success Look Like?

Success for Danantara would not simply mean a larger balance sheet.

It would mean:

More productive SOEs.

Higher risk-adjusted returns.

Better capital allocation.

Stronger private investment mobilization.

Higher domestic value added.

More competitive strategic industries.

Improved infrastructure and productive capacity.

Stronger technology capability.

Reduced need for inefficient capital injections.

Greater fiscal resilience.

And transparent evidence that public assets are creating long-term value.

The institution should therefore be judged over time.

Investment cycles are long.

Some projects will fail.

A credible investment institution is not one in which every investment succeeds.

It is one in which failures are limited, recognized early, learned from, and prevented from becoming systemic losses.

11.24. From State Assets to National Wealth

The deeper concept behind Danantara is not state ownership.

It is national wealth management.

A state owns assets because previous generations accumulated capital through public enterprises, infrastructure, natural resources, land, financial institutions, and other forms of national wealth.

The economic responsibility is therefore intergenerational.

Assets should not merely be consumed.

They should be managed so that future generations inherit productive capacity.

This creates a long-term principle:

Current Asset → Productive Investment → Future Income → Future Fiscal Capacity → Future Opportunity.

The opposite pathway is also possible:

Current Asset → Low-Return Allocation → Debt or Losses → Future Fiscal Burden.

The distinction is the essence of investment-state policy.

11.25. The Hardest Question

The hardest question is not whether Indonesia should have a state investment institution.

It is whether Indonesia can build the institutions necessary to manage one at scale.

That requires professional capital allocation.

It requires governance.

It requires transparent reporting.

It requires credible risk management.

It requires clear separation between commercial and public-policy objectives.

It requires the ability to say no to weak projects.

And it requires the ability to exit.

Danantara's future economic significance will therefore depend less on the size of its mandate than on the quality of its decisions.

The institution has been created.

The real test is now operational.

11.26. From Investment State to Economic Transformation

Chapter 9 described the architecture.

Chapter 10 examined industrial policy and downstreaming.

Chapter 11 has examined the capital system that can potentially support both.

The sequence is now visible:

State Assets → Capital Allocation → Industrial Investment → Productivity → Jobs → Household Income → Tax Base → National Wealth.

But the sequence can also reverse:

Poor Governance → Poor Investment → Weak Returns → Fiscal Pressure → Lower Investment Capacity.

Danantara therefore sits at a critical intersection between economic ambition and institutional discipline.

Its potential is significant because Indonesia possesses a large state-owned enterprise ecosystem and a substantial pool of strategic assets.

Its risks are equally significant because the scale of those assets means that poor capital allocation can have consequences beyond individual companies.

The central analytical conclusion is therefore neither optimism nor pessimism.

It is conditional:

State capital becomes development capital only when governance converts ownership into disciplined investment.

The next part of the book will move outward from Indonesia's domestic economic architecture to the global environment in which that architecture must operate.

Chapter 12 will examine global fragmentation and trade.

The question will be whether Indonesia's industrial and investment strategy can remain resilient in a world where trade rules, supply chains, geopolitical relationships, and strategic competition are changing.

The investment state has been built.

Now it must operate in a global economy that is becoming harder to navigate.

Figure 11.1 — THE STATE-CAPITAL TRANSFORMATION CHAIN

State Assets → Professional Governance → Capital Allocation → Strategic & Commercial Investment → Private Capital Mobilization → Productivity → Jobs & Income → Tax Base → National Wealth.

PART V — THE GLOBAL TSUNAMI

CHAPTER 12

GLOBAL FRAGMENTATION & TRADE

Can Indonesia Stay Resilient in a Fragmenting World?

The world economy is not becoming less connected.

It is becoming more strategic.

For several decades, the dominant direction of the international economy appeared relatively clear: lower trade barriers, deeper supply chains, greater cross-border investment, expanding global value chains, and increasing economic interdependence.

That direction has not disappeared.

But it is no longer automatic.

Trade is increasingly influenced not only by comparative advantage and market efficiency, but also by national security, strategic technologies, industrial policy, energy security, climate policy, supply-chain resilience, and geopolitical competition.

Governments are asking a different question from the one that dominated the earlier globalization era.

Not simply:

Where can this product be produced most efficiently?

But:

Where should this product be produced if geopolitical conditions suddenly change?

That distinction matters enormously for Indonesia.

Indonesia is simultaneously a commodity exporter, a large domestic market, an emerging manufacturing platform, a major recipient of

foreign investment, a member of ASEAN and RCEP, and an increasingly active industrial-policy state.

This combination creates opportunity and vulnerability at the same time.

The opportunity is substantial.

Global firms seeking supply-chain diversification may look for alternative production locations. Indonesia has natural resources, a large domestic market, a strategic geographic position, a sizeable labor force, and growing industrial capabilities.

The vulnerability is equally important.

If the global economy becomes more fragmented, Indonesia cannot assume that natural resources, market size, or geopolitical neutrality will automatically translate into sustained investment, export growth, and productivity.

The country must compete for market access, technology, capital, production networks, and institutional trust.

This creates the central question of this chapter:

Can Indonesia remain resilient in a world where globalization is becoming more strategic, more political, and potentially more fragmented?

The answer depends less on choosing between globalization and protectionism than on constructing an economic strategy that combines openness, diversification, productivity, and institutional flexibility.

12.1. The End of Business as Usual

The globalization of the late twentieth and early twenty-first centuries created an extraordinary expansion of international economic integration.

Production became geographically distributed.

A product could be designed in one country, assembled in another, use components from several economies, financed through international capital markets, and sold simultaneously across dozens of markets.

The system generated substantial efficiency gains.

It also created dependencies.

A disruption in one economy could affect production elsewhere. The COVID-19 pandemic exposed supply-chain vulnerabilities. The war in Ukraine demonstrated the strategic consequences of energy and commodity dependence. Semiconductor restrictions showed that access to technology could become an instrument of geopolitical policy. Trade tensions demonstrated that tariffs and industrial policies could alter commercial incentives even when the underlying economics of production had not changed.

The WTO's 2026 Global Trade Outlook provides an important qualification to the idea that globalization has simply collapsed. World merchandise trade remained resilient, while WTO analysis found that fragmentation pressures increased again in 2025, particularly in connection with intensifying trade tensions and further decoupling between the United States and China (WTO 2026a; WTO 2026b).

The implication is not that globalization has ended.

Rather, globalization is being reorganized.

Trade continues.

Investment continues.

Supply chains continue.

But governments and firms increasingly assign strategic value to where production occurs, who controls critical inputs, and how dependent an economy is on a particular partner.

This is the environment in which Indonesia must operate.

The policy challenge is therefore not to predict the disappearance of globalization.

It is to understand the new rules of globalization.

12.2. Fragmentation is not Deglobalization

It is tempting to describe the current period as deglobalization.

The evidence is more nuanced.

The WTO reported that approximately 72 percent of world merchandise trade was still conducted on most-favoured-nation terms

by early 2026. That share had fallen from approximately 80 percent in 2024, reflecting tariff actions and the growth of preferential arrangements, but MFN treatment remained the dominant framework for global merchandise trade (WTO 2026a).

This distinction is fundamental.

Deglobalization would imply a broad retreat from international economic integration.

Fragmentation means something different.

Some trade becomes more regional.

Some supply chains are diversified.

Some technologies are restricted.

Some strategic industries receive government support.

Some firms reduce dependence on particular countries.

Some governments increasingly connect trade policy with national security.

The result is not the disappearance of international trade.

It is a more differentiated global economy.

The distinction can be expressed simply.

Globalization asks:

How can Indonesia integrate efficiently into the world economy?

Fragmentation asks:

How can Indonesia remain integrated without becoming excessively dependent on one market, one supplier, one technology, one source of capital, or one geopolitical relationship?

That is a more difficult question.

It is also the more relevant question for the next phase of Indonesian economic development.

12.3. A World Still Trading

The scale of global trade remains substantial.

The WTO's 2026 analysis estimated that world merchandise trade volume grew strongly in early 2026, supported in part by demand for

electronic components associated with artificial-intelligence investment. At the same time, trade policy uncertainty and geopolitical tensions remained significant risks (WTO 2026c).

This creates an important analytical warning.

Fragmentation should not be interpreted as a permanent collapse in global trade.

The world economy can simultaneously experience:

high trade volumes;

regionalization;

trade restrictions;

supply-chain diversification;

and geopolitical fragmentation.

These developments are not mutually exclusive.

Indeed, fragmentation may increase trade in some sectors while reducing it in others.

Technology is one example.

Trade in AI-enabling goods has become an important source of global trade growth. Meanwhile, strategic technologies may face greater restrictions.

Energy provides another example.

Geopolitical tensions can disrupt shipping and increase energy prices while simultaneously encouraging investment in alternative energy systems.

The global economy is therefore not moving from integration to isolation.

It is moving toward a more complex combination of integration and strategic separation.

For Indonesia, this means that the opportunity remains open.

But the competitive environment is becoming harder.

12.4. Indonesia'S Trade Position

Indonesia enters this new environment with substantial external integration.

WTO data show that Indonesia exported approximately US$281.7 billion in merchandise in 2025. China accounted for 23.8 percent of exports, the United States 11.0 percent, the European Union 6.9 percent, India 6.5 percent, and Japan 6.3 percent (WTO 2026d).

This reveals two characteristics simultaneously.

First, Indonesia has a diversified set of export destinations.

No single destination accounts for a majority of exports.

Second, concentration remains meaningful.

China alone represented nearly one-quarter of Indonesia's merchandise exports in 2025.

This does not mean that Indonesia is excessively dependent on China by definition.

It means that developments in the Chinese economy can have material implications for Indonesian exporters.

The composition of exports adds another layer.

Major Indonesian export products in 2025 included palm oil, coal, ferro-nickel, jewellery, natural gas, nickel intermediates, and copper ores and concentrates (WTO 2026d).

Indonesia therefore remains strongly connected to natural resources and resource-based manufacturing.

The issue is not whether commodity exports are good or bad.

The deeper question is whether commodities become the foundation for structural transformation or the ceiling on it.

A resource-rich economy can use commodity revenues to build industrial capabilities.

But this requires a transition:

Resources
→ Processing
→ Manufacturing
→ Technology

→ Supplier Networks
→ Higher Productivity
→ Global Value Chains

Without that transition, diversification of destinations may simply distribute commodity dependence across more markets.

With it, trade can become an engine of structural transformation.

12.5. The New External Balance

Indonesia's recent trade statistics provide an important real-time test.

BPS reported that Indonesia's exports during January–July 2026 reached US$167.03 billion, up 4.43 percent from the same period of 2025. Imports reached US$163.33 billion, increasing 19.94 percent. The trade balance remained in surplus by US$3.70 billion, consisting of a US$22.45 billion non-oil-and-gas surplus and an US$18.75 billion oil-and-gas deficit (BPS, 2026j).

The narrowing of the headline surplus should not automatically be interpreted as deterioration.

The composition of imports matters.

BPS data for 2025 show that raw and auxiliary materials accounted for approximately 70.1 percent of imports, capital goods approximately 20.7 percent, and consumer goods approximately 9.3 percent (BPS, 2026k).

This distinction is critical.

Imports can represent vulnerability.

But imports can also represent investment.

A factory importing machinery is not equivalent to a household importing a finished consumer product.

Imported intermediate inputs may support domestic manufacturing.

Imported capital goods may expand productive capacity.

Imported technology may increase productivity.

The relevant question is therefore not:

Is Indonesia importing too much?

It is:

What productive capacity is Indonesia creating through what it imports?

This leads to a more sophisticated external-balance framework:

Trade Balance
+
Import Composition
+
Export Complexity
+
Investment Productivity
=
External Resilience

A country can temporarily experience a smaller trade surplus while building productive capacity that strengthens future exports.

Conversely, a country can maintain a large surplus while remaining dependent on a narrow range of commodities.

The headline balance therefore needs to be interpreted through structure.

12.6. China: Market, Supplier, Investor, Competitor

Indonesia's relationship with China illustrates the complexity of modern economic interdependence.

China is simultaneously an important export destination, import source, investor, manufacturing partner, technology provider, and competitor.

WTO data show that China accounted for 23.8 percent of Indonesia's merchandise exports in 2025 and 36.2 percent of imports (WTO 2026d).

BPS data similarly place China as Indonesia's largest import source in 2025, with approximately US$87.4 billion in imports (BPS, 2026k).

This relationship generates both opportunities and dependencies.

Chinese demand can support Indonesian exports.

Chinese investment can accelerate industrial development.

Chinese machinery and intermediate goods can support production.

Chinese firms can participate in domestic value chains.

At the same time, high concentration in one economic relationship can increase exposure to external shocks.

The policy implication is not necessarily disengagement.

It is optionality.

An economy becomes more resilient when firms can sell to multiple markets, source from multiple suppliers, finance investment through multiple channels, and access technology from multiple partners.

Diversification is therefore not equivalent to decoupling.

It is the construction of strategic flexibility.

12.7. The United States and Market Access

The United States represents another critical dimension of Indonesia's external position.

It is one of Indonesia's largest export destinations and an important source of technology, investment, finance, and corporate linkages.

The IMF's 2026 Article IV assessment incorporated a 19 percent US tariff assumption into its projections for Indonesia and identified trade-policy shocks, prolonged uncertainty, and global financial volatility as downside risks (IMF, 2026a).

The important lesson is that tariffs do not operate only at customs borders.

They can influence:

export prices;

firm margins;

investment decisions;

supply-chain locations;

commodity demand;

employment;

exchange rates;

and expectations.

The transmission can therefore be represented as:

Trade Policy Shock
→ Export Cost
→ Foreign Demand
→ Corporate Revenue
→ Investment
→ Employment
→ Household Income
→ Consumption
→ GDP Growth

But the reverse mechanism is also possible.

Supply-Chain Diversification
→ New Investment
→ Manufacturing Capacity
→ Technology Transfer
→ Productivity
→ Export Competitiveness
→ Higher Income

Indonesia's position in this process will depend on whether it becomes merely a supplier of resources or a more sophisticated node in international production networks.

12.8. ASEAN as a Buffer

If global integration becomes more fragmented, regional integration becomes more important.

ASEAN can function as a bridge between domestic capability and global markets.

The ASEAN Economic Community Strategic Plan 2026–2030 explicitly emphasizes deeper integration, stronger production networks, competitiveness, resilience, innovation, and participation in global value chains (ASEAN 2025).

This matters because modern trade competitiveness depends on much more than tariffs.

Firms compete on:

customs efficiency;

port performance;

logistics;

digital documentation;

standards;

electricity;

industrial land;

supplier networks;

tax administration;

and regulatory predictability.

ASEAN's current integration agenda therefore has direct productivity implications.

The objective is not simply to move goods across borders.

It is to reduce the friction of doing business across borders.

Indonesia does not need to choose between national industrial policy and ASEAN integration.

They can reinforce each other if Indonesian firms become competitive participants in regional production networks.

12.9. RCEP and the Value of Options

RCEP adds another layer of strategic optionality.

The agreement connects ASEAN with Australia, China, Japan, South Korea, and New Zealand.

At the Fifth RCEP Ministers' Meeting on September 21, 2026, members emphasized stronger implementation of the agreement, deeper trade and investment relations, and greater utilization by businesses, including MSMEs, in response to an evolving global environment (ASEAN 2026).

The value of RCEP is therefore not limited to tariff preferences.

It is also about options.

A firm able to sell to multiple markets is less exposed to a demand shock in one market.

A manufacturer able to source from multiple countries is less exposed to a supply shock.

An economy participating in several regional arrangements has more room to adapt when one commercial relationship becomes less favorable.

Trade agreements are therefore potentially instruments of resilience.

But agreements create opportunities rather than automatic results.

Indonesian firms still need:

competitive products;

international standards;

efficient logistics;

financing;

market intelligence;

digital capabilities;

and the ability to scale.

The existence of a trade agreement does not make an SME an exporter.

Productivity does.

12.10. The Hidden Frontier: Non-Tariff Measures

The modern trade environment is increasingly shaped by non-tariff measures.

Technical standards, certification, licensing, traceability, sanitary requirements, customs procedures, and documentation can determine whether products actually cross borders.

World Bank WITS data show substantial coverage of non-tariff measures in Indonesia's trade regime. For imports, the reported NTM coverage ratio is 68.95 percent and the frequency ratio 56.33 percent; for exports, the corresponding figures are 59.75 percent and 33.67 percent (World Bank, 2026f).

These numbers should not be interpreted as evidence that all such measures are harmful.

Many serve legitimate purposes.

Food safety requires standards.

Environmental protection requires regulation.

Consumer protection requires certification.

Strategic products may require traceability.

The policy challenge is therefore not deregulation for its own sake.

It is regulatory efficiency.

A useful test is:

Does the measure solve a clearly identified public-policy problem?

Is it proportionate?

Can compliance be measured?

Can firms comply at reasonable cost?

Does it unintentionally reduce competition?

Does it disproportionately burden smaller firms?

Is it aligned with internationally recognized standards where appropriate?

The next frontier of trade competitiveness may therefore be administrative.

A country can have favorable tariff arrangements and still be an expensive place to trade if regulations, documentation, and logistics impose excessive friction.

12.11. Downstreaming Meets the Global Trade System

Chapter 10 examined downstreaming as an industrial strategy.

Chapter 12 adds an external constraint.

Domestic processing capacity is not sufficient by itself.

The resulting products must remain competitive in international markets.

The chain becomes:

Resource
→ Processing
→ Manufacturing
→ Export
→ Global Market Acceptance
→ Productivity
→ Scale

The WTO dispute concerning Indonesian nickel measures illustrates the tension.

In DS592, the European Union challenged Indonesia's nickel export prohibition and domestic processing requirement. The WTO panel found the measures inconsistent with Article XI:1 of the GATT 1994. Indonesia appealed the panel report in December 2022, but the WTO Appellate Body remained unable to hear the appeal because of the continuing institutional impasse over appointments (WTO 2022; WTO 2026e).

The legal status matters.

The dispute is not simply a historical footnote.

It demonstrates that industrial policy operates within an international rules system.

Indonesia may pursue domestic value creation.

Trading partners may challenge the instruments used to achieve it.

Therefore, industrial policy and trade diplomacy cannot be designed independently.

The strategic objective should not merely be:

Process more at home.

It should be:

Build internationally competitive value chains at home.

That distinction separates industrial policy from permanent protection.

12.12. Strategic Autonomy without Isolation

Strategic autonomy has become increasingly important in economic policy.

Its appeal is understandable.

A country does not want to discover during a crisis that it cannot obtain critical medicines, food, energy, industrial inputs, strategic technologies, or essential components.

But strategic autonomy can mean two different things.

The first is self-sufficiency.

Produce everything domestically.

The second is strategic flexibility.

Maintain sufficient domestic capabilities while preserving multiple international sources of supply.

For a large modern economy, the second approach is generally more compatible with the economics of specialization.

No major economy produces everything efficiently.

Even large economies depend on international markets for specialized components, technologies, services, raw materials, and consumers.

The relevant objective is therefore not zero dependence.

It is manageable dependence.

A useful framework is:

Critical Product
→ Domestic Capability
→ Multiple Suppliers
→ Strategic Reserves Where Justified
→ Alternative Trade Routes
→ International Partnerships
→ Crisis Response Capacity

This is resilience by design.

It is not economic isolation.

12.13. Foreign Direct Investment in a Fragmenting World

Global fragmentation is also changing the geography of investment.

When firms diversify supply chains, countries compete to receive the resulting investment.

Indonesia has several potential advantages:

a large domestic market;

natural resources;

strategic geography;

ASEAN membership;

RCEP participation;

a substantial labor force;

and expanding industrial capabilities.

But advantages are not enough.

Foreign investors compare Indonesia with Vietnam, Thailand, Malaysia, India, Mexico, and other emerging production locations.

The relevant question is not:

Does Indonesia possess natural resources?

It is:

Can Indonesia convert resources, market size, and strategic geography into a reliable investment ecosystem?

That requires predictable regulation, infrastructure, logistics, reliable energy, skills, access to land, efficient tax administration, and competitive domestic suppliers.

IMF analysis published in 2026 emphasizes that reforms in trade policy, logistics, human capital, and the investment climate can strengthen Indonesia's integration into global value chains and support gains from shifting supply chains (IMF, 2026a).

This is especially important because fragmentation can increase competition for investment.

Every country wants to capture supply-chain reallocation.

Not every country will.

12.14. From Commodity Exports to Global Value Chains

Indonesia's long-term challenge is not simply to increase exports.

It is to increase the value and sophistication embedded in exports.

There is a major difference between exporting an unprocessed resource and exporting a complex manufactured product.

The second requires:

engineering;

design;

quality control;

specialized skills;

supplier networks;

technology;

finance;

logistics;

intellectual property;

and global marketing.

These capabilities generate productivity spillovers.

Global value-chain participation therefore matters.

But participation itself is not sufficient.

The strategic objective is upgrading.

The progression may look like:

Raw Materials
→ Basic Processing
→ Intermediate Manufacturing
→ Advanced Manufacturing
→ Engineering
→ Design
→ Technology
→ Global Services

The path will not be linear.

Some industries may move rapidly.

Others may remain resource-intensive.

But the direction matters.

This is why trade policy cannot be separated from education policy.

Industrial policy cannot be separated from infrastructure.

Investment policy cannot be separated from competition policy.

Export policy cannot be separated from productivity.

12.15. Trade and the Middle Class

Global trade shocks ultimately reach households.

A fall in commodity prices can reduce incomes in resource-producing regions.

A tariff can reduce manufacturing exports.

A supply-chain disruption can increase prices.

A weaker currency can raise the domestic cost of imported inputs.

A reduction in foreign investment can slow employment creation.

The transmission mechanism is therefore:

Global Shock
→ Trade
→ Investment
→ Production
→ Employment
→ Wages
→ Household Consumption

This makes trade resilience a social-policy issue.

An economy can appear resilient in aggregate while specific workers, regions, or industries experience substantial adjustment costs.

Workers leaving declining industries may not immediately possess the skills demanded by expanding industries.

Regions dependent on one commodity may experience larger shocks than the national average.

Small firms may lack access to finance required to adapt.

Trade adjustment therefore requires:

skills development;

labor mobility;

social protection;

SME financing;

regional diversification;

and infrastructure.

Openness without adjustment capacity can generate resistance.

Adjustment without openness can weaken productivity.

The challenge is to build both.

12.16. The Five-Dimension Trade Resilience Model

Indonesia's external resilience can be evaluated through five dimensions.

First, MARKET DIVERSIFICATION.

Can Indonesian firms sell across multiple geographic markets?

Second, PRODUCT DIVERSIFICATION.

Can exports move beyond a relatively concentrated group of commodities and resource-based products?

Third, SUPPLY-CHAIN DIVERSIFICATION.

Can critical industries source important inputs from multiple suppliers?

Fourth, VALUE-CHAIN DEPTH.

Can Indonesia capture more value through processing, manufacturing, technology, and services?

Fifth, INSTITUTIONAL FLEXIBILITY.

Can trade policy, customs, investment regulation, and industrial policy adjust when external conditions change?

These dimensions interact.

Market diversification without product diversification may simply distribute commodity dependence across more destinations.

Product diversification without supply-chain diversification may leave manufacturers vulnerable to imported inputs.

Supply-chain diversification without productivity may create resilience at excessive cost.

Value-chain depth without institutional flexibility may discourage investment.

Institutional flexibility without strategic direction may generate policy inconsistency.

Resilience is therefore a system rather than a single indicator.

12.17. The Eight-Point Global Fragmentation Stress Test

Indonesia's trade strategy should be tested against at least eight scenarios.

TEST 1 — MAJOR-POWER TRADE WAR

What happens if trade restrictions among major economies intensify?

Potential channels include lower global demand, higher tariffs, supply-chain disruption, investment delays, and commodity-price volatility.

TEST 2 — CHINA DEMAND SHOCK

What happens if weaker Chinese demand reduces Indonesian exports?

The test is whether alternative markets and domestic demand can absorb the shock.

TEST 3 — COMMODITY PRICE COLLAPSE

What happens if prices of major export commodities fall sharply?

The test is whether manufacturing and services can compensate.

TEST 4 — CRITICAL INPUT DISRUPTION

What happens if an essential imported input becomes unavailable?

The test is whether alternative suppliers or domestic capabilities exist.

TEST 5 — SHIPPING DISRUPTION

What happens if geopolitical tensions disrupt major maritime routes?

The test is logistics diversification, inventory resilience, and alternative routing.

TEST 6 — FDI REDIRECTION

What happens if multinational firms choose competing economies for new production?

The test is investment competitiveness.

TEST 7 — TRADE-DISPUTE PRESSURE

What happens if an industrial-policy instrument is challenged internationally?

The test is whether domestic development objectives can be pursued through instruments compatible with international commitments.

TEST 8 — TECHNOLOGY FRAGMENTATION

What happens if access to advanced technologies becomes restricted?

The test is domestic technological capability and the diversity of international partnerships.

A resilient trade strategy should not assume that none of these shocks will occur.

It should assume that some will.

12.18. What Should Indonesia Do?

The answer is not simply more openness.

Nor is it simply more protection.

A more useful strategy is selective openness combined with strategic resilience.

First, deepen market access.

Indonesia needs more export destinations, not fewer.

Second, reduce unnecessary trade friction.

Regulation should protect legitimate public interests without imposing avoidable costs.

Third, strengthen ASEAN and RCEP utilization.

Trade agreements must become actual transactions for Indonesian firms.

Fourth, upgrade export quality.

The objective should be greater domestic value added, technology, productivity, and services content.

Fifth, diversify critical supply chains.

Dependence on one supplier should be reduced where substitution is feasible and economically justified.

Sixth, improve policy consistency.

Frequent changes in trade rules can weaken investment incentives even when individual measures have legitimate objectives.

Seventh, strengthen trade diplomacy.

Industrial ambitions require international negotiation capability.

Eighth, connect trade policy to productivity policy.

The ultimate source of durable export competitiveness is productivity.

12.19. The Paradox of Protection

Protection can sometimes help an emerging industry develop capabilities.

But protection can also reduce competitive pressure.

This creates a central policy paradox.

An industry may need temporary support to develop capabilities.

But permanent protection can create firms that survive because they are protected rather than because they are productive.

The difference is governance.

A disciplined industrial-policy regime requires:

clear objectives;

measurable performance indicators;

time limits;

competition;

cost-benefit analysis;

sunset mechanisms;

and periodic review.

IMF analysis similarly emphasizes the importance of targeting genuine market failures, preserving competition, applying cost-benefit analysis, and maintaining governance safeguards in industrial policy (IMF, 2026a).

This principle becomes even more important during fragmentation.

Geopolitical concerns can make intervention easier to justify.

The danger is that temporary strategic intervention becomes permanent economic insulation.

A resilient economy must distinguish strategic intervention from inefficient protection.

12.20. The Economics of Diversification

Diversification has a cost.

Maintaining multiple suppliers can be more expensive than relying on the cheapest supplier.

Domestic production can cost more than imports.

Strategic inventories tie up capital.

Duplicating supply chains reduces some economies of scale.

Resilience is therefore not free.

The relevant question is:

How much resilience is economically justified?

This requires risk management.

For ordinary products, market efficiency may dominate.

For critical goods, resilience may justify a premium.

The policy challenge is determining which products belong in which category.

Not every dependency is dangerous.

Not every domestic capability is strategic.

Not every import restriction increases resilience.

Not every trade agreement creates competitiveness.

The objective is not maximum autonomy.

It is economically sustainable resilience.

12.21. From Fragmentation to Opportunity

Global fragmentation also creates opportunities.

When multinational firms diversify supply chains, new production locations become necessary.

Indonesia can potentially capture part of this reallocation.

But the opportunity is conditional.

The country must offer:

competitive costs;

reliable energy;

efficient ports;

predictable regulation;

skilled workers;

industrial clusters;

supplier networks;

digital infrastructure;

access to regional markets;

and policy credibility.

Natural resources may attract the first investment.

A large domestic market may attract the second.

But productivity determines whether investment expands.

The opportunity therefore follows a chain:

Global Fragmentation
→ Supply-Chain Reallocation
→ FDI Opportunity
→ Domestic Industrial Capacity
→ Supplier Development
→ Skills
→ Productivity
→ Export Competitiveness

The chain can break at any point.

Fragmentation is therefore not automatically good news for Indonesia.

It is an opportunity that must be converted into capability.

12.22. The Resilience Paradox

There is a deeper paradox.

The world may become more fragmented.

Yet Indonesia may need more international integration, not less, to remain resilient.

More trade agreements can diversify markets.

More foreign investment can diversify production.

More international partnerships can diversify technology.

More regional integration can diversify supply chains.

More competition can improve productivity.

More openness can provide alternative sources of inputs.

In other words:

Resilience does not necessarily require less globalization.

It may require better globalization.

The objective is an economy that is globally connected but not excessively concentrated.

Open but not naive.

Strategic but not isolated.

Integrated but not dependent on one partner.

Protected where necessary but competitive by design.

12.23. The Prabowo-Era Trade Question

The global environment creates a direct test for the economic architecture examined in Part IV.

The Prabowo administration has emphasized industrialization, downstreaming, food and energy security, investment, and stronger domestic productive capacity.

These objectives interact directly with global trade.

Downstreaming requires export markets.

Industrialization requires imported capital goods and technology.

Food security may require both domestic production and international trade.

Energy security depends on domestic resources and global markets.

State investment requires access to technology, finance, and international partnerships.

Economic sovereignty is therefore not separable from international integration.

The relevant question is not whether Indonesia should participate in globalization.

It already does.

The more consequential question is:

What kind of globalization should Indonesia participate in?

A commodity-centered model?

A manufacturing-centered model?

A technology-intensive model?

A regional production-network model?

A resource-processing model?

Or a diversified combination?

The answer will shape Indonesia's productivity trajectory.

12.24. What Would Success Look Like?

A resilient Indonesian trade strategy should produce measurable outcomes.

Not merely more trade agreements.

Not merely more factories.

Not merely higher export values.

The deeper indicators should include:

greater export-product diversification;

higher domestic value added;

more sophisticated manufactured exports;

higher productivity among exporting firms;

greater MSME participation in global value chains;

more diversified export destinations;

more diversified critical suppliers;

stronger logistics performance;

lower unnecessary trade costs;

greater technology transfer;

higher-skilled employment;

and stronger private investment.

The ultimate objective is not trade volume.

It is productive integration.

An economy can export more while remaining structurally vulnerable.

It can also temporarily record a smaller trade surplus while importing machinery and technology that expand future productive capacity.

Trade statistics must therefore always be interpreted through the broader development structure.

12.25. The Deeper Test

The central question of global fragmentation is not:

Will globalization survive?

The evidence suggests that international trade and economic integration remain deeply embedded in the world economy, even as their rules and patterns are changing.

The deeper question is:

What kind of globalization will survive, and where will Indonesia stand within it?

If Indonesia remains primarily a commodity supplier, fragmentation may expose the country to price cycles and geopolitical bargaining.

If Indonesia develops diversified manufacturing and tradable services, fragmentation may create new investment opportunities.

If Indonesia builds domestic capabilities while remaining internationally connected, it may gain strategic flexibility.

If it substitutes protection for productivity, the cost of resilience may become excessive.

If it uses trade integration to accelerate productivity, external openness can become a source of domestic strength.

12.26. The Global Tsunami Revisited

The metaphor of the economic tsunami becomes more precise here.

A tsunami does not need to destroy every structure to be economically significant.

It changes the conditions under which structures operate.

Global fragmentation is doing something similar.

It is changing:

the cost of trade;

the geography of investment;

the location of production;

the strategic value of resources;

the importance of technology;

the meaning of economic security;

and the relationship between national policy and global markets.

Indonesia cannot control the wave.

It can influence how it prepares for it.

The country's resilience will depend on whether its domestic economic architecture is flexible enough to adapt to external shocks.

But trade is only one channel through which the global economy reaches Indonesia.

The next channel is financial.

A tariff can change export earnings.

A geopolitical shock can change capital flows.

A change in global interest rates can change financing costs.

A change in investor sentiment can change the value of the rupiah.

And once the currency moves, the shock can return to households and firms through imported prices, debt servicing, investment, and expectations.

The next chapter therefore moves from goods to money.

From trade flows to financial flows.

From global markets for products to global markets for capital.

The question becomes:

What happens to the rupiah when the world becomes more uncertain?

And can Indonesia maintain investor confidence while pursuing an increasingly ambitious economic transformation?

Figure 12.1 — THE GLOBAL FRAGMENTATION–RESILIENCE FRAMEWORK



Analytical framework for this chapter.

CHAPTER 13

THE RUPIAH, MARKETS & INVESTOR CONFIDENCE

Can Indonesia Absorb Global Financial Shocks?

The trade shock is only one part of the global tsunami. The financial shock can move faster. A change in global interest rates, risk appetite, commodity prices, or geopolitical expectations can travel through capital flows, the exchange rate, bond yields, equity prices, and corporate financing conditions before changes become visible in headline GDP.

For Indonesia, the Rupiah is one of the most important transmission mechanisms. It absorbs part of the adjustment to external shocks, while also transmitting those shocks into inflation, imported inputs, debt-service costs, investment decisions, and household purchasing power. The analytical question is therefore not whether the Rupiah should always rise or fall. It is whether Indonesia can allow markets to adjust without allowing market stress to become a broader financial or macroeconomic crisis.

The latest evidence presents a mixed but measurable picture. On September 23, 2026, Bank Indonesia kept the BI-Rate at 5.75 percent and emphasized exchange-rate stabilization, market deepening, and external resilience. Foreign portfolio investment in the third quarter of 2026 through September 21 recorded a net inflow of US$0.4 billion. Foreign-exchange reserves stood at US$146.5 billion at end-August, equivalent to 5.4 months of imports, or 5.3 months when government external-debt service is included. The Rupiah was Rp17,855 per U.S. dollar on September 22, 2026, down 0.78 percent from end-August. These numbers describe pressure and adjustment, but they do not by themselves establish a financial crisis.

This distinction is central to the chapter. A currency level is an observation. A currency crisis is a diagnosis. Investor confidence is not a mood that can be read from one exchange-rate quotation. It is a

market outcome shaped by expected returns, risk, institutions, liquidity, policy credibility, and the ability of the economy to absorb shocks.

13.1. The Rupiah as a Transmission Mechanism

An external financial shock reaches Indonesia through several channels at once. Portfolio investors can rebalance holdings. Domestic borrowers with foreign-currency exposure can face higher repayment costs. Importers can pay more in Rupiah terms. Exporters may gain from a weaker currency, depending on their import content. Government and corporate bond yields can respond to changes in global risk premia. Banks can experience changes in liquidity and credit demand.

The exchange rate therefore has two roles. It is a price in the foreign-exchange market and an adjustment mechanism for the wider economy. IMF analysis has emphasized that the exchange rate should continue to function as a shock absorber, while foreign-exchange intervention can be used judiciously under appropriate shocks and market frictions.

13.2. Where the Rupiah Stood in September 2026

The September 2026 snapshot matters because it provides a current reference point rather than a historical average. Bank Indonesia reported the Rupiah at Rp17,855 per U.S. dollar on September 22, following a 0.78 percent depreciation from the end-August level. At the same time, reserves remained substantial at US$146.5 billion, and third-quarter portfolio flows through September 21 were positive by US$0.4 billion.

The combination is analytically important. Currency pressure can coexist with reserve adequacy and positive portfolio inflows. Conversely, a stable exchange rate can coexist with deeper vulnerabilities if it depends on persistent intervention, short-term capital, or balance-sheet mismatches. The correct diagnosis therefore requires several indicators rather than one market price.

13.3. A Currency is not a Verdict

The temptation in financial commentary is to treat depreciation as evidence of economic failure and appreciation as evidence of economic success. Both shortcuts are misleading. Exchange rates respond to relative interest rates, inflation expectations, commodity prices, global risk appetite, trade conditions, capital flows, and expectations about future policy.

A weaker currency can support export competitiveness while increasing the domestic-currency cost of imported goods and foreign-currency liabilities. A stronger currency can reduce imported inflation while weakening the Rupiah value of exporters' foreign revenues. The relevant question is therefore not whether the currency is strong in isolation, but whether its movement is consistent with underlying fundamentals and whether balance sheets can absorb it.

13.4. Four Forces Behind the Rupiah

Four forces are especially important: the U.S. dollar and global interest-rate cycle; Indonesia's external balance; domestic monetary and fiscal credibility; and investor expectations about future growth and policy.

These forces interact. A rise in global yields can increase the attractiveness of dollar assets. A deterioration in Indonesia's external balance can amplify pressure. Credible institutions can reduce the risk premium. Strong productivity prospects can attract longer-horizon investment. None of these mechanisms operates independently.

13.5. Capital Flows: the Fast Channel

Portfolio capital is generally the fastest financial channel. Government bonds and equities can be re-priced quickly as investors change their assessment of global risk or domestic conditions. IMF analysis has highlighted that sudden shifts in investor sentiment can generate exchange-rate and capital-flow volatility and spikes in sovereign yields.

That does not make portfolio investment undesirable. Deep portfolio markets can lower financing costs, distribute risk, and improve price discovery. The resilience question is whether the market is deep enough and the investor base diversified enough that one wave

of global repricing does not become a self-reinforcing domestic liquidity shock.

13.6. FDI: the Stickier Capital

Foreign direct investment is generally more closely tied to productive assets, operating facilities, technology, and long-term commercial commitments than portfolio investment. It is therefore usually less immediately reversible. But FDI is not risk-free or permanently fixed. Firms can postpone projects, reduce reinvestment, restructure operations, or redirect future capital.

For Indonesia, the policy objective is consequently not simply to maximize the volume of FDI. The more important question is whether investment creates productivity, supplier linkages, technology capability, skilled employment, and export capacity. This connects directly to the industrial-policy discussion in Chapter 10.

13.7. The Reserve Buffer

Foreign-exchange reserves are a first line of external resilience because they provide liquidity when foreign-currency demand rises or market functioning becomes disorderly. At end-August 2026, Indonesia held US$146.5 billion in reserves, equivalent to 5.4 months of imports and 5.3 months including government external-debt service. Bank Indonesia reported that the position remained above the commonly cited international adequacy benchmark of around three months of imports.

But reserves are a buffer, not an unlimited defense of a particular exchange-rate level. Persistent intervention can reduce the buffer and may delay adjustment if the underlying shock is fundamental. IMF guidance similarly emphasizes preserving reserve buffers while allowing the exchange rate to adjust when fundamentals require it.

13.8. The External Liability Question

External resilience also depends on what Indonesia owes, to whom, and in what form. Short-term foreign-currency liabilities can create refinancing pressure when global liquidity tightens. Long-term direct investment liabilities have a different risk profile. Domestic-currency government debt held by foreigners creates market-price and flow

risks, but not the same mechanical foreign-currency repayment problem as dollar-denominated debt.

This is why the composition of external liabilities matters as much as the headline stock. A resilient balance sheet is one in which maturity, currency, and investor structure are sufficiently diversified to prevent one shock from becoming a synchronized funding problem.

13.9. The Sovereign Yield Channel

Bond yields are a second major transmission mechanism. When global risk premia rise, investors may demand higher compensation for holding emerging-market debt. Higher sovereign yields can increase government financing costs and influence the pricing of corporate credit.

The danger is not simply a higher yield. It is a feedback loop: higher yields increase interest costs; higher interest costs can narrow fiscal space; narrower fiscal space can increase risk premia; higher risk premia can raise yields again. This is one reason fiscal credibility, discussed in Chapters 6–8, becomes a financial-market asset.

13.10. Stock Market and the Real Economy

Equity markets can transmit global sentiment into domestic investment decisions. Falling valuations can make new equity financing more expensive, reduce the wealth of investors, and affect corporate confidence. Yet equity-price volatility does not automatically imply deterioration in the productive economy.

The more relevant question is whether financial-market repricing changes real investment, employment, credit availability, and productivity. A market correction that remains contained within asset prices is different from one that damages bank balance sheets, corporate liquidity, and household spending.

13.11. Investor Confidence is not Sentiment Alone

Investor confidence is often discussed as if it were psychological. In economic terms, it is better understood as an assessment of expected return relative to risk. Investors consider policy credibility, market liquidity, legal and institutional predictability, macroeconomic stability, growth prospects, corporate profitability, and exit options.

That is why confidence can improve even when one market indicator deteriorates. A weaker Rupiah may coexist with confidence if investors believe the movement reflects global conditions and remains manageable. Conversely, a stable Rupiah may conceal fragility if it depends on unsustainable financing or intervention.

13.12. The Role of Bank Indonesia

Bank Indonesia operates across several channels: policy rates, foreign-exchange operations, macroprudential instruments, liquidity management, payment systems, and market-development measures. On September 23, 2026, BI maintained the BI-Rate at 5.75 percent, with the Deposit Facility at 4.75 percent and the Lending Facility at 6.50 percent. The stated strategy combined exchange-rate stabilization, inflation management, capital-flow support, and financial-market deepening.

The central-bank challenge is calibration. Tightening policy can support the currency and inflation expectations but can also weaken domestic demand. Easing can support growth and credit but may add pressure to the exchange rate under adverse global conditions. The appropriate policy mix therefore depends on the shock, not on a permanent preference for either tight or loose policy.

13.13. The Market-Deepening Test

Financial resilience improves when domestic markets provide more instruments for savers, borrowers, and risk managers. A deeper bond market can broaden funding sources. A more liquid foreign-exchange market can improve price discovery and hedging. Derivatives can allow firms to manage currency exposure rather than simply absorb it.

This is particularly important for an economy with substantial trade and investment exposure. Market depth converts volatility from an unavoidable shock into a risk that can be priced, transferred, and managed.

13.14. Hedging and the Cost of Volatility

Exchange-rate volatility becomes economically expensive when firms cannot hedge. Importers face uncertain input costs. Exporters

face uncertain Rupiah revenues. Firms with foreign-currency debt face uncertain repayment obligations.

Bank Indonesia has continued expanding mechanisms intended to strengthen hedging and foreign-exchange-market functioning. In September 2026, BI reported that incentives for eligible underlying foreign funding transactions had been expanded beyond portfolio inflows to include bank foreign loans and FDI.

The deeper principle is straightforward: resilience does not require eliminating volatility. It requires building institutions and instruments that allow households, firms, banks, and government to live with volatility without turning every movement into a balance-sheet crisis.

13.15. The Banking System as Shock Absorber

Banks sit between financial markets and the real economy. If they remain well capitalized, liquid, and adequately supervised, they can absorb part of an external shock. If asset quality deteriorates sharply or foreign-currency mismatches become excessive, the same system can amplify the shock through tighter credit.

The financial-sector question is therefore not simply whether banks are profitable. It is whether capital, liquidity, asset quality, and risk management are sufficient to keep credit functioning when markets become stressed.

13.16. Household Transmission

Households experience financial shocks indirectly. A weaker Rupiah can raise the domestic price of imported goods. Higher interest rates can increase borrowing costs. Falling asset prices can weaken household wealth. Slower credit can affect housing, vehicles, education, and small-business financing.

The burden is uneven. Households with foreign-currency exposure, variable-rate debt, limited savings, or high import-intensive consumption may be more sensitive to financial volatility. The middle-class discussion in Chapter 4 therefore cannot be separated from the financial architecture.

13.17. Corporate Transmission

Corporations face an equally important set of channels. Currency depreciation affects imported machinery and intermediate goods. Higher yields affect refinancing. Equity-market weakness affects capital raising. Global demand affects export revenue.

The strongest corporate balance sheets are not necessarily those with the highest leverage or fastest expansion. They are those with sufficient liquidity, diversified revenues, manageable currency exposure, and the capacity to continue investing during temporary market stress.

13.18. The Fiscal-Monetary Interface

Financial stability depends partly on whether fiscal and monetary policies reinforce or offset one another. Large fiscal expansion can support demand, but if investors interpret it as weakening fiscal discipline, risk premia can rise. Monetary tightening can contain inflation and currency pressure, but if fiscal policy is simultaneously expansionary, the central bank may face a more difficult trade-off.

The IMF has emphasized the importance of a carefully calibrated policy mix, preservation of policy credibility, and guardrails around below-the-line and quasi-fiscal activity.

13.19. Danantara and Market Perception

Danantara introduces an additional layer to the market story because a large state-investment architecture can affect expectations about capital allocation, SOE performance, investment flows, and the public sector's overall financial footprint.

The relevant market question is not whether investors should automatically welcome or reject such an institution. It is whether governance, reporting, valuation, leverage, and accountability make its activities sufficiently transparent for markets to distinguish commercial investment from public-policy expenditure.

That distinction matters because opaque contingent liabilities can increase risk premia even before a fiscal loss becomes visible. IMF Directors explicitly highlighted the importance of robust governance

and accountability frameworks around Danantara to limit contingent liabilities and quasi-fiscal risks.

13.20. The Credibility Premium

Credibility has economic value. When investors believe institutions will respond consistently to shocks, the required risk premium can be lower than it would otherwise be. This can reduce financing costs and give policymakers more room to respond during stress.

Credibility is not created by communication alone. It accumulates through repeated behavior: transparent data, predictable rules, disciplined fiscal management, credible monetary policy, effective supervision, and institutions that can correct mistakes without concealment.

13.21. The Three-Layer Market Defense

Indonesia's financial resilience can be organized into three layers.

- Layer 1 — Buffers: foreign-exchange reserves, bank capital, liquidity, fiscal space, and household savings.
- Layer 2 — Shock absorbers: flexible exchange rates, monetary policy, macroprudential tools, hedging instruments, and automatic fiscal stabilizers.
- Layer 3 — Structural resilience: deep domestic markets, diversified exports, productive FDI, strong institutions, and credible long-term policy.

A system that relies only on the first layer can survive a shock but remain vulnerable to repeated shocks. A system with all three layers can absorb, adjust, and recover.

13.22. The Seven-Point Rupiah Stress Test

- 1. Currency shock — What happens if the Rupiah depreciates sharply and remains weaker for several quarters?
- 2. Capital-flow shock — Can domestic markets absorb a rapid portfolio outflow without disorderly repricing?
- 3. Yield shock — Can the government and corporations refinance if global and domestic yields rise substantially?

- 4. Reserve shock — How much intervention can occur before reserve buffers become materially thinner?
- 5. Banking shock — Can banks maintain capital, liquidity, and credit supply under simultaneous market stress?
- 6. Corporate balance-sheet shock — How many firms have material foreign-currency or short-term refinancing exposure?
- 7. Confidence shock — Can institutions communicate and execute a credible response quickly enough to prevent temporary stress from becoming a self-reinforcing cycle?

These questions convert the abstract concept of financial resilience into observable variables. The answer need not be binary. Resilience can strengthen in one dimension while weakening in another.

13.23. The Rupiah–Investment–Productivity Chain

The exchange rate ultimately matters because it affects the cost and composition of investment. If currency volatility raises imported-equipment costs and financing uncertainty, productive investment can slow. If depreciation improves export competitiveness and firms respond by upgrading capacity, the same shock can contribute to adjustment and productivity.

The policy objective is therefore not a permanently strong Rupiah. It is a financial system in which exchange-rate movement does not prevent productive investment, distort resource allocation, or destabilize balance sheets.

13.24. What Investors Actually Need

Investors need information as much as incentives. They need reliable fiscal data, credible monetary communication, transparent SOE reporting, predictable regulation, enforceable contracts, liquid markets, and clear rules for capital repatriation and taxation.

These are not concessions to investors. They are infrastructure for capital allocation. Better information reduces uncertainty for domestic and foreign investors alike.

13.25. The Limits of Central-Bank Power

No central bank can permanently neutralize global financial conditions. It can influence liquidity, interest rates, expectations, and market functioning, but it cannot determine global dollar demand, geopolitical risk, commodity cycles, or foreign investors' portfolio choices.

This is why financial resilience ultimately depends on the wider economic structure. Monetary policy can buy time and smooth adjustment. It cannot substitute for productivity, fiscal credibility, diversified exports, strong institutions, or healthy private-sector balance sheets.

13.26. The Deeper Question: What Kind of Financial System?

The deeper issue is not whether Indonesia can defend the Rupiah at a particular number. It is whether Indonesia is building a financial system that supports long-term development while remaining resilient to external shocks.

Such a system would mobilize domestic savings, attract productive foreign capital, support long-term investment, provide hedging instruments, distribute risk efficiently, and maintain enough buffers to absorb volatility. It would also allow markets to transmit information without allowing temporary panic to become systemic instability.

13.27. The Prabowo-Era Financial Question

The financial question of the Prabowo era is therefore connected to the broader economic architecture examined in Chapters 9–12. An industrial strategy needs financing. Downstreaming needs foreign and domestic investment. Danantara needs governance that markets can evaluate. Fiscal transformation needs credible funding. Trade diversification needs capital-market depth.

The administration's economic architecture will consequently be judged by a chain of mechanisms rather than by one market indicator: whether capital is mobilized, whether investment becomes productive, whether productivity rises, and whether the financial system remains stable while those changes occur.

13.28. What Would Success Look Like?

A resilient financial system would not necessarily display a continuously appreciating Rupiah or permanently rising asset prices. More meaningful indicators would include orderly exchange-rate adjustment, adequate reserves, diversified capital inflows, manageable external liabilities, deep domestic markets, strong bank buffers, effective hedging, credible fiscal and monetary institutions, and continued productive investment during periods of global stress.

This is a higher standard than exchange-rate stability alone. It asks whether the financial system can continue performing its economic function when conditions are unfavorable.

13.29. The Global Financial Stress Test

IMF analysis identifies a combination of global financial volatility, sudden shifts in investor sentiment, exchange-rate turbulence, capital-flow volatility, and sovereign-yield spikes as a meaningful downside-risk channel for Indonesia.

Indonesia enters such a stress test with identifiable buffers, but buffers are not the same as immunity. The resilience equation is better expressed as:

EXTERNAL SHOCKS + STRONG BUFFERS + CREDIBLE INSTITUTIONS + DEEP MARKETS = FINANCIAL RESILIENCE

The equation is conditional. Weak institutions can waste buffers. Shallow markets can amplify volatility. Excessive leverage can turn a currency movement into a solvency problem. Conversely, strong institutions and deep markets can transform the same external shock into a manageable adjustment.

13.30. The Rupiah as a Mirror

The Rupiah reflects more than foreign-exchange supply and demand. It also reflects how markets assess Indonesia's external position, inflation outlook, policy mix, fiscal credibility, growth prospects, and institutional capacity.

That makes the currency a useful mirror, but not a complete diagnosis. A mirror can reveal pressure without explaining its cause.

The economic analyst must therefore move from the exchange rate to the balance sheets and institutions behind it.

13.31. Global Tsunami Revisited

Chapter 12 showed how global fragmentation changes trade and investment decisions. Chapter 13 adds the financial transmission mechanism. Trade shocks affect export demand and supply chains. Financial shocks affect capital flows, the Rupiah, yields, liquidity, and balance sheets. The two channels interact.

The central finding is conditional rather than categorical: Indonesia's financial system has meaningful buffers, but resilience depends on maintaining those buffers while deepening markets, strengthening institutions, and reducing vulnerabilities in public and private balance sheets. Current evidence shows external pressure without establishing a systemic financial breakdown.

The next question is more physical and more strategic. What happens when financial resilience meets the vulnerabilities that households and firms cannot hedge indefinitely: energy, food, and critical resources? That is the transition to Chapter 14.

Figure 13.1 — THE RUPIAH–MARKET–INVESTOR CONFIDENCE TRANSMISSION FRAMEWORK

Global rates / risk appetite → Capital flows → Rupiah → Inflation, yields & financing costs → Bank and corporate balance sheets → Investment & consumption → Growth and fiscal capacity. Feedback loop: policy credibility, reserves, market depth, and institutional quality influence every stage.

CHAPTER 14

ENERGY, FOOD & STRATEGIC VULNERABILITY

Can Indonesia Secure the Foundations of Its Growth?

Economic resilience is ultimately physical. A country can have foreign-exchange reserves, credible institutions, deep financial markets, and a sophisticated industrial strategy. But households still need fuel. Factories need electricity. Farmers need fertilizer. Transport needs energy. Cities need food.

Chapter 12 examined global trade fragmentation. Chapter 13 examined financial transmission through the Rupiah, capital flows, markets, and investor confidence. Chapter 14 moves to the physical foundations of production.

The question is not whether Indonesia can become completely self-sufficient. No modern economy is. The more useful question is whether Indonesia can maintain essential supplies at manageable cost when global prices rise, shipping routes are disrupted, currencies weaken, or geopolitical tensions restrict access to critical inputs.

Strategic vulnerability is not simply import dependence. A country may import a large share of a commodity and remain resilient if it has diversified suppliers, adequate inventories, flexible logistics, fiscal capacity, and substitution options. Conversely, domestic production can still be vulnerable if it depends on imported machinery, fertilizer, technology, finance, or concentrated distribution.

ENERGY SECURITY + FOOD SECURITY + SUPPLY-CHAIN RESILIENCE = STRATEGIC ECONOMIC RESILIENCE

14.1. The Physical Foundation of Economic Growth

Energy and food are inputs into almost every sector. Factories require power; transportation requires fuel; agriculture requires water,

fertilizer, machinery, and logistics; digital infrastructure requires electricity; households require food and transport. A disruption in energy can affect inflation, production, and fiscal conditions, while a food disruption can affect inflation, wages, consumption, poverty, and political economy.

14.2. Indonesia'S Energy Paradox

Indonesia possesses substantial natural resources and remains an important producer of coal and other energy commodities. Yet resource abundance does not automatically create energy security. The IEA's Southeast Asia Energy Outlook 2026 identifies declining oil production, tighter gas balances, concentrated supply routes, and rising import exposure as regional vulnerabilities, while identifying Indonesia as Southeast Asia's dominant coal producer. Energy security is therefore a question of system architecture, not simply resource ownership.

14.3. The Oil Problem

Oil remains critical because transportation is highly dependent on liquid fuels. Domestic production below domestic consumption creates import exposure. Global oil price ↑ → import bill ↑ → foreign-exchange demand ↑ → Rupiah pressure ↑ → fuel-cost pressure ↑ → inflation and subsidy pressure ↑ → household purchasing power ↓ → fiscal space ↓ . A global energy shock can therefore become an external-balance, inflation, fiscal, and household-income problem simultaneously.

14.4. B50 and the Economics of Substitution

The government launched mandatory B50 in July 2026, increasing the biodiesel blend in diesel fuel to 50 percent. The stated objectives include reducing diesel imports, saving foreign exchange, increasing domestic CPO absorption, creating employment, and strengthening energy security. Bank Indonesia's B50 research considers diesel-import savings, foregone CPO export earnings, and fiscal requirements. The stronger analytical test is whether reduced petroleum dependence creates a net economic gain after fiscal cost, CPO opportunity cost, land use, food-system effects, environmental consequences, and productivity are considered.

14.5. Energy Security is not Energy Autarky

Energy independence does not require eliminating foreign dependence. Energy security means obtaining essential energy at acceptable cost through diversified sources, adequate buffers, and enough flexibility to absorb disruptions. A country can import energy and remain secure; a country can produce energy domestically and remain vulnerable.

14.6. The Gas Transition

Gas can support industry and electricity while renewable capacity, grids, storage, and efficiency expand. But declining regional supply can increase LNG exposure. The IEA's 2026 outlook projects higher regional gas use in power generation under current policies even as domestic supply declines. Gas can be a bridge, but the bridge must lead to investment in renewables, transmission, storage, efficiency, and alternative fuels.

14.7. Electricity: the Next Bottleneck

Indonesia's future energy challenge is increasingly an electricity challenge. Manufacturing, data centers, transport electrification, cooling, digital infrastructure, and households all require more electricity. The IEA emphasizes investment in generation, grids, storage, and flexibility. The key questions are whether electricity reaches the right locations, the grid can handle industrial demand, renewable generation can be integrated, and industrial users can obtain competitive electricity.

14.8. The Grid as Strategic Infrastructure

A country can possess large renewable resources and still struggle to use them if generation is far from demand or transmission is inadequate. Indonesia's geography makes this especially important because demand is uneven, resources are dispersed, industrial clusters require reliable power, and remote regions require access. Energy security is therefore also a spatial-economics problem.

14.9. Renewable Energy: from Potential to Productivity

Indonesia has major renewable potential, including geothermal, hydro, solar, and bioenergy. But potential is not capacity; capacity is not reliability; reliability is not affordability; affordability is not automatically competitiveness. A renewable project becomes transformative when it delivers reliable electricity at competitive cost while creating domestic capabilities in engineering, construction, maintenance, technology, finance, and supply chains.

14.10. Coal: Security Asset and Transition Challenge

Coal remains embedded in Southeast Asian electricity systems, and Indonesia is the region's dominant coal producer. The IEA notes coal's continuing role in system adequacy alongside air-pollution and emissions risks. Coal can contribute to short-term energy security while creating long-term transition risks. The challenge is maintaining reliability while reducing carbon-intensive dependence through investment, infrastructure, technology, and sequencing.

14.11. The Cost of Energy Security

Indonesia's 2026 budget framework allocated approximately Rp402.4 trillion in fiscal support for energy security, including subsidies, tax incentives, renewable-energy development, and village electricity programs. Subsidies can stabilize prices and support development, but they create opportunity costs. The key questions are who receives them, what behavior they create, how much they cost, whether they protect vulnerable households, and whether they strengthen fiscal resilience.

14.12. Food Security is the Second Pillar

If energy is the fuel of the economy, food is the fuel of the household. Food supply shock → food prices ↑ → real income ↓ → household consumption ↓ → poverty vulnerability ↑ → wage pressure ↑ → inflation expectations ↑ → monetary-policy constraint ↑ . Because food carries a large weight in household consumption, food shocks can quickly reduce real purchasing power.

14.13. Indonesia'S Rice Position

BPS reported 2025 rice production for population consumption at 34.69 million tons, up 13.29 percent from 2024; paddy production reached 60.21 million tons. Food security should be assessed through domestic production, productivity, storage, distribution, farmer incentives, climate resilience, and reserves—not imports alone.

14.14. The Strategic Value of Food Stocks

The 2026 budget framework allocated Rp22.7 trillion for Bulog to maintain rice and paddy stocks. By June 2026, the government reported national rice reserves of approximately 5.2 million tons. Reserves have value because they buy time during harvest failures, price spikes, logistics disruption, and market uncertainty.

14.15. Fertilizer: the Hidden Energy Link

Energy prices ↑ → fertilizer costs ↑ → farm input costs ↑ → production costs ↑ → food prices ↑ . Fertilizer markets are vulnerable to energy-price and geopolitical shocks, so food resilience cannot be separated from energy and input-market stability.

14.16. Climate as a Multiplier

Extreme rainfall, drought, heat, flooding, and changing seasons affect agricultural yields, electricity generation, transport infrastructure, and water. Bank Indonesia in June 2026 linked volatile-food inflation risks to weather conditions and El Niño preparedness. Climate vulnerability is therefore simultaneously a productivity, food, infrastructure, fiscal, and financial-risk issue.

14.17. The Food–Energy Competition

Biofuel expansion, food production, renewable projects, agricultural intensification, and industrialization can compete for land, water, fertilizer, electricity, and logistics. Recent Nature Sustainability research models trade-offs among biodiesel, rice self-sufficiency, forest conservation, and emissions reduction; its scenarios should be treated as model-based projections rather than direct forecasts.

14.18. B50 and the Opportunity-Cost Test

The B50 question is an allocation problem. More CPO for biodiesel can reduce diesel-import exposure but also change export availability, fiscal requirements, land use, and environmental costs. Analytical framework: NET ENERGY BENEFIT = IMPORT SAVINGS – FOREGONE EXPORT VALUE – FISCAL COST – RESOURCE COST – ENVIRONMENTAL COST. This is a framework for measurement, not a predetermined result.

14.19. Strategic Resources and the New Security Economics

Modern economies depend on critical minerals, fertilizers, pharmaceuticals, semiconductors, telecommunications equipment, machinery, and specialized technologies. Strategic autonomy cannot mean producing everything domestically. Selective resilience means domestic production where advantage is strong, supplier diversification where imports are efficient, inventories where disruption is costly, substitution where technology permits, and regional partnerships where they reduce risk.

14.20. The Importance of Logistics

Food and energy security are logistics problems as well as production problems. Ports, roads, warehouses, pipelines, grids, cold chains, and inter-island shipping become strategic infrastructure. Infrastructure should be evaluated not only by construction value but by resilience value.

14.21. The Importance of Price Signals

If prices are permanently disconnected from underlying costs, incentives to conserve, invest, innovate, and substitute weaken. But rapid adjustment can burden vulnerable households. A more sophisticated framework separates price signals from social protection: markets communicate scarcity while targeted policy protects households that cannot absorb the adjustment.

14.22. Food Security and the Middle Class

Food inflation can squeeze households before they qualify for conventional poverty assistance. When food, transport, housing, education, and energy costs rise together, disposable income falls. A resilient food and energy system therefore functions as indirect middle-class protection.

14.23. Energy, Food and Industrial Competitiveness

Manufacturers compete on electricity costs, logistics, input prices, financing, reliability, and supplier access. Energy resilience → lower production volatility → more predictable investment → higher industrial capacity → productivity → higher wages → larger fiscal base.

14.24. The Fiscal Feedback Loop

Higher oil prices can raise subsidies; fertilizer costs can raise agricultural support; food instability can increase social protection; disasters can require reconstruction; Rupiah depreciation can raise imported-commodity costs. External shock → import cost ↑ → subsidy/support cost ↑ → fiscal space ↓ → borrowing needs ↑ → financing cost ↑ → fiscal vulnerability ↑ .

14.25. The External-Balance Feedback Loop

Global oil prices ↑ → import bill ↑ → foreign-currency demand ↑ → Rupiah pressure ↑ → imported energy cost ↑ → subsidy cost ↑ → inflation pressure ↑ → more difficult monetary-policy trade-off. The original shock may be external, but its domestic impact depends on economic structure.

14.26. The Strategic Vulnerability Framework

Six dimensions organize vulnerability: 1. Dependence — external sourcing requirement. 2. Concentration — supplier, route, technology, or production concentration. 3. Buffer — inventories, reserves, spare capacity. 4. Substitution — ability to replace disrupted inputs. 5. Infrastructure — ability of ports, grids, storage, transport, and distribution to function. 6. Fiscal capacity — ability to cushion shocks without undermining debt sustainability and productive spending.

Analytical chain: DEPENDENCE → CONCENTRATION → BUFFER → SUBSTITUTION → INFRASTRUCTURE → FISCAL CAPACITY → RESILIENCE

14.27. The Eight-Point Energy Stress Test

1. Currency and oil shock. 2. Supply-route shock. 3. Gas shock. 4. Electricity shock. 5. Fiscal shock. 6. Transition shock. 7. Infrastructure shock. 8. Efficiency shock. The test asks whether Indonesia can maintain supply, affordability, reliability, and fiscal sustainability under simultaneous stress.

14.28. The Eight-Point Food Stress Test

1. Production shock. 2. Climate shock. 3. Fertilizer shock. 4. Logistics shock. 5. Import shock. 6. Reserve shock. 7. Farmer-income shock. 8. Fiscal shock. The test asks whether supply, prices, farmer incentives, reserves, and public finances can remain manageable.

14.29. The Energy–Food–Fiscal Triangle

ENERGY, FOOD, and FISCAL CAPACITY form an interdependent triangle. Energy prices affect fertilizer and transport; food prices affect household purchasing power and inflation; fiscal capacity determines stabilization ability; subsidies affect energy and food prices; and shocks in either sector affect the fiscal balance. There is no single policy lever.

14.30. The Prabowo-Era Strategic Question

The Prabowo administration has placed energy sovereignty and food security prominently within its economic agenda. The 2026 budget framework allocated approximately Rp164.7 trillion for food security and Rp402.4 trillion for energy security, including fertilizer support, agricultural development, reserves, subsidies, renewable energy, and village electricity programs. Budget size is not the same as resilience. The harder test is whether spending changes exposure, productivity, farmer viability, energy reliability, grid quality, fiscal targeting, private investment, and reserve effectiveness.

14.31. The Productivity Test

An energy program can increase supply while raising industrial costs. A food program can increase output while degrading the resource base. A subsidy can protect prices while weakening efficiency incentives. A reserve system can prevent shortages while imposing storage costs. The objective is not maximum intervention; it is maximum resilience per unit of public and private resources.

14.32. The Intergenerational Test

Energy and food policy creates future consequences. Fossil consumption, land conversion, and fiscal transfers can improve current resilience while creating future vulnerabilities. The relevant question is whether today's security strengthens tomorrow's productive capacity.

14.33. The Regional Test

National averages can conceal regional vulnerability. Surplus and deficit regions, energy-producing and energy-consuming islands, and strong and weak industrial corridors require connectivity. Resilience depends on infrastructure connecting production, consumption, and contingency capacity.

14.34. ASEAN as a Resilience Platform

Regional energy cooperation can provide diversification and emergency-response capacity. The IEA identifies coordinated stockholding, emergency-response arrangements, and expanded regional electricity interconnection as potential resilience tools. Strategic autonomy and regional integration therefore do not have to be opposites.

14.35. The Paradox of Self-Sufficiency

Domestic protection can increase costs, reduce competitive pressure, concentrate land use, or create dependence on another feedstock. A policy designed to reduce dependence can create dependence on a different system. Resilience therefore requires diversification rather than simply substitution.

14.36. What Would Success Look Like?

Success would be visible through reliable essential energy during shocks, manageable food prices, deployable reserves, increasingly targeted subsidies, reliable electricity, scalable renewable investment, rising agricultural productivity, resilient fertilizer supply, lower logistics costs, competitive industrial energy prices, greater private investment, and lower fiscal exposure to global commodity shocks.

14.37. The Five-Layer Resilience Model

Layer 1 — Resources: oil, gas, coal, renewables, land, water, agricultural resources.
Layer 2 — Infrastructure: ports, roads, pipelines, grids, storage, irrigation, warehouses, cold chains.
Layer 3 — Markets: pricing, competition, trade, procurement, inventories, financial instruments.
Layer 4 — Institutions: government, SOEs, regulators, local governments, emergency systems.
Layer 5 — Households and Firms: consumers, farmers, manufacturers, transport operators, businesses.

Weakness in any layer can reduce resilience.

14.38. The Economic Tsunami Test

Global conflict → shipping disruption → oil and gas prices ↑ → import bill ↑ → Rupiah pressure ↑ → fuel and fertilizer costs ↑ → food and transport prices ↑ → household purchasing power ↓ → interest-rate and fiscal pressure ↑ → investment conditions weaken → growth slows.

The wave does not need to destroy the economy. It only needs to travel through enough channels simultaneously to reduce resilience.

14.39. The Deeper Question

Indonesia does not need to eliminate every external dependency. It needs to decide which dependencies are acceptable, dangerous, or worth reducing. Essential inputs with high disruption costs deserve greater reserves and diversification. Inputs with many suppliers can remain internationally sourced. Inputs where Indonesia has comparative advantage can be developed domestically. Advanced

technologies may be secured through partnerships and supply-chain diversification.

14.40. Global Tsunami Revisited

Chapter 12 examined fragmentation in global trade. Chapter 13 examined financial transmission through capital flows, the Rupiah, markets, and investor confidence. Chapter 14 adds the physical layer: trade determines access; finance determines liquidity; energy determines production capacity; food determines household security; fiscal capacity determines how much of the shock the state can absorb.

Indonesia has meaningful productive capacity, substantial policy instruments, growing reserves in key food systems, and a large domestic resource base. At the same time, import exposure, concentrated supply routes, infrastructure constraints, fiscal costs, climate risks, land-use trade-offs, and global commodity volatility remain material sources of vulnerability.

The strategic question for the Prabowo era is whether Indonesia can build an economy in which external shocks remain manageable because the country has diversified supplies, productive domestic capacity, adequate reserves, flexible markets, strong infrastructure, credible institutions, and enough fiscal space to protect households without undermining future growth.

That is the real test of economic sovereignty.

If energy and food shocks can determine the cost of living and production, who ultimately bears those costs? That is the subject of Part VI.

Figure 14.1 — THE ENERGY–FOOD–FISCAL RESILIENCE FRAMEWORK



PART VI — WHO BEARS THE COST?

CHAPTER 15

INEQUALITY, POVERTY & REGIONAL INDONESIA

Who Benefits When the Economy Grows?

The growth number is national.

The experience of growth is not.

A country can record rising GDP, expanding investment, stronger exports, growing government revenue, and improving macroeconomic stability while households experience very different economic realities.

One household may receive a higher wage.

Another may obtain only irregular work.

One region may attract new factories, logistics networks, and investment.

Another may remain dependent on low-productivity agriculture.

One city may experience rising property values and expanding services.

A rural district may still struggle with transport costs, school quality, health access, and limited employment opportunities.

This is the distributional question.

It is also the question that follows naturally from the previous chapters.

Chapter 3 examined whether five-percent growth is sufficient. Chapter 4 moved from GDP to purchasing power, wages, jobs, and the middle class. Chapter 5 identified productivity as the underlying engine of durable income growth. Chapters 6 through 8 examined the fiscal system that finances public action. Chapters 9 through 11 examined industrial policy,

downstreaming, state capital, and the emerging investment-state architecture. Chapters 12 through 14 examined external fragmentation, financial shocks, energy, food, and strategic vulnerability.

Chapter 15 asks what happens after all those mechanisms reach the household.

Who receives the new jobs?

Who captures the productivity gains?

Who benefits from infrastructure?

Who gains access to better education and health?

Who remains exposed to food-price shocks?

Which regions accumulate productive capital?

Which households move permanently upward?

And which households remain one shock away from falling backward?

The question is not ideological.

It is economic accounting.

A serious assessment of development must follow the incidence of growth through the economy:

Growth → Jobs → Wages → Purchasing Power → Public Services → Human and Physical Capital → Mobility → Resilience.

If the chain breaks at any point, aggregate growth may coexist with persistent insecurity.

That is why the question is not simply whether Indonesia is becoming richer.

It is whether Indonesia is becoming more economically secure.

15.1. The Distribution Question

GDP measures the value of economic activity.

It does not tell us who receives the income generated by that activity, where employment is created, how secure those jobs are, or whether households can accumulate assets and human capital.

This distinction matters because development is cumulative.

A household that moves from irregular work into a stable, productive job gains more than current income. It may gain access to credit, insurance, better housing, education, health care, savings, and the ability to withstand temporary shocks.

A household whose income rises only temporarily may experience a very different outcome.

The same principle applies to regions.

A new industrial facility can raise local output without necessarily generating a broad local productivity ecosystem. The economic effect becomes much larger when investment creates supplier networks, skilled employment, technology transfer, infrastructure, business formation, and fiscal capacity.

The distribution of growth therefore has at least four dimensions.

The first is income distribution.

The second is employment distribution.

The third is geographic distribution.

The fourth is intergenerational distribution.

The fourth dimension is often the least visible.

A child born into a household with adequate nutrition, quality education, reliable transport, digital access, and a productive local labor market begins adulthood with a different opportunity set from a child facing weak schools, poor health access, limited connectivity, and a narrow employment base.

This is why inequality is not only about how much people earn today.

It is also about how economic systems determine what they can become tomorrow.

The distributional question is therefore fundamentally a mobility question.

15.2. Poverty is Falling — but the Question is not Finished

Indonesia's official poverty rate has continued to decline.

In March 2026, BPS reported a national poverty rate of 8.07 percent, equivalent to 22.93 million people. The rate was 0.18 percentage points lower than in September 2025 and 0.40 percentage points lower than in March 2025.

Urban poverty stood at 6.34 percent, while rural poverty was 10.67 percent.

The number of poor people also declined. Urban poverty fell to 10.83 million people, while rural poverty remained higher at approximately 12.10 million.

The direction of the national poverty statistic is therefore clear: measured by the official Indonesian poverty line, poverty declined between March 2025 and March 2026 (BPS, 2026c).

That is an important fact.

It should not be obscured by the broader debate about inequality or economic insecurity.

But declining poverty does not mean the distributional problem has disappeared.

A poverty line identifies a threshold.

It does not describe the entire distribution of living standards above that threshold.

Consider two households.

Household A moves from just below the poverty line to slightly above it.

Household B moves from modest security to a substantially higher standard of living.

Both contribute to a decline in the poverty rate.

But the economic meaning of the two movements is very different.

The first household has crossed a statistical threshold.

The second may have accumulated enough income, savings, skills, assets, and employment security to withstand future shocks.

The distinction is central.

Poverty reduction is necessary.

Economic security is broader.

15.3. The Poverty-Line Problem

One of the most important analytical developments in 2026 was the joint clarification by BPS and the World Bank concerning national and international poverty lines.

The distinction matters because public discussion can easily confuse different measures.

BPS reported Indonesia's March 2026 national poverty line at Rp669,235 per person per month.

Approximately 74.70 percent of this threshold represented the food poverty line, while 25.30 percent represented the non-food component.

This composition is revealing.

For households close to the poverty threshold, food expenditure remains central to economic security.

When food prices rise rapidly, the same nominal income purchases fewer calories and less variety.

When transport, housing, electricity, education, or health costs rise, the non-food component becomes a constraint.

Poverty is therefore partly an income problem and partly a price problem.

A household can experience economic deterioration even when nominal income does not fall if essential prices rise faster than income.

This is why purchasing power matters more than nominal income alone.

The distinction also connects Chapter 15 directly to Chapter 14.

Energy prices affect transportation and production.

Fuel prices affect logistics.

Fertilizer prices affect agriculture.

Food prices affect household welfare.

Exchange-rate movements affect imported inputs.

Climate shocks affect food supply.

Fiscal policy affects taxes, subsidies, transfers, and public services.

The poverty line therefore sits at the intersection of many economic systems examined throughout this book.

15.4. The 64.1 Percent Question

The figure of 64.1 percent requires particular care.

The World Bank estimates that 64.1 percent of Indonesians were below the international upper-middle-income poverty line of US$8.30 per person per day, using purchasing-power-parity methodology.

This figure should not be described as meaning that 64.1 percent of Indonesians are officially poor under Indonesia's national definition.

It does not.

BPS and the World Bank explicitly clarified in September 2026 that the two measures use different poverty thresholds for different purposes.

BPS measures poverty in the Indonesian context, using national methodology and cost-of-living conditions within Indonesia.

The World Bank's international poverty line is designed for cross-country comparison.

The US$8.30 threshold is associated with the upper-middle-income-country benchmark. Indonesia's classification as an upper-middle-income economy led to the adoption of the higher international benchmark from the previous US$4.20 threshold (BPS–World Bank, 2026).

The difference is therefore methodological, not evidence that living standards suddenly collapsed.

This distinction is essential for serious economic writing.

A higher international poverty threshold can classify more people as being below the benchmark without implying that those people became poorer.

But the international measure still contains an important development message.

A country aspiring to higher income levels cannot define success only as moving people above a very low subsistence threshold.

The development challenge eventually changes.

The question becomes whether households can achieve living standards compatible with economic security, productive employment, quality public services, resilience to shocks, and upward mobility.

That is the deeper meaning behind the international comparison.

Indonesia's challenge is not simply to reduce poverty.

It is to expand the population that can live securely without being highly vulnerable to the next economic shock.

15.5. Poverty is not the Same as Economic Insecurity

This distinction becomes more important as countries become richer.

A household can be non-poor and still be economically insecure.

It may have income above the poverty line but possess little savings.

It may depend on one informal job.

It may have debt obligations that consume a large portion of monthly income.

It may face high education or health expenses.

It may live in a region with limited employment alternatives.

It may own few productive assets.

It may be unable to insure itself against unemployment, illness, disaster, or business failure.

The World Bank's Indonesia Poverty Assessment emphasizes this wider concept of economic security. More than one-third of Indonesians remain economically insecure and can be pushed into

poverty by shocks. The report also identifies limited access to high-skilled jobs, weak productivity in important sectors, constrained labor-force participation among women, and regional human-capital differences as important structural challenges (World Bank, 2024).

This changes the policy question.

Traditional poverty policy asks:

How many people are below the line?

Economic-security policy asks:

How many people can withstand a shock without falling below the line?

These are different questions.

The second is particularly important for the Economic Tsunami framework.

A tsunami does not begin by asking whether a household is technically poor.

It begins with exposure.

A household with low savings, unstable income, high food expenditure, weak insurance coverage, and limited access to productive employment may be highly exposed even if it is currently above the poverty threshold.

Economic resilience therefore requires reducing exposure as well as reducing poverty.

15.6. The Rural–Urban Divide

The national poverty rate conceals a substantial geographic difference.

In March 2026, poverty stood at 6.34 percent in urban areas and 10.67 percent in rural areas.

The difference was more than four percentage points.

The absolute distribution also matters.

There were approximately 12.10 million poor people in rural areas compared with 10.83 million in urban areas (BPS, 2026c).

The rural–urban divide should not be interpreted mechanically.

Urban areas provide agglomeration economies, diversified labor markets, larger markets, greater access to services, and proximity to firms.

But cities also contain inequality.

Housing costs can be high.

Informal employment can be widespread.

Transport costs can consume income.

Low-income workers may live far from employment centers.

Urban inequality can therefore be substantial even when the urban poverty rate is lower.

Rural areas face a different structure.

Agricultural income is exposed to weather, commodity prices, input costs, land productivity, and market access.

Non-farm employment opportunities may be limited.

Distance increases the cost of accessing schools, hospitals, financial services, and markets.

The implication is important.

Indonesia does not need a single poverty policy.

It needs policies that recognize different economic mechanisms.

Urban poverty is often connected to labor markets, housing, transport, skills, and service access.

Rural poverty is more strongly connected to productivity, connectivity, agricultural value chains, diversification, and access to markets.

A single national indicator cannot capture these differences.

15.7. Inequality: the Gini Story

Poverty and inequality are related, but they are not the same.

BPS reported Indonesia's Gini ratio at 0.368 in March 2026.

The figure was higher than 0.363 in September 2025 but lower than 0.375 in March 2025.

The urban Gini ratio was 0.387, compared with 0.296 in rural areas.

Under the World Bank's expenditure-share measure, the bottom 40 percent accounted for 19.22 percent of national expenditure in March 2026. The corresponding shares were 18.31 percent in urban areas and 22.24 percent in rural areas (BPS, 2026d).

The movement of the Gini ratio demonstrates why distributional analysis cannot rely on a single direction.

Poverty declined.

The Gini ratio increased between September 2025 and March 2026.

This does not constitute a contradiction.

Poverty measures the proportion below a threshold.

The Gini ratio describes the distribution across the population.

A society can reduce poverty while experiencing a temporary increase in measured inequality.

It can also reduce inequality without eliminating poverty.

The policy implications are therefore different.

Poverty policy focuses on raising households above a minimum standard.

Inequality policy focuses on how gains and opportunities are distributed.

Mobility policy focuses on whether households can move upward over time.

These three dimensions should be analyzed together.

15.8. Why Inequality Can Fall While Insecurity Remains

There is another reason why the distributional picture cannot be reduced to the Gini ratio.

Imagine that the incomes of the bottom 40 percent rise while the incomes of the middle 40 percent stagnate.

Poverty may fall.

The Gini ratio may move in one direction or another depending on what happens at the top.

Yet the middle class may still feel increasingly insecure.

This is particularly important because economic security depends on expectations as well as current consumption.

A household may be above the poverty line but unable to afford a house.

It may own a motorcycle but not have adequate savings.

It may send children to school but fear the cost of university.

It may have stable employment but face uncertain pension security.

It may have rising nominal income but declining purchasing power.

The distributional analysis therefore needs three levels.

Level one is absolute deprivation.

Level two is relative inequality.

Level three is economic security and mobility.

The first asks whether households meet minimum needs.

The second asks how resources are distributed.

The third asks whether households can build durable economic capacity.

For an economy approaching higher-income status, the third question becomes increasingly important.

15.9. The Geography of Poverty

Indonesia is not one economic geography.

It is a collection of highly differentiated regional economies.

BPS data for March 2026 show substantial variation in provincial poverty rates.

The rate was 3.44 percent in Bali and 3.96 percent in DKI Jakarta.

It was 6.54 percent in West Java and 5.38 percent in Banten.

At the other end of the distribution, Nusa Tenggara Timur recorded 17.52 percent.

Aceh recorded 12.34 percent, Bengkulu 11.83 percent, and Nusa Tenggara Barat 11.17 percent (BPS, 2026c).

These differences are not simply statistical curiosities.

They reflect different combinations of productivity, geography, employment structure, infrastructure, human capital, urbanization, public services, market access, and historical development.

The regional problem therefore cannot be solved simply by transferring more money.

Transfers matter.

But transfers can only partially compensate for weak productive capacity.

A region becomes more economically resilient when it can continuously generate productive employment, attract investment, develop human capital, connect firms to markets, and convert public expenditure into higher-quality services.

15.10. Java: Richer, Denser, Still Home to Millions of Poor

Java presents an important paradox.

It has higher productivity, greater urbanization, stronger infrastructure, larger markets, and greater concentration of economic activity than many other parts of Indonesia.

Yet Java also contains a large share of Indonesia's population.

Therefore, a lower poverty rate does not mean the absolute number of poor households is necessarily small.

This distinction between incidence and concentration is fundamental.

Incidence asks:

What proportion of the population is poor?

Concentration asks:

Where are the largest numbers of poor people located?

A region with a very high poverty rate but a small population can have fewer poor people in absolute terms than a densely populated region with a much lower poverty rate.

This is why national poverty policy needs both perspectives.

High-incidence regions require targeted structural interventions.

High-concentration regions require scale.

Java also illustrates the limits of geographic concentration.

The World Bank has documented that regional income convergence in Indonesia slowed in the decade before the pandemic, while Java-Bali's economic dominance persisted. The challenge is not simply that other regions are poor; it is that catch-up has not proceeded consistently enough to close productivity and income gaps (World Bank, 2024).

This makes regional development a national productivity issue.

When workers and firms in lagging regions face lower productivity because of infrastructure, skills, market access, or institutional constraints, the entire Indonesian economy loses potential output.

15.11. Eastern Indonesia: High Incidence, Smaller Population

Eastern Indonesia illustrates the opposite side of the distributional equation.

Several eastern provinces record poverty rates substantially above the national average.

Nusa Tenggara Timur, for example, recorded a poverty rate of 17.52 percent in March 2026.

Papua and its newly formed provinces also show highly differentiated poverty and inequality indicators, requiring province-specific interpretation rather than a single “Eastern Indonesia” category (BPS, 2026c).

The geographic challenges can be significant.

Distance raises logistics costs.

Small markets limit economies of scale.

Human-capital constraints can restrict firm productivity.

Infrastructure gaps can reduce connectivity.

Natural disasters and climate exposure can increase household risk.

Public administration capacity can determine whether fiscal transfers are converted into reliable services.

But the eastern-region story should not become a narrative of permanent disadvantage.

Regional development is not predetermined.

Resource endowments, tourism, fisheries, agriculture, renewable energy, digital services, and downstream industries can create different development pathways.

The critical question is whether these opportunities produce local value capture.

Extraction alone does not guarantee broad-based development.

The connection between resources and households runs through employment, supplier networks, wages, local businesses, public revenue, and public services.

15.12. The Regional Productivity Gap

Income differences are ultimately productivity differences.

A worker producing more value per hour can generally support higher wages.

A firm with higher productivity can generally pay better wages, invest more, compete more effectively, and generate greater taxable income.

A region with a dense ecosystem of productive firms can support a broader labor market.

This creates a feedback loop:

Productivity → Wages → Consumption → Investment → Fiscal Capacity → Public Services → Human Capital → Productivity.

But the opposite loop is also possible:

Low Productivity → Low Wages → Weak Demand → Low Investment → Limited Fiscal Capacity → Weak Services → Low Human Capital → Low Productivity.

This is the regional productivity trap.

Breaking it requires more than infrastructure.

Infrastructure without productive firms can become underutilized.

Training without demand for skilled workers can generate migration rather than local employment.

Industrial estates without supplier ecosystems can create enclaves.

Universities without links to firms may produce credentials without productivity gains.

Fiscal transfers without administrative capacity can generate spending without equivalent improvements in outcomes.

Regional convergence therefore requires coordination across multiple layers.

15.13. The Infrastructure Geography of Opportunity

Infrastructure is often discussed as physical capital.

Its deeper economic role is to reduce distance.

Roads reduce travel time.

Ports reduce trade costs.

Electricity reduces production constraints.

Digital networks reduce information costs.

Water systems reduce health risks.

Public transport expands the effective labor market.

Hospitals reduce the economic cost of illness.

Schools increase the future productivity of workers.

The distributional effect of infrastructure therefore depends on what it connects.

A road connecting a village to a productive agricultural market can raise farm incomes.

A port connected to industrial clusters can reduce export costs.

A railway connecting workers to employment centers can increase labor mobility.

A broadband network connected to capable firms and skilled workers can expand access to services and markets.

The relevant question is not:

How much infrastructure was built?

It is:

What economic constraint did the infrastructure remove?

This is a crucial test for public investment.

Infrastructure should be evaluated through utilization, productivity, access, service quality, and long-term economic returns—not only through construction volume.

15.14. Human Capital Across Regions

Human capital is the bridge between geography and mobility.

The World Bank's Indonesia Poverty Assessment notes that human-capital outcomes have improved but remain below peer-country levels in several dimensions, with particularly important gaps in parts of Eastern Indonesia (World Bank, 2024).

This matters because regional inequality can reproduce itself through human capital.

A child growing up in a region with weaker schools may enter the labor market with fewer skills.

Lower skills can lead to lower productivity.

Lower productivity can lead to lower wages.

Lower wages can limit household investment in education.

The next generation may therefore face the same constraint.

This is the intergenerational dimension of regional inequality.

Breaking the cycle requires early childhood development, nutrition, school quality, teacher quality, health services, vocational education, digital access, and pathways from education to employment.

Education policy therefore cannot be separated from industrial policy.

If Indonesia builds advanced manufacturing capacity but cannot supply the required technicians, engineers, supervisors, and managers, firms will face skill shortages.

If the country develops digital industries but large parts of the workforce lack digital capability, productivity gains will remain concentrated.

Human capital is therefore not merely a social-sector issue.

It is an economic infrastructure issue.

15.15. The Labor-Market Geography

Jobs are the transmission mechanism between growth and household welfare.

But jobs differ enormously.

A productive formal-sector job with training, social protection, and career progression has different economic consequences from unstable informal employment.

The same number of employed people can therefore correspond to very different levels of economic security.

This is why employment quantity is insufficient.

The relevant questions include:

What is the productivity of the job?

What is the wage?

How stable is employment?

Does the worker receive training?

Can the worker move into higher-productivity occupations?

Is the worker covered by social insurance?

Does the job create transferable skills?

Can the worker accumulate savings?

These questions are particularly important for younger workers.

A labor market that generates employment without productivity progression can reduce immediate poverty while leaving mobility constrained.

A labor market that generates career ladders can produce a much stronger long-term effect.

The World Bank has highlighted the scarcity of high-skilled jobs and the importance of better, higher-productivity employment for Indonesia's path toward greater economic security (World Bank, 2024).

This connects directly to Chapter 5.

Productivity is not an abstract statistic.

For households, productivity eventually appears as income.

15.16. Natural Resources and the Regional Paradox

Indonesia's natural-resource regions face a distinctive paradox.

Natural resources can generate exports, investment, tax revenue, and employment.

But resource abundance can also coexist with limited diversification.

The central question is therefore not whether a region possesses resources.

It is whether resources generate a broader productive ecosystem.

Consider the transmission chain:

Resource → Investment → Processing → Suppliers → Skills → Jobs → Wages → Local Businesses → Public Revenue → Services → Human Capital.

If the chain is complete, resource wealth can support regional transformation.

If the chain stops at extraction or processing, the region may experience output growth without sufficient diversification.

This is particularly relevant to downstreaming.

Chapter 10 argued that downstreaming should be evaluated not as an ideological objective but as an economic instrument.

The distributional test is similar.

Who obtains the jobs?

How much value remains locally?

How many domestic suppliers participate?

What skills are transferred?

What infrastructure is shared?

How much local fiscal capacity is generated?

What environmental costs are borne by local communities?

The answer determines whether downstreaming becomes a regional development strategy or primarily a production strategy.

15.17. Cities, Agglomeration & Opportunity

Cities create economic opportunity because proximity has value.

Firms benefit from being near suppliers.

Workers benefit from being near employers.

Knowledge travels faster among dense networks.

Specialization increases.

Competition can intensify.

Infrastructure can be used more efficiently.

These agglomeration effects can raise productivity.

But agglomeration also creates distributional pressure.

Housing becomes more expensive.

Congestion increases.

Low-income workers may be pushed to distant locations.

Transport costs can rise.

Public services can become strained.

The economic geography of opportunity can therefore become the geography of exclusion.

The solution is not to prevent urbanization.

Urbanization is part of structural transformation.

The challenge is to make urbanization productive and inclusive.

That requires housing supply, public transport, infrastructure, spatial planning, education, health, and labor-market connectivity.

Low urban migration can also reduce the ability of workers in lower-productivity areas to access higher-productivity jobs.

The World Bank has identified low urban migration as one factor limiting productivity gains from agglomeration (World Bank, 2024).

This suggests that regional convergence does not always require moving firms to every location.

Sometimes it requires enabling people to move toward opportunity while ensuring that origin regions also develop productive economic bases.

15.18. Rural Indonesia and the Productivity Challenge

Rural development should not be reduced to agricultural subsidies.

Agriculture remains important, but rural economies are increasingly multidimensional.

They include food processing, logistics, tourism, small manufacturing, digital commerce, services, construction, fisheries, and remittances.

The objective should be rural diversification.

A farmer should be able to increase income through productivity, processing, storage, logistics, digital market access, and value-added activities.

A rural entrepreneur should be able to obtain finance and reach markets.

A young person should be able to choose between migration, local entrepreneurship, and skilled employment without being forced into one option by the absence of alternatives.

The rural economy therefore requires connectivity.

Connectivity to markets.

Connectivity to finance.

Connectivity to skills.

Connectivity to digital platforms.

Connectivity to public services.

Connectivity to larger economic centers.

The strongest rural policy is often not the one that protects an existing low-productivity structure indefinitely.

It is the one that helps households move toward higher productivity while protecting them against transition costs.

15.19. Middle-Class Vulnerability

Poverty is not the only distributional concern.

The middle class matters because it represents a large part of consumption, private investment, human-capital accumulation, and social stability.

But middle-class status is not identical to economic security.

A household can have middle-class consumption while maintaining limited financial buffers.

A mortgage, education expenses, transportation costs, health costs, and unstable income can create substantial vulnerability.

This is why the middle class must be analyzed through balance sheets as well as income.

Income asks:

How much does the household earn?

The balance sheet asks:

How much does it own?

How much does it owe?

How much can it save?

How long could it survive a loss of income?

How much would a major medical or education expense affect its finances?

This is the household version of fiscal space.

A government with little fiscal space has limited ability to absorb shocks.

A household with little financial space faces the same problem at a smaller scale.

This is one reason why economic resilience is distributional.

The same macroeconomic shock does not affect all households equally.

15.20. Who Bears Inflation?

Inflation is an average.

Its distributional effects are not.

A household spending a large share of its budget on food experiences food inflation differently from a higher-income household that spends a smaller share on food.

This is visible in the structure of the national poverty line.

In March 2026, food accounted for 74.70 percent of the official poverty line, while non-food needs accounted for 25.30 percent (BPS, 2026c).

This does not mean every household allocates exactly that share of its expenditure to food.

It does show the importance of food prices for households close to the poverty threshold.

This creates an important transmission mechanism:

Food shock → Real purchasing power → Household consumption → Nutrition → Labor productivity → Poverty risk.

Energy creates another:

Energy shock → Transport and production costs → Food and service prices → Real income → Household welfare.

Exchange-rate volatility creates another:

Rupiah depreciation → Imported input costs → Production costs → Prices → Purchasing power.

These channels explain why macroeconomic stability has a distributional dimension.

Inflation control is not only a central-bank objective.

It is also household protection.

15.21. Who Benefits from Downstreaming?

Downstreaming creates potential gains through investment, processing, employment, exports, and industrial capability.

But the distribution of these gains is not automatic.

There are several channels through which downstreaming can affect households.

The first is employment.

The second is wages.

The third is domestic supplier development.

The fourth is local infrastructure.

The fifth is fiscal revenue.

The sixth is technology transfer.

The seventh is regional business formation.

The eighth is environmental cost.

These channels can move in different directions.

A project may generate high investment but relatively limited direct employment.

Another may generate many jobs but modest productivity gains.

A third may create high-value exports while importing much of its machinery and intermediate inputs.

A fourth may create significant local demand while imposing environmental costs on nearby communities.

Therefore, the distributional evaluation of downstreaming must go beyond investment value.

The appropriate question is:

How much productive capacity remains in Indonesia after the investment is made?

This is the distributional extension of the productivity test from Chapter 10.

15.22. Who Benefits from State Capital?

The same logic applies to state capital.

State-owned assets and investment vehicles can generate dividends, capital gains, infrastructure, industrial capacity, and strategic investments.

But the distributional transmission mechanism must be identified.

A state investment produces public value only if its returns ultimately enter one or more of the following channels:

higher productivity,

higher employment,

higher household income,

higher fiscal capacity,

better public services,

stronger national balance sheets,

or greater resilience.

This does not mean every state investment must maximize immediate financial return.

Some investments can have strategic or public-purpose objectives.

But those objectives should be measurable.

If an investment has a commercial mandate, its financial performance should be evaluated.

If it has a developmental mandate, its development impact should also be evaluated.

If it combines both, the trade-offs should be transparent.

This principle connects Chapter 11 with Chapter 15.

State capital is not automatically inclusive.

Its distributional effect depends on how successfully ownership is converted into productive assets, jobs, services, and long-term national wealth.

15.23. Fiscal Transfers and Regional Capacity

Fiscal transfers are essential to Indonesia's regional architecture.

But equalizing resources and equalizing outcomes are not the same thing.

Two provinces can receive similar fiscal resources per capita and still produce different public-service outcomes because of differences in geography, administrative capacity, population density, procurement systems, staffing, and local economic structures.

The distributional question therefore has two stages.

Stage one:

How much fiscal capacity reaches the region?

Stage two:

What does the region produce with that capacity?

This is why decentralization requires administrative capability.

A region with strong planning, budgeting, procurement, data systems, and service delivery can potentially convert fiscal resources into better outcomes.

A region with weak administrative capability may struggle to do so.

The World Bank has emphasized the importance of stronger subnational administrative capacity in improving public services and supporting pro-poor investments (World Bank, 2024).

Fiscal transfers should therefore be evaluated not only by size but by additionality and outcomes.

What would not have happened without the transfer?

Did service quality improve?

Did infrastructure become more productive?

Did human capital improve?

Did local revenue capacity increase?

Did dependence decline over time?

These are the questions that turn fiscal transfers into an economic-development instrument rather than merely a redistribution mechanism.

15.24. Public Services as Equalizers

Public services can reduce inequality even when market incomes remain unequal.

A household that receives high-quality public education gains something with economic value.

A household that has access to affordable health care avoids catastrophic expenditure.

A household connected to reliable transport gains access to a larger labor market.

A household with clean water and sanitation experiences lower health risks.

Public services therefore function as a form of social infrastructure.

Their economic value should be measured in terms of avoided costs and expanded opportunity.

This is especially important for poor households.

For a high-income household, paying for private transport may be inconvenient.

For a low-income household, unreliable public transport can determine whether a job is economically viable.

For a high-income household, private tutoring may compensate for weak schooling.

For a low-income household, school quality may determine the next generation's opportunity.

The equalizing effect of public services is therefore strongest when they are reliable, accessible, and high quality.

This makes expenditure quality as important as expenditure volume.

15.25. Education, Health & Mobility

Education and health are often described as social investments.

They are also productivity investments.

A healthy child learns more effectively.

A skilled worker produces more value.

A healthy worker misses fewer workdays.

A trained entrepreneur can adopt technology faster.

A better-educated population can support more sophisticated industries.

The mobility chain is therefore:

Health → Learning → Skills → Employment → Productivity → Income → Assets → Mobility.

When one link is weak, the entire chain can weaken.

This explains why inequality can persist even after infrastructure improves.

Physical infrastructure can connect a region to markets.

But human capital determines how effectively people participate in those markets.

The same highway can have very different economic effects depending on the skills and productive capacity of the communities it connects.

This is why inclusive growth cannot be reduced to redistribution.

It requires capability formation.

15.26. Social Protection: Protection vs Dependency

Social protection has a clear economic function.

It protects households from shocks that could destroy human capital, assets, or productive capacity.

A household that receives temporary support after a disaster may avoid selling productive assets.

A child who remains in school during an income shock may preserve future earning potential.

A worker with social insurance may avoid catastrophic consumption cuts.

Protection can therefore prevent temporary shocks from becoming permanent poverty.

But social protection also needs to be designed carefully.

The objective is not to create permanent dependence where households could otherwise transition into productive employment.

The policy challenge is to combine protection with opportunity.

This suggests a three-part architecture:

Protect the vulnerable.

Build capabilities.

Create pathways to productive employment.

Social assistance without opportunity can leave households vulnerable to future shocks.

Opportunity without protection can expose households to severe losses during transition.

A resilient system needs both.

15.27. The Fiscal Incidence Question

Every fiscal policy has an incidence.

Taxes affect households differently.

Subsidies affect households differently.

Transfers affect households differently.

Public services affect households differently.

Infrastructure spending affects regions differently.

Therefore, fiscal policy should be evaluated not only by aggregate revenue and expenditure but by distributional incidence.

The basic question is:

Who pays?

Who receives?

Who gains?

Who bears the cost?

And over what time horizon?

A subsidy that appears universal may provide more absolute benefit to households that consume more of the subsidized product.

A targeted transfer may provide larger relative welfare gains to low-income households.

An infrastructure project may produce national benefits while imposing concentrated local costs.

A tax reform may reduce one distortion while creating another.

A state investment may generate future dividends but require substantial capital today.

These trade-offs do not have simple ideological answers.

They require evidence.

This is why fiscal incidence should become part of Indonesia's policy evaluation infrastructure.

The country needs to know not only how much a policy costs, but how its benefits and costs are distributed.

15.28. Regional Indonesia as a Portfolio of Economies

Indonesia is often described as one economy.

Economically, it is better understood as a portfolio of regional economies.

Java has dense manufacturing and services.

Sumatra has major commodity, energy, plantation, and manufacturing bases.

Kalimantan combines resources, mining, energy, plantations, and a growing role associated with the national capital transition.

Sulawesi has developed important industrial and mineral-processing ecosystems.

Bali has a distinctive tourism-based economy.

Nusa Tenggara combines agriculture, tourism, fisheries, and significant development constraints.

Maluku and Papua contain strategic natural resources and maritime potential alongside difficult geography and large service-delivery challenges.

This portfolio perspective changes the policy question.

The objective is not to make every region identical.

It is to enable every region to develop productive comparative advantages while ensuring basic standards of opportunity and public services.

Regional convergence does not require identical economic structures.

It requires convergence in the capacity to generate human welfare.

That is a more realistic definition of regional equality.

15.29. Five Channels of Regional Convergence

Regional convergence can be understood through five channels.

First: productive employment.

Regions need jobs that generate rising productivity and wages.

Second: human capital.

Schools, health systems, nutrition, and skills must support productive participation.

Third: infrastructure and connectivity.

Physical and digital infrastructure must reduce economic distance.

Fourth: firm productivity.

Local businesses must be able to access finance, technology, markets, and skilled workers.

Fifth: institutional capacity.

Regional governments must be capable of converting fiscal resources into effective services and investment.

These channels reinforce one another.

Productive firms create jobs.

Jobs raise income.

Higher income expands local demand.

Demand supports businesses.

Businesses generate tax revenue.

Tax revenue and transfers finance services.

Services improve human capital.

Human capital raises productivity.

This is the regional convergence loop.

The opposite is also possible.

Weak productivity produces low wages.

Low wages limit demand.

Weak demand discourages investment.

Low investment limits productivity.

Weak fiscal capacity constrains public services.

Poor services weaken human capital.

The regional challenge is therefore to change the direction of the loop.

15.30. The Poverty Stress Test

A serious poverty stress test should ask five questions.

First:

How many households are close enough to the poverty line that a modest shock could push them below it?

Second:

How much of household expenditure is exposed to volatile food and energy prices?

Third:

How stable is household income?

Fourth:

How much financial and social protection is available?

Fifth:

How quickly can the household recover after a shock?

This produces a more meaningful poverty-risk framework than the poverty rate alone.

A country can have declining poverty but rising vulnerability if households remain close to the threshold and lack buffers.

Conversely, a country can have a relatively high poverty rate but rapidly improving economic security if productive employment, human capital, and social protection are strengthening.

The stress test therefore needs both stock and flow indicators.

Stock:

Current poverty.

Flow:

Probability of moving into or out of poverty.

This is the difference between measuring a condition and measuring mobility.

15.31. The Inequality Stress Test

The inequality stress test asks whether economic gains are broadly distributed across the income and expenditure distribution.

Five indicators are particularly relevant.

One:

The Gini ratio.

Two:

The expenditure or income share of the bottom 40 percent.

Three:

Real wage growth by income group.

Four:

Asset ownership and access to finance.

Five:

Access to quality public services.

A fall in the Gini ratio is informative.

But it is not sufficient.

Suppose inequality falls because high-income incomes decline during a recession.

That does not necessarily represent inclusive development.

Suppose inequality rises because high-productivity investment initially benefits skilled workers while creating a larger productivity base for the future.

That requires a different interpretation.

The quality of distribution therefore matters.

The objective should not be mathematical equality.

The objective is broad access to productive opportunity and rising living standards.

15.32. The Regional Resilience Test

Regional resilience requires more than low poverty.

A resilient region should have multiple economic engines.

If a region depends on one commodity, one employer, one export market, or one climate-sensitive activity, its exposure is high.

Diversification matters.

So does connectivity.

A regional resilience scorecard can therefore include:

Economic diversification.

Employment diversity.

Fiscal capacity.

Human-capital quality.

Infrastructure reliability.

Private investment.

Local business density.

Social protection coverage.

Disaster preparedness.

Environmental sustainability.

The purpose is not to rank provinces.

It is to identify structural vulnerabilities.

A region that scores poorly on several dimensions requires a different development strategy from a region with diversified industries and strong institutions.

Regional policy should therefore become increasingly diagnostic.

15.33. The Intergenerational Mobility Test

The deepest distributional question is not:

How much does a household earn today?

It is:

How much does the next generation inherit in terms of opportunity?

Intergenerational mobility depends on several forms of capital.

Human capital.

Physical assets.

Financial assets.

Social networks.

Geographic access.

Digital access.

Environmental quality.

Institutional quality.

A child born into a low-income household can still achieve upward mobility if these systems function effectively.

Education can compensate for parental income.

Health can protect productive capacity.

Public transport can expand job access.

Digital connectivity can expand market access.

Social protection can prevent shocks from destroying educational investment.

But when multiple constraints accumulate, mobility becomes harder.

This is why inclusive growth should be judged over decades, not quarters.

The ultimate test of an economic system is whether it allows people to escape the circumstances into which they were born.

15.34. The Prabowo-Era Distribution Question

The economic architecture examined in Part IV introduces major policy ambitions around growth, industrialization, downstreaming, food and energy security, human capital, state capital, and national investment.

The distributional question is not whether these policies are inherently inclusive or exclusive.

Their effects must be observed through transmission mechanisms.

For industrial policy:

Are productive jobs created?

For downstreaming:

Does domestic value added increase?

For state capital:

Does investment generate measurable economic and fiscal returns?

For food policy:

Does food security improve without imposing disproportionate costs on vulnerable households?

For energy policy:

Does security improve at an acceptable economic cost?

For fiscal policy:

Are public resources converted into services and productive assets?

For regional policy:

Does productivity converge?

For human-capital policy:

Do learning and employment outcomes improve?

The relevant test is therefore empirical.

The Prabowo-era economic architecture should be evaluated through outcomes, not slogans.

The key distributional indicators should include:

Real household consumption.

Real wages.

Quality employment.

Poverty transitions.

Economic insecurity.

Gini ratio.

Bottom-40 expenditure share.

Regional productivity.

Human-capital outcomes.

Public-service quality.

Household financial resilience.

These indicators provide a bridge between macroeconomic policy and household reality.

15.35. What Would Inclusive Growth Actually Look Like?

Inclusive growth is sometimes treated as a moral aspiration.

It can be made measurable.

Inclusive growth would mean that productivity rises.

Real wages rise alongside productivity over time.

Employment shifts toward higher-value activities.

Poverty declines.

Economic insecurity declines.

The bottom 40 percent participates in consumption and income gains.

Middle-income households accumulate assets and financial buffers.

Regional productivity gaps narrow.

Human-capital gaps narrow.

Public-service quality improves.

Private investment expands beyond a small number of regions.

Economic opportunities become less dependent on household origin.

This definition does not require every household to receive the same income.

It requires broad participation in productivity gains.

That distinction matters.

An economy can have inequality and still generate strong upward mobility.

It can also have relatively stable inequality while producing very little mobility.

The more meaningful objective is therefore:

shared productivity growth.

When productivity rises broadly, distributional improvement becomes more sustainable because it is financed by a larger economic base rather than redistribution alone.

15.36. The Five-Layer Inclusion Framework

The analysis of this chapter can be condensed into five layers.

Layer One: Opportunity.

Can people access productive employment, entrepreneurship, education, and markets?

Layer Two: Income.

Do opportunities translate into rising real wages and household income?

Layer Three: Services.

Can households access reliable education, health, transport, infrastructure, and digital connectivity?

Layer Four: Security.

Can households withstand unemployment, illness, inflation, disaster, and other shocks without falling into poverty?

Layer Five: Mobility.

Can households accumulate human and physical capital and improve their position over time?

These five layers form the inclusion framework:

OPPORTUNITY

↓

INCOME

↓

SERVICES

↓

SECURITY

↓

MOBILITY

The system becomes resilient when each layer reinforces the next.

Opportunity generates income.

Income allows saving and investment.

Services increase productivity.

Security prevents shocks from destroying accumulated gains.

Mobility raises the next generation's opportunity.

The system becomes fragile when any layer is missing.

This is the central distributional architecture of the book.

15.37. Economic Tsunami: Who Gets Hit First?

The metaphor of the Economic Tsunami can now be applied at the household level.

A financial shock does not arrive equally.

A food-price shock does not arrive equally.

A currency shock does not arrive equally.

An energy shock does not arrive equally.

A recession does not arrive equally.

Households with low savings are more exposed to income interruptions.

Households with high food expenditure are more exposed to food inflation.

Informal workers may have less employment protection.

Small businesses may have less access to financing.

Highly indebted households may have less financial flexibility.

Remote regions may face higher logistics costs.

Communities dependent on a single commodity may face concentrated employment risk.

This does not mean these groups are destined to suffer.

It means their exposure channels are different.

The analytical task is therefore to identify where the shock enters the system.

Consider the transmission chain:

External Shock

→ Exchange Rate / Commodity / Financial Market

→ Domestic Prices / Investment / Employment

→ Household Income

→ Consumption

→ Savings

→ Human Capital

→ Mobility.

If household buffers are strong, the chain can stop.

If buffers are weak, a temporary shock can become a permanent welfare loss.

This is the household-level definition of resilience.

15.38. The Deeper Question

The deeper question is not whether Indonesia has inequality.

Every large economy has inequality.

The question is whether inequality is compatible with upward mobility.

A society can tolerate considerable income differences if people believe—and experience—that effort, education, entrepreneurship, and productive participation can materially improve their economic position.

The opposite is also possible.

Even moderate inequality can become socially and economically destabilizing if mobility is weak and economic opportunity depends heavily on inherited circumstances.

This makes mobility one of the most important long-term economic indicators.

GDP tells us how much the economy produces.

Poverty tells us how many people fall below a minimum threshold.

The Gini ratio tells us something about distribution.

But mobility tells us whether the economic system changes people's trajectories.

15.39. Who Bears the Cost?

The title question of Part VI can now be answered in economic rather than rhetorical terms.

The cost of economic transformation is distributed through prices, employment, taxation, investment, public services, environmental effects, and opportunity.

The benefits are distributed through wages, profits, productivity, infrastructure, human capital, public services, asset accumulation, and future opportunities.

The central policy challenge is to ensure that adjustment costs do not become permanently concentrated among households with the fewest buffers.

This does not mean preventing economic change.

Structural transformation necessarily creates winners and losers in the short run, as resources move between sectors and technologies change.

The policy objective is to make the transition sufficiently productive and sufficiently protective that temporary displacement does not become permanent exclusion.

This is where economic policy meets social mobility.

A resilient economy does not eliminate shocks.

It prevents shocks from permanently destroying opportunity.

15.40. Part Vi Revisited

Part VI began with a simple question:

Who bears the cost?

The answer cannot be found in GDP alone.

It requires following the economic chain from aggregate growth to household welfare.

Growth must create jobs.

Jobs must create rising productivity.

Productivity must support real wage growth.

Income must generate purchasing power.

Purchasing power must allow households to accumulate assets and human capital.

Public services must reduce the cost of essential needs.

Social protection must prevent temporary shocks from becoming permanent poverty.

Regional policy must expand productive opportunity.

And mobility must allow the next generation to begin from a stronger position.

The framework can therefore be summarized as:

GROWTH

↓

JOBS

↓

WAGES

↓

PURCHASING POWER

↓

PUBLIC SERVICES

↓

HUMAN & PHYSICAL CAPITAL

↓

MOBILITY

↓

RESILIENCE

But the chain is not linear.

It is a feedback system.

Prices can interrupt purchasing power.

Fiscal policy can strengthen or weaken services.

Regional capacity can accelerate or slow convergence.

Productivity can increase wages.

Wages can increase demand.

Demand can attract investment.

Investment can increase productivity.

This is why distribution is not merely the final chapter after growth.

Distribution is part of the growth mechanism itself.

Indonesia's economic question is therefore no longer only whether poverty is falling.

It is whether growth is creating enough productive opportunities, across enough regions, for enough households to become permanently more secure.

That is the standard against which the next phase of Indonesia's economic transformation should be evaluated.

And it leads directly to the next question.

If the middle class is expanding but becoming more financially exposed, if poverty is falling but economic insecurity remains widespread, and if productivity gains are uneven across regions and occupations, what happens to social mobility?

Chapter 16 turns to that question:

Middle-Class Pressure & Social Mobility.

The issue is no longer simply who is poor.

It is who can stay secure, who can move upward, and who risks falling backward.

Figure 15.1 — THE GROWTH–DISTRIBUTION–MOBILITY FRAMEWORK

GROWTH

↓

JOBS

↓

WAGES

↓

PURCHASING POWER

↓

PUBLIC SERVICES

↓

HUMAN & PHYSICAL CAPITAL

↓

MOBILITY

↓

RESILIENCE

Cross-cutting forces:

PRICES • TAXES • TRANSFERS • INVESTMENT • REGIONAL CAPACITY • SHOCKS

CHAPTER 16

THE MIDDLE CLASS UNDER PRESSURE

When Economic Security Starts to Feel Fragile

The middle class is where macroeconomics becomes personal.

For households near the poverty line, economic policy is often experienced through food prices, employment, housing, health care, education, and social protection.

For affluent households, economic shocks can often be absorbed through accumulated assets, diversified income, financial reserves, and access to capital.

The middle class occupies a different position.

It has something to protect.

It has accumulated expectations, commitments, and aspirations.

A middle-class household may own a home or be paying a mortgage. It may own a vehicle. It may finance education. It may support elderly parents. It may have insurance, consumer credit, business loans, or investment accounts.

Its economic life is therefore increasingly complex.

A modest decline in real income can affect consumption.

A rise in housing costs can delay asset accumulation.

A period of weak wage growth can reduce savings.

A job transition can change household security even when the household remains far above the official poverty line.

This is the central theme of Chapter 16.

The middle class does not need to become poor to become economically insecure.

It can remain statistically non-poor while experiencing declining room to maneuver.

That distinction matters for Indonesia's economic transformation.

Chapter 15 examined poverty, inequality, regional disparities, and who bears the cost of economic change.

Chapter 16 moves one level upward.

The question is not simply who is poor.

It is:

Who can remain secure?

Who can accumulate assets?

Who can afford to invest in the next generation?

Who can absorb a shock?

And who can continue moving upward?

The middle class is therefore not merely a social category.

It is a transmission mechanism between growth and economic mobility.

16.1. The Middle Class as an Economic Engine

Middle-class households are important because they do more than consume.

They consume services.

They purchase housing.

They finance education.

They save.

They invest.

They start businesses.

They use financial products.

They create demand for better-quality goods.

They contribute taxes.

They accumulate human and physical capital.

For these reasons, a large and economically secure middle class can strengthen the domestic economic base.

BPS reported that in 2024 the middle class and those approaching middle-class status together represented 66.35 percent of Indonesia's population and accounted for 81.49 percent of household consumption (BPS, 2024). The figure illustrates why middle-class purchasing power matters beyond individual households: it is deeply connected to the domestic-demand engine.

The feedback loop is:

Middle-Class Income → Consumption → Business Revenue → Investment → Employment → Income.

But the reverse loop is also possible.

Weak real wages can constrain consumption.

Weak consumption can discourage investment.

Lower investment can limit high-productivity employment.

Weak job creation can restrain wages.

The result is a middle-class pressure loop.

This is why the middle class is not simply an outcome of economic growth.

It can also influence the growth trajectory itself.

16.2. Defining the Middle Class: Size is not Security

There is no single universally correct definition of the middle class.

Different institutions use income, consumption, expenditure, occupational status, vulnerability to poverty, or combinations of these measures.

This matters because the measured size of the middle class changes with the definition.

A household can be middle class under one threshold and aspiring middle class under another.

A household can also move between categories as income, consumption, prices, and household composition change.

For this book, four concepts should therefore be separated:

Middle-class status.

Aspiring middle-class status.

Economic security.

Economic mobility.

They are related but not interchangeable.

Middle-class status describes where a household sits in a distribution.

Aspiring middle-class status describes a household that has moved beyond poverty but remains vulnerable to shocks.

Economic security describes the household's ability to maintain its living standard when exposed to adverse events.

Economic mobility describes whether the household can move upward over time.

This distinction produces a more useful proposition:

A large middle class is not necessarily a strong middle class.

The size question asks:

How many households are middle class?

The strength question asks:

How secure are they?

The mobility question asks:

Can they move upward?

This book is primarily concerned with the second and third questions.

16.3. The Aspiring Middle Class

Between poverty and durable economic security lies a large group of households that are neither poor nor fully protected.

They may have rising consumption.

They may own consumer durables.

They may have stable employment.

They may live in urban or peri-urban areas.

But they may also have limited savings.

A single job loss can materially change their financial position.

A major illness can generate substantial expenditure.

A food or energy shock can reduce discretionary consumption.

An increase in debt-service costs can narrow financial flexibility.

These households are particularly important because their economic trajectory can move in either direction.

They can become economically secure.

Or they can experience downward mobility.

The policy objective should therefore not be framed only around protecting the existing middle class.

It should also address the transition from vulnerability to security.

That transition is one of the most important development processes in a middle-income economy.

16.4. The Consumption Paradox

Indonesia's economy is heavily dependent on domestic consumption.

Yet the distribution of consumption growth matters as much as its aggregate level.

The World Bank's June 2025 Indonesia Economic Prospects reported that between 2019 and 2024, real consumption among the aspiring middle class—roughly the 40th to 90th percentiles of the consumption distribution—grew by about 1.3 percent annually.

The World Bank also observed that growth in consumption was stronger among poorer households and the richest segment than among the aspiring middle class (World Bank, 2025a).

This produces an important paradox.

Indonesia can maintain aggregate consumption growth while a large segment of households experiences relatively weak improvement in consumption capacity.

The macroeconomic aggregate can therefore conceal a distributional slowdown.

Why does this matter?

Because the middle class purchases many of the goods and services associated with development.

Education.

Housing.

Transportation.

Healthcare.

Digital services.

Financial products.

Leisure.

Professional services.

Better-quality food.

When these expenditures stagnate, the consequences can spread beyond households.

Businesses serving middle-income consumers may face weaker demand.

Investment decisions may be postponed.

Households may increase precautionary saving.

Consumer credit may slow.

The economy can become more dependent on other sources of demand.

This does not mean middle-class weakness automatically produces an economic crisis.

It means that persistent middle-class pressure can become a structural constraint on domestic demand.

16.5. The Wage Question

The most important source of sustainable middle-class expansion is not credit.

It is income from productive work.

A household cannot permanently upgrade its living standard through borrowing.

It needs rising earning capacity.

That brings the analysis back to productivity.

BPS reported that the average wage of employees in February 2026 was approximately Rp3.29 million per month. The figure varied considerably across sectors, illustrating how strongly earnings depend on the structure of economic activity (BPS, 2026f).

The aggregate average is therefore only a starting point.

The more important question is:

Where are middle-class wages being created?

This is the labor-market version of the productivity question.

If productivity rises in sectors that employ relatively few people, aggregate productivity can improve without producing broad middle-class expansion.

If employment expands mainly in low-productivity sectors, unemployment can fall without sufficient growth in middle-class earnings.

This is why employment quantity and employment quality must be separated.

The World Bank's recent assessments have emphasized the gap between job creation and the creation of better-paying employment, making productivity-enhancing reforms central to the labor-market challenge (World Bank, 2025b; World Bank, 2026a).

The issue is therefore not simply unemployment.

It is the structure of employment.

16.6. When Job Creation is not Enough

An economy can create millions of jobs and still struggle to expand the economically secure middle class.

The reason is simple.

Jobs have different productivity.

Jobs have different wages.

Jobs have different stability.

Jobs have different career paths.

A worker entering a low-productivity occupation may be employed but remain economically vulnerable.

A worker entering a high-productivity occupation may experience a substantially different trajectory.

This creates the concept of the middle-class job.

A middle-class job is not defined only by salary.

It should ideally combine:

Adequate real wages.

Employment stability.

Productivity.

Skills development.

Career progression.

Social protection.

Access to finance.

Potential for asset accumulation.

The Economic Tsunami framework therefore requires a broader labor-market test.

A strong labor market should not merely prevent unemployment.

It should create upward economic trajectories.

16.7. The Real-Wage Transmission

Nominal wage growth can create an illusion of progress.

Suppose wages rise by 5 percent.

If the prices of essential goods, housing, transportation, education, and healthcare rise by a similar or greater amount, real purchasing power may not improve.

The household sees a larger number on its payslip.

But it does not necessarily feel richer.

This is why real wages matter.

The transmission can be written as:

NOMINAL WAGE
↓
MINUS PRICE GROWTH
↓
REAL WAGE
↓
PURCHASING POWER
↓
SAVING CAPACITY
↓
ASSET ACCUMULATION
↓
ECONOMIC SECURITY.

A second channel runs through consumption:

REAL WAGE
↓
DISCRETIONARY INCOME
↓
CONSUMPTION
↓
BUSINESS REVENUE
↓
INVESTMENT
↓
EMPLOYMENT.

A third runs through human capital:

REAL WAGE
↓
HOUSEHOLD SURPLUS
↓
EDUCATION & HEALTH INVESTMENT
↓
SKILLS
↓
PRODUCTIVITY

↓
FUTURE INCOME.

The importance of real wages therefore extends far beyond monthly purchasing power.

Weak real-wage growth can simultaneously weaken consumption, savings, human-capital accumulation, and mobility.

The World Bank's evidence of declining real wages between 2018 and 2024 is consequently relevant not merely as a labor statistic but as a middle-class resilience indicator (World Bank, 2025b).

16.8. The Household Balance Sheet

Income tells only half the story.

The other half is the household balance sheet.

Consider two households with identical monthly income.

Household A has:

Savings.

Low debt.

Health insurance.

A stable job.

Some financial assets.

Household B has:

High consumer debt.

A mortgage.

Limited savings.

Education obligations.

Irregular income.

The same income produces different levels of resilience.

This is the household equivalent of fiscal space.

Fiscal space is the government's capacity to absorb shocks without losing credibility or forcing abrupt adjustment.

Household financial space is the family's capacity to absorb shocks without cutting essential consumption or selling productive assets.

The middle class becomes fragile when its income rises but its financial space does not.

This can happen when:

Housing costs rise.

Education costs rise.

Healthcare costs rise.

Debt expands.

Savings stagnate.

Asset prices rise faster than wages.

Consumer expectations increase.

The result can be a paradox.

A household may look wealthier from the outside while becoming financially tighter internally.

This is why middle-class analysis should include balance sheets, not just consumption.

16.9. The Housing Question

Housing sits at the center of middle-class economics.

A home can be:

Shelter.

An asset.

A source of collateral.

A long-term savings mechanism.

A location decision.

A transportation decision.

An intergenerational transfer.

But housing can also become a financial constraint.

When housing prices rise faster than household incomes, younger households may delay ownership.

When housing is far from employment centers, transport costs rise.

When mortgage obligations become large relative to income, household financial flexibility declines.

When affordable housing is located far from productive jobs, the nominally cheaper house can become economically expensive.

This is why housing is not simply a social issue.

It is part of labor-market productivity.

A worker who spends several hours commuting has less time for work, family, education, and recovery.

A firm that cannot attract workers because housing near employment centers is unaffordable faces a labor-market constraint.

The World Bank's June 2025 Indonesia Economic Prospects placed housing at the center of its analysis of middle-class welfare and productivity, emphasizing the connection between housing, jobs, mobility, and prosperity (World Bank, 2025a).

Housing policy is therefore economic policy.

16.10. The Education Cost of Upward Mobility

For middle-class households, education is simultaneously an aspiration and a financial obligation.

Parents may accept substantial current consumption sacrifices to finance better education for their children.

This reflects a rational intergenerational investment.

But the return is uncertain.

Education does not automatically produce high income.

The labor market must create productive jobs that use those skills.

This creates a chain:

Education
→ Skills
→ Employment
→ Productivity

→ Wages
→ Asset Accumulation
→ Next Generation.

If the chain breaks after education, households may experience credential inflation.

More people obtain degrees.

But the number of high-productivity jobs does not increase sufficiently.

The result can be underemployment among educated workers.

This is particularly important for Indonesia's young middle class.

The country cannot simply expand educational attainment.

It must expand the productivity of the economy that receives those graduates.

Otherwise, education becomes increasingly expensive while its economic return becomes less predictable.

Human-capital policy and industrial policy must therefore move together.

16.11. Healthcare and the Middle-Class Buffer

Health shocks can be particularly damaging to households that are above the poverty line but have limited financial reserves.

A low-income household may qualify for substantial social assistance.

A wealthy household may self-finance treatment.

A middle-income household can face a different exposure profile.

It may have some insurance but still face deductibles, uncovered services, transportation costs, lost income, caregiving costs, or periods away from work.

The economic effect of illness is therefore larger than the medical bill.

It can include:

Lost working days.

Reduced productivity.

Lost business income.

Education disruption.

Debt.

Asset sales.

Reduced savings.

A resilient middle class requires health systems that prevent temporary illness from becoming a permanent economic setback.

This is another reason why social protection should be understood as economic infrastructure rather than merely a welfare program.

16.12. The Debt Question

Debt is not inherently harmful.

Credit can finance productive assets.

A mortgage can finance housing.

A business loan can finance equipment.

Education finance can finance human capital.

Working capital can expand a productive enterprise.

The problem arises when debt finances consumption without corresponding growth in future earning capacity.

This creates an important distinction:

Productive debt can increase future capacity.

Unproductive debt can reduce future flexibility.

Middle-class households therefore need access to credit, but they also need financial literacy, income stability, and appropriate risk management.

At the macro level, credit expansion can support consumption and investment.

At the household level, excessive leverage can increase vulnerability.

The policy challenge is not to eliminate household debt.

It is to improve the quality of household borrowing.

A resilient financial system should allocate credit toward activities that increase future income and productivity while managing the risks associated with excessive leverage.

16.13. The Digital Middle Class

Digitalization is changing the structure of middle-class opportunity.

Digital platforms can reduce market-entry costs.

Remote work can expand geographic access to employment.

Online education can expand access to skills.

Digital finance can expand financial inclusion.

E-commerce can connect small businesses to larger markets.

But digitalization can also intensify competition.

Routine occupations can be automated.

Platform workers may face income volatility.

Digital access can be unequal.

Skills gaps can widen.

The distributional effect therefore depends on capability.

A digitally connected but poorly skilled worker may gain little.

A highly skilled worker can use digital technology to access global markets.

This produces another productivity chain:

Digital Access
→ Skills
→ Technology Adoption
→ Productivity
→ Income
→ Mobility.

The middle-class challenge is therefore increasingly linked to digital human capital.

The future middle class will not be defined only by formal employment.

It will increasingly depend on the ability to participate in higher-productivity digital and knowledge-intensive activities.

16.14. The Regional Middle Class

The Indonesian middle class is not geographically uniform.

A household earning a given nominal income can experience a very different standard of living depending on location.

Housing costs differ.

Transportation costs differ.

School quality differs.

Healthcare access differs.

Employment opportunities differ.

Digital infrastructure differs.

Local public services differ.

This creates the regional middle-class paradox.

A household can have a middle-class income but limited middle-class opportunity if it lives in a region with few high-productivity jobs.

Conversely, a household with a lower nominal income may have stronger economic security in a lower-cost environment if housing and basic services are accessible.

This is why nominal income should not be used alone to compare regional middle-class welfare.

The relevant concept is purchasing power combined with opportunity.

A region becomes more attractive to the middle class when it offers:

Productive jobs.

Affordable housing.

Quality schools.

Reliable healthcare.

Efficient transport.

Digital connectivity.

Safe public spaces.

Financial services.

Business opportunities.

Without these, middle-class households may migrate.

Migration can improve individual welfare.

But persistent migration can also weaken the human-capital base of origin regions.

Regional policy therefore needs to manage both opportunity and mobility.

16.15. The Middle-Class Consumption Engine

Middle-class consumption has a distinctive composition.

Poor households spend a large proportion of their resources on essential needs.

High-income households can allocate more resources toward investment and discretionary consumption.

Middle-class households occupy a broad space between the two.

They purchase education.

Housing.

Transportation.

Healthcare.

Communications.

Consumer electronics.

Financial products.

Recreation.

Professional services.

These sectors generate extensive employment.

Therefore, middle-class purchasing power has a multiplier effect.

If the middle class becomes financially constrained, the effect can spread across many service industries.

This helps explain why the middle class functions as an economic buffer.

But the buffer works only if its income is sufficiently stable.

A middle class financed primarily through debt is a fragile buffer.

A middle class financed through rising productivity and real wages is a stronger buffer.

This distinction is central to Indonesia's development trajectory.

16.16. From Consumption to Asset Accumulation

A household becomes more resilient when it can move beyond consumption toward asset accumulation.

The transition can be described as:

Income
→ Basic Consumption
→ Savings
→ Productive Assets
→ Investment Income
→ Greater Security.

Assets can include:

Housing.

Savings.

Pension accounts.

Financial securities.

Business ownership.

Education.

Professional skills.

Digital capabilities.

Each form of asset provides a different type of resilience.

Human capital increases future earning capacity.

Financial assets provide liquidity.

Housing provides shelter and potentially collateral.

Business assets generate income.

The problem is that households facing weak real wage growth often have little surplus available for accumulation.

Income is absorbed by current consumption.

Debt absorbs part of future income.

Asset prices may rise faster than wages.

The household therefore remains in a consumption-income loop rather than an accumulation loop.

This is one of the deepest middle-class challenges.

16.17. The Mobility Test

The central test of the middle class is mobility.

Can a household move from aspiring middle class to economically secure middle class?

Can an established middle-class household move into higher productivity and greater financial security?

Can the next generation achieve higher real living standards than the previous one?

These questions require a dynamic rather than static definition of class.

A household can move:

Upward.

Sideways.

Downward.

The speed and frequency of these transitions matter.

A society with strong upward mobility can tolerate significant differences in current income because economic opportunity remains open.

A society with weak mobility can become increasingly dependent on inherited assets, geography, education quality, and family networks.

This is why the middle-class debate is ultimately a debate about opportunity.

The objective is not to freeze households into categories.

It is to create pathways through which households can advance.

16.18. The Middle-Class Stress Test

The middle class can be stress-tested through seven questions.

First:

Can household income withstand a temporary employment shock?

Second:

Can the household absorb a major health or education expense?

Third:

Can the household continue paying debt if income falls?

Fourth:

Can it maintain housing security?

Fifth:

Can it continue investing in children's education?

Sixth:

Can it maintain adequate savings?

Seventh:

Can at least one household member access a higher-productivity job if the current job disappears?

The seventh question is particularly important.

Financial savings can absorb a short shock.

Skills and labor-market mobility can absorb longer shocks.

This creates two layers of resilience:

Financial resilience.

Productive resilience.

The strongest middle-class system possesses both.

16.19. The Middle-Class Productivity Test

The long-term solution to middle-class pressure cannot be permanent consumption support.

It must include productivity growth.

The productivity test asks:

Are firms becoming more productive?

Are workers becoming more skilled?

Are wages rising with productivity?

Are investments creating higher-value employment?

Are domestic firms moving into higher-value segments?

Are regional economies diversifying?

Are technology gains broadening rather than concentrating opportunity?

If the answers are positive, middle-class expansion can become increasingly self-sustaining.

If productivity remains weak, middle-class support may require greater reliance on fiscal transfers, credit, or subsidies.

Those instruments can provide short-term relief.

But they cannot permanently substitute for productivity.

The arithmetic is straightforward:

Higher Productivity
→ Larger Income Base
→ Higher Potential Real Wages
→ Stronger Purchasing Power
→ Stronger Demand
→ More Investment
→ Higher Productive Capacity.

This is the sustainable middle-class loop.

16.20. The Middle-Class Fiscal Question

The middle class is not only a recipient of fiscal policy.

It is also an important contributor to fiscal capacity.

As households become richer, their tax contribution can rise.

As businesses expand, corporate tax capacity can rise.

As consumption formalizes, indirect-tax collection can increase.

As property and financial assets expand, the tax base can deepen.

This creates a reciprocal relationship:

Middle-Class Expansion
→ Tax Base
→ Public Revenue
→ Public Services
→ Productivity
→ Middle-Class Expansion.

But the relationship can weaken if households perceive taxes as rising faster than the quality of public services.

The economic issue is therefore not simply tax rates.

It is the fiscal contract.

Households ask:

What do I contribute?

What do I receive?

How reliable are public services?

How fairly are taxes collected?

Can the system convert revenue into public value?

The middle class becomes an important part of fiscal legitimacy because it increasingly participates in taxation while simultaneously relying on public services and financing private alternatives.

16.21. The Middle Class and State Capital

The state-capital architecture discussed in Chapter 11 can affect middle-class mobility through several channels:

Infrastructure.

Industrial development.

Energy.

Financial markets.

Housing.

Employment.

Technology.

Regional development.

But the distributional effect depends on transmission.

If state capital increases productivity and creates productive jobs, households can benefit through wages and opportunities.

If state capital improves infrastructure, households may benefit indirectly through lower transport and transaction costs.

If state investment generates fiscal returns, those returns can finance public services.

If state investment creates productive ecosystems, domestic firms may gain access to new markets and supply chains.

The question is therefore not whether state capital is inherently beneficial or harmful to the middle class.

The question is:

Through which measurable mechanism does state capital affect household economic security?

That is the appropriate analytical test.

16.22. The Prabowo-Era Middle-Class Question

The economic architecture examined in Part IV places emphasis on growth, industrialization, downstreaming, food and energy security, human capital, state capital, and investment.

The middle-class test is therefore specific.

Can this architecture create enough productive jobs to expand economic security?

Can industrialization raise real wages?

Can downstreaming create supplier ecosystems that benefit domestic firms?

Can infrastructure reduce household costs?

Can food and energy policies protect purchasing power?

Can state capital generate productive investment?

Can fiscal policy preserve household confidence while maintaining fiscal capacity?

Can human-capital policy raise worker productivity?

These are empirical questions.

The analysis should therefore move from policy announcement to transmission mechanism to measurable outcome.

A useful policy-to-household matrix is:

Policy → Immediate Mechanism → Household Channel → Measurable Indicator.

For industrial policy:

Investment
→ Factory and supplier demand
→ Employment and wages
→ Real wage growth and job quality.

For downstreaming:

Domestic processing
→ Value-added activity
→ Skills, suppliers, regional income
→ Domestic value added and supplier participation.

For infrastructure:

Connectivity
→ Lower travel and logistics costs
→ Wider labor and market access
→ Travel time, logistics costs, employment access.

For food policy:

Supply and price stabilization
→ Lower price volatility
→ Purchasing-power protection
→ Real food expenditure and food-price volatility.

For energy policy:

Energy security
→ Supply reliability and cost
→ Household and business resilience
→ Energy affordability and reliability.

For state capital:

Investment
→ Productive assets
→ Jobs, productivity, fiscal returns
→ Return on capital, employment, productivity, fiscal contribution.

For human capital:

Education and skills
→ Worker capability
→ Productivity and wages
→ Learning, employment, and real wage outcomes.

This is the correct level at which the Prabowo-era economic architecture should be evaluated.

Not by intention.

Not by rhetoric.

But by transmission and outcomes.

16.23. The Five-Layer Middle-Class Security Model

The middle-class problem can be summarized through five layers.

Layer One: Income Security.

Does the household have reliable and rising real income?

Layer Two: Asset Security.

Can it accumulate savings, housing, financial assets, or business assets?

Layer Three: Service Security.

Can it access education, health, transport, and infrastructure at manageable cost?

Layer Four: Shock Security.

Can it withstand unemployment, inflation, illness, or financial volatility?

Layer Five: Mobility Security.

Can the household and its children move upward over time?

The framework is:

INCOME
↓
ASSETS
↓
SERVICES
↓
SHOCK ABSORPTION
↓
MOBILITY.

If income rises but assets do not accumulate, security remains limited.

If assets rise but services deteriorate, household costs can absorb the gains.

If services improve but jobs remain low-productivity, mobility can stall.

If income and assets rise but shock protection is weak, a crisis can reverse progress.

The strongest middle-class system therefore requires all five layers.

16.24. Economic Tsunami: When the Middle Class Feels the Wave

The middle class often experiences economic shocks differently from the poor.

The poor may already be close to subsistence.

The affluent may have substantial buffers.

The middle class can experience a different phenomenon:

Expectation shock.

A household accustomed to improving living standards may experience stagnation as a loss even when absolute consumption remains relatively high.

This is economically important.

Expectations influence:

Consumption.

Saving.

Investment.

Migration.

Education decisions.

Entrepreneurship.

Home purchases.

Retirement planning.

When households become uncertain about future income, they may postpone major expenditure.

This can weaken aggregate demand.

The result is a feedback loop:

Income Uncertainty
→ Precautionary Saving
→ Lower Consumption
→ Lower Business Demand
→ Lower Investment
→ Weaker Job Creation
→ Greater Income Uncertainty.

The middle-class challenge can therefore become macroeconomic.

This is why consumer confidence should not be interpreted merely as psychology.

It can reflect rational responses to household balance sheets, labor-market conditions, and expected future income.

16.25. What Would a Stronger Middle Class Look Like?

A stronger middle class is not necessarily one that consumes more.

It is one that possesses greater economic capacity.

It would have:

Higher real wages.

More productive employment.

Greater savings.

More affordable housing.

Better financial protection.

Higher-quality education.

Reliable healthcare.

Greater access to productive credit.

Stronger human capital.

More diversified income opportunities.

Better regional access to jobs.

Greater ability to withstand shocks.

Most importantly, it would have upward mobility.

The middle class should therefore be measured not only by how much it consumes.

It should be measured by how much productive capacity it controls.

16.26. The Deeper Question

The deepest question is whether Indonesia can move from a consumption-based middle class toward a productivity-based middle class.

A consumption-based middle class is defined by what households can buy.

A productivity-based middle class is defined by what households can produce, earn, save, invest, and pass to the next generation.

The distinction is fundamental.

Consumption can rise through:

Higher wages.

Higher productivity.

Credit.

Transfers.

Asset sales.

Temporary windfalls.

Only some of these are sustainable.

A durable middle class requires productive income.

That means:

Better firms.

Better jobs.

Better skills.

Better infrastructure.

Better institutions.

Better financial systems.

Better public services.

This is the economic foundation beneath social mobility.

16.27. The Middle-Class Resilience Scorecard

The chapter's analysis can be converted into a practical scorecard.

Dimension One: Earnings.

Indicator: real wage growth.

Question: Are workers gaining purchasing power?

Dimension Two: Employment.

Indicator: share of workers in productive, adequately paid employment.

Question: Are new jobs creating upward trajectories?

Dimension Three: Financial Capacity.

Indicators: household savings, debt service, and financial buffers.

Question: Can households absorb shocks?

Dimension Four: Asset Formation.

Indicators: housing access, financial assets, business ownership, and human-capital investment.

Question: Are households accumulating productive assets?

Dimension Five: Service Access.

Indicators: education, health, transport, housing, and digital access.

Question: Are household costs being reduced through reliable public and private services?

Dimension Six: Mobility.

Indicators: movement into higher-productivity occupations and intergenerational educational and income progression.

Question: Can households move upward?

Dimension Seven: Regional Opportunity.

Indicators: regional wages, productivity, job diversity, and access to services.

Question: Does location determine opportunity too strongly?

This scorecard changes the middle-class question from:

“How large is the middle class?”

to:

“How resilient is the middle class?”

That is a more demanding question.

It is also more useful for policy evaluation.

16.28. Chapter 16 Revisited

Chapter 15 asked:

Who bears the cost?

Chapter 16 asks:

Who remains economically secure while the economy changes?

The answer cannot be determined from poverty statistics alone.

It requires examining:

Real wages.

Employment quality.

Household balance sheets.

Housing.

Education.

Healthcare.

Debt.

Savings.

Regional opportunity.

Productivity.

Social protection.

Mobility.

Indonesia's middle class matters because it connects households to the broader growth system.

When the middle class becomes more productive and financially secure, domestic demand becomes more resilient.

When real wages stagnate and financial buffers weaken, household caution can become a macroeconomic constraint.

The central relationship is:

PRODUCTIVITY
↓
REAL WAGES
↓
INCOME SECURITY
↓
SAVINGS & ASSETS
↓
SHOCK ABSORPTION
↓
MOBILITY
↓
INTERGENERATIONAL SECURITY.

The objective is therefore not simply to preserve the middle class.

It is to expand the capacity of households to remain secure and move upward.

This is the difference between middle-class size and middle-class strength.

A large middle class can support growth.

A strong middle class can help sustain it.

And a mobile middle class can transmit economic progress across generations.

The Economic Tsunami test therefore becomes more precise.

The question is not whether every household can avoid every shock.

No economy can provide that guarantee.

The question is whether households have enough productive capacity, financial buffers, human capital, and institutional protection to absorb shocks without permanently losing their trajectory.

That is the true test of middle-class resilience.

And it leads directly to the next stage of the book.

Chapter 17 turns from distribution to system-wide stress testing.

Five scenarios will examine what happens when growth slows, financial conditions tighten, external demand weakens, fiscal space narrows, or several shocks arrive simultaneously.

Chapter 16 has identified the households and mechanisms that matter.

Chapter 17 will ask how the entire economic system responds when pressure rises.

Figure 16.1 — THE MIDDLE-CLASS SECURITY & MOBILITY FRAMEWORK

PRODUCTIVITY
↓
REAL WAGES
↓
INCOME SECURITY
↓
SAVINGS & ASSETS
↓
SHOCK ABSORPTION
↓
MOBILITY
↓
INTERGENERATIONAL SECURITY

Cross-cutting forces: HOUSING • EDUCATION • HEALTH • DEBT • TAXES • TECHNOLOGY • REGIONAL OPPORTUNITY

PART VII — THE STRESS TEST

CHAPTER 17

FIVE STRESS-TEST SCENARIOS

What Happens When the Economic System Is Hit From Several Directions?

The previous chapters have examined Indonesia's economy from different angles.

Growth.

Productivity.

Household purchasing power.

The state budget.

Debt.

Tax revenue.

Industrial policy.

State capital.

Trade.

The Rupiah.

Energy.

Food.

Poverty.

Inequality.

The middle class.

Each chapter examined a different component of the economic system.

But economies are not collections of independent components.

They are systems.

A shock that begins in one part can move into another.

A trade shock can become an investment shock.

An exchange-rate shock can become an inflation shock.

An energy shock can become a fiscal shock.

A fiscal shock can become a confidence shock.

A confidence shock can become a financial-market shock.

And a financial-market shock can eventually reach households through employment, wages, credit, and purchasing power.

This is why resilience cannot be evaluated by looking at individual indicators in isolation.

A country may have adequate foreign-exchange reserves but weak fiscal space.

It may have a manageable public-debt ratio but limited revenue capacity.

It may have strong domestic demand but weak productivity growth.

It may have large natural resources but insufficient downstream technological capability.

It may have a large middle class but insufficient household financial buffers.

The question is therefore not whether Indonesia has vulnerabilities.

Every economy does.

The more useful question is whether the system can absorb a sufficiently large shock without allowing temporary stress to become persistent economic damage.

That is the purpose of a stress test.

A stress test is not a forecast.

It is not a prediction of what will happen.

It is a structured exercise asking:

What if?

What if external demand weakens sharply?

What if the Rupiah comes under sustained pressure?

What if energy and food prices rise simultaneously?

What if fiscal space becomes tighter?

What if several of these shocks occur at the same time?

The answer determines not the future itself, but the points at which resilience may be tested.

Indonesia enters this exercise with meaningful buffers.

Bank Indonesia reported international reserves of US$146.5 billion at the end of August 2026, equivalent to 5.4 months of imports, or 5.3 months including government external-debt servicing. BI also reported the Rupiah at Rp17,855 per US dollar on September 22, 2026, while maintaining the BI-Rate at 5.75 percent. (Bank Indonesia, 2026a; 2026b)

The World Bank's June 2026 baseline projected growth of 5.0 percent in 2026 and 5.2 percent in 2027–28, while warning that external pressures could weigh on investment and exports and that fiscal space and productivity remained important constraints. (World Bank, 2026a)

The IMF likewise identified trade tensions, geopolitical risks, financial-market volatility, and changes in global risk premia as important downside channels. Its stress scenario illustrates that the economy could experience a significant output loss without necessarily crossing into a full systemic crisis. (IMF, 2026a)

That distinction is central.

Stress is not collapse.

A stress test is designed to identify the distance between the two.

17.1. The Purpose of the Stress Test

The five scenarios in this chapter are not designed to produce a single number.

They are designed to expose transmission mechanisms.

Each scenario asks five questions:

First:

Where does the shock originate?

Second:

Through which economic channel does it travel?

Third:

Which institutions absorb the first impact?

Fourth:

Which households, firms, and regions are most exposed?

Fifth:

What determines whether the shock remains temporary or becomes persistent?

The framework can be expressed as:

SHOCK
→ TRANSMISSION
→ FIRST-LINE BUFFER
→ SECOND-ROUND EFFECT
→ POLICY RESPONSE
→ HOUSEHOLD & FIRM IMPACT
→ RECOVERY OR PERSISTENCE.

This structure allows the book's central metaphor to become more precise.

An economic tsunami is not simply a large shock.

It is a shock that travels through multiple connected channels.

17.2. The Baseline Before the Storm

A stress test requires a baseline.

Without a baseline, it becomes impossible to distinguish deterioration from normal volatility.

Indonesia's baseline entering late 2026 is neither an economy in crisis nor an economy without vulnerabilities.

Growth remains positive.

Domestic demand remains an important support.

Foreign reserves remain substantial.

The banking system continues to provide credit.

Inflation remains within the policy framework.

Yet external conditions remain uncertain.

The World Bank's June 2026 assessment projected 5.0 percent growth in 2026, with external pressures weighing on investment and exports. The report also noted risks from elevated global bond yields, higher risk premia, energy-market disruptions, and limited fiscal space. (World Bank, 2026a)

Bank Indonesia's September 2026 assessment similarly emphasized continued global uncertainty and the need to strengthen external resilience. (Bank Indonesia, 2026a)

The baseline can therefore be summarized as:

RESILIENT BUT EXPOSED.

That is the appropriate starting point for the stress test.

17.3. Scenario One — the Global Demand Shock

The first scenario begins outside Indonesia.

Global growth weakens.

Major trading partners experience slower investment and consumption.

Commodity demand falls.

International trade volumes decline.

Indonesia's exports weaken.

The first transmission channel is external demand.

The second is commodity prices.

The third is corporate investment.

The fourth is government revenue.

The fifth is employment.

This is important because Indonesia's openness to trade means that global weakness does not remain entirely external.

The chain becomes:

GLOBAL SLOWDOWN
→ LOWER EXPORT DEMAND
→ LOWER COMMODITY REVENUE
→ LOWER CORPORATE CASH FLOW
→ LOWER INVESTMENT
→ WEAKER EMPLOYMENT
→ LOWER HOUSEHOLD INCOME
→ LOWER CONSUMPTION.

The severity of the shock depends heavily on composition.

If the slowdown is concentrated in low-value commodity demand, resource-producing regions can be affected disproportionately.

If it spreads to manufactured exports, industrial employment becomes more exposed.

If it also reduces tourism, services-oriented regions can face additional pressure.

The regional dimension therefore matters.

17.4. What Absorbs the Global Demand Shock?

Indonesia has several potential buffers.

Domestic consumption is one.

Fiscal policy is another.

Foreign reserves are relevant to external financial stability.

Exchange-rate flexibility can help absorb part of the external adjustment.

The banking system can continue to provide credit if asset quality remains manageable.

But each buffer has a limit.

Domestic consumption cannot fully replace lost external demand if household income is simultaneously weakening.

Fiscal stimulus cannot continue indefinitely if revenue falls and financing costs rise.

Foreign reserves can smooth excessive currency volatility, but they cannot permanently replace export earnings.

Bank credit can support firms, but banks cannot lend indefinitely into deteriorating cash flows.

The result is a central principle:

A buffer is useful because it buys time.

It does not eliminate the underlying shock.

17.5. The Commodity Concentration Test

The global demand scenario also tests the diversification achieved through downstreaming.

If Indonesia exports more processed products but those products remain highly dependent on the same underlying commodity cycle, exposure may change form without disappearing.

This produces a critical distinction:

VALUE-ADDED DIVERSIFICATION
versus
COMMODITY-PRICE DIVERSIFICATION.

A country can move from exporting raw nickel to processed nickel products and still remain exposed to global nickel demand.

True diversification requires a broader industrial ecosystem.

That includes:

Multiple products.

Multiple markets.

Domestic supplier networks.

Technology capabilities.

Human capital.

Competitive firms.

Different export destinations.

Different sources of foreign exchange.

The stress test therefore asks:

Does downstreaming reduce concentration?

Or does it simply move the country one step higher within the same commodity cycle?

17.6. Scenario Two — the Rupiah and Capital-Flow Shock

The second scenario begins in global financial markets.

Risk aversion rises.

International investors reduce exposure to emerging-market assets.

Portfolio flows weaken.

The Rupiah comes under pressure.

Domestic bond yields rise.

Financing costs increase.

The transmission chain becomes:

GLOBAL RISK-OFF
→ CAPITAL OUTFLOWS
→ RUPIAH PRESSURE
→ IMPORTED INFLATION RISK
→ MONETARY TIGHTENING OR LIMITED EASING
→ HIGHER FINANCING COSTS
→ LOWER INVESTMENT
→ SLOWER GROWTH.

This scenario is particularly relevant because Indonesia remains integrated into international capital markets.

But integration is not the same as fragility.

The size of the shock matters.

The composition of liabilities matters.

The maturity structure matters.

The share of foreign-currency exposure matters.

The credibility of policy institutions matters.

And the availability of foreign-exchange reserves matters.

Bank Indonesia's reserve position provides an important first-line buffer. At the end of August 2026, reserves stood at US$146.5 billion,

above the international adequacy benchmark of approximately three months of imports. (Bank Indonesia, 2026b)

The question is therefore not whether reserves exist.

The question is how effectively the entire policy system can use time bought by those reserves.

17.7. The Interest-Rate Dilemma

A sharp Rupiah shock can create a difficult policy trade-off.

If monetary policy is tightened to support the currency, domestic borrowing costs may rise.

If monetary policy is eased aggressively to support growth, pressure on the currency may increase.

The policy challenge is therefore multidimensional.

Exchange-rate stability.

Inflation stability.

Financial stability.

Growth.

These objectives can move in different directions during a shock.

Bank Indonesia's policy framework explicitly combines monetary, macroprudential, payment-system, and market-deepening measures. In September 2026, BI maintained the BI-Rate at 5.75 percent while emphasizing Rupiah stabilization, inflation control, foreign-capital incentives, and financial-market deepening. (Bank Indonesia, 2026a)

The stress test asks whether these instruments remain effective when several pressures arrive simultaneously.

17.8. Households Under a Rupiah Shock

Currency depreciation does not affect all households equally.

The first channel is imported goods.

The second is fuel and energy.

The third is transportation.

The fourth is food.

The fifth is interest-sensitive expenditure.

The sixth is employment in firms dependent on imported inputs.

For middle-class households, the most important transmission may be real purchasing power.

RUPIAH DEPRECIATION
→ IMPORT COST
→ PRICE PRESSURE
→ REAL-WAGE PRESSURE
→ LOWER PURCHASING POWER
→ LOWER SAVING CAPACITY
→ LOWER ASSET ACCUMULATION.

The Chapter 16 framework therefore becomes part of the stress test.

A currency shock becomes socially important when it damages household economic mobility.

17.9. Scenario Three — the Energy and Food Shock

The third scenario begins with supply.

Geopolitical conflict disrupts energy markets.

Shipping routes become more expensive or less reliable.

Oil prices rise.

Food-input costs increase.

Fertilizer prices rise.

Transport costs increase.

The shock reaches Indonesia through both inflation and fiscal channels.

The chain becomes:

ENERGY/FOOD SHOCK
→ HIGHER INPUT COSTS
→ HIGHER TRANSPORT COSTS
→ HIGHER FOOD PRICES
→ LOWER REAL INCOME
→ SUBSIDY PRESSURE

→ HIGHER FISCAL COST → LESS FISCAL SPACE.

The World Bank's June 2026 baseline explicitly incorporated elevated oil prices and shipping disruptions into its risk assessment, while noting the implications for fiscal space and subsidy costs. (World Bank, 2026a)

This scenario therefore connects Chapters 6, 8, 14, and 16.

It is simultaneously:

An inflation shock.

A fiscal shock.

A household shock.

A corporate-cost shock.

A regional shock.

17.10. Who Feels the Food Shock First?

Food inflation is distributionally asymmetric.

Lower-income households spend a larger share of their resources on essential consumption.

Middle-income households have more flexibility, but they are not immune.

They may respond by reducing:

Savings.

Education expenditure.

Healthcare spending.

Leisure.

Asset purchases.

Business investment.

A food-price shock can therefore affect future mobility even if it does not immediately create poverty.

This is why inflation should be evaluated through distribution, not only through the headline rate.

The central question becomes:

How much of the shock can households absorb without sacrificing future productive capacity?

17.11. The Subsidy Dilemma

Governments often respond to energy shocks through subsidies or price controls.

These mechanisms can protect households from sudden price increases.

But they also create fiscal costs.

If the shock is temporary, the fiscal burden may be manageable.

If it persists, subsidies can become structurally expensive.

The policy problem becomes:

PRICE PROTECTION
versus
FISCAL SPACE.

The most resilient response is therefore not necessarily the largest subsidy.

It is a response that protects vulnerable households while preserving the fiscal capacity required for investment and social protection.

This reinforces the revenue question examined in Chapter 8.

The ability to respond to shocks depends partly on the fiscal capacity built before the shock arrives.

17.12. Scenario Four — the Fiscal Space Shock

The fourth scenario begins inside the government balance sheet.

Suppose economic growth slows.

Tax revenue weakens.

Interest costs rise.

Subsidy spending increases.

At the same time, the government faces pressure to protect households and maintain investment.

The deficit widens.

Financing needs increase.

Bond yields may rise.

The transmission chain becomes:

LOWER GROWTH
→ LOWER REVENUE
+
HIGHER INTEREST COSTS
+
HIGHER SUPPORT SPENDING
→ LARGER DEFICIT
→ HIGHER FINANCING NEED
→ HIGHER RISK PREMIUM
→ HIGHER INTEREST COST
→ FURTHER FISCAL PRESSURE.

This is a feedback loop.

But it does not automatically become a fiscal crisis.

The key variables are:

Debt maturity.

Interest-growth differential.

Primary balance.

Revenue capacity.

Domestic investor base.

Foreign financing.

Debt credibility.

Contingent liabilities.

The IMF's 2026 Article IV stress exercise illustrates this distinction. Under a no-policy-reaction scenario, output would be materially lower than baseline and the fiscal deficit could slightly exceed the 3 percent ceiling around 2028, while public debt would remain below the 60 percent debt ceiling. (IMF, 2026a)

The implication is important.

A fiscal shock can be serious without being equivalent to sovereign default or economic collapse.

17.13. The Revenue Test

Fiscal resilience begins before the crisis.

A government with a low tax base has less room to respond.

A government with stronger revenue mobilization has more options.

This creates the chain:

REVENUE CAPACITY
→ FISCAL SPACE
→ SHOCK RESPONSE
→ PUBLIC INVESTMENT
→ PRODUCTIVITY
→ FUTURE REVENUE.

The reverse can also occur:

WEAK REVENUE
→ LIMITED FISCAL SPACE
→ LOWER INVESTMENT
→ WEAKER PRODUCTIVITY
→ SLOWER GROWTH
→ WEAKER REVENUE.

This is why tax reform is not simply a revenue-collection exercise.

It is part of national resilience.

17.14. Scenario Five — the Synchronized Shock

The fifth scenario is the most demanding.

Several shocks arrive together.

Global growth weakens.

Capital flows reverse.

The Rupiah depreciates.

Energy prices rise.

Food prices increase.

Tax revenue slows.

Interest costs rise.

Household confidence weakens.

Investment falls.

This is where the Economic Tsunami metaphor becomes analytically useful.

A single wave may be absorbed.

Multiple waves arriving together can overwhelm defenses that appear adequate individually.

The transmission chain becomes:

GLOBAL SHOCK
→ EXPORT WEAKNESS
→ CAPITAL-FLOW PRESSURE
→ RUPIAH DEPRECIATION
→ IMPORTED INFLATION
→ HIGHER INTEREST COST
→ LOWER INVESTMENT
→ LOWER TAX REVENUE
→ FISCAL PRESSURE
→ LOWER HOUSEHOLD PURCHASING POWER
→ LOWER CONSUMPTION
→ LOWER BUSINESS REVENUE
→ LOWER EMPLOYMENT.

The critical feature is feedback.

The shock no longer moves in one direction.

It becomes circular.

17.15. Why Correlation Matters

Stress tests often fail when risks are assessed independently.

Suppose:

Currency risk is manageable.

Fiscal risk is manageable.

Commodity risk is manageable.

Banking risk is manageable.

Household risk is manageable.

That does not mean the combined system is equally manageable.

The correlations matter.

A currency shock can increase inflation.

Inflation can increase interest rates.

Higher interest rates can weaken investment.

Lower investment can weaken employment.

Lower employment can weaken tax revenue.

Lower tax revenue can reduce fiscal space.

Reduced fiscal space can weaken confidence.

This is a second-round effect.

The first-round shock may be modest.

The second-round feedback can be larger.

The most important stress-test question is therefore not:

"How large is the first shock?"

It is:

"How much amplification occurs after the first shock?"

17.16. The Banking System as a Buffer

Banks are critical because they connect financial markets to the real economy.

During stress, banks can either absorb shocks or transmit them.

If capital and liquidity remain strong, banks can continue lending.

If asset quality deteriorates sharply, banks may become more conservative.

The transmission then becomes:

SHOCK
→ CORPORATE CASH-FLOW PRESSURE

→ NON-PERFORMING LOANS
→ TIGHTER CREDIT
→ LOWER INVESTMENT
→ LOWER EMPLOYMENT
→ FURTHER CASH-FLOW PRESSURE.

This is why banking resilience must be evaluated together with corporate leverage and household debt.

A financially stable banking system is not sufficient if borrowers become structurally weaker.

17.17. The Corporate Sector Test

Large corporations may possess foreign-currency debt, imported inputs, or exposure to global demand.

Small firms may have weaker financial buffers.

Exporters can benefit from currency depreciation.

Import-dependent firms can face higher costs.

Commodity producers may benefit from higher prices.

Consumer-facing firms may suffer from declining household purchasing power.

There is therefore no single “corporate sector” response.

The stress test must identify:

Foreign-exchange exposure.

Interest-rate exposure.

Import dependence.

Export dependence.

Debt maturity.

Cash-flow resilience.

Market concentration.

Supplier dependence.

The strongest firms are not necessarily those with the largest balance sheets.

They are those with the greatest capacity to adapt their balance sheets and business models when conditions change.

17.18. The Regional Stress Test

The five scenarios also produce different regional effects.

Commodity-producing provinces can be highly sensitive to global prices.

Manufacturing regions can be sensitive to trade and investment.

Tourism regions can be sensitive to international mobility.

Agricultural regions can be sensitive to food and fertilizer prices.

Large urban regions can be sensitive to financial conditions, housing, and services.

Eastern Indonesia can face different constraints from Java.

This means a national average can conceal substantial regional stress.

The regional stress test therefore asks:

Which regions experience the first shock?

Which regions possess the strongest buffers?

Which regions can diversify?

Which regions depend on fiscal transfers?

Which regions can attract private investment?

Which regions possess the human capital required for adjustment?

Regional resilience is not identical to national resilience.

A country can remain stable while some regions experience severe adjustment.

17.19. The Middle-Class Stress Test

Chapter 16 established that middle-class resilience depends on more than income.

The five scenarios test:

Real wages.

Savings.

Debt.

Housing.

Employment quality.

Education.

Healthcare.

Asset accumulation.

The critical mechanism is:

SHOCK
→ REAL-INCOME PRESSURE
→ SAVINGS REDUCTION
→ ASSET ACCUMULATION SLOWDOWN
→ LOWER MOBILITY
→ INTERGENERATIONAL EFFECT.

This is why the middle class can become a leading indicator of deeper economic stress.

Households may reduce discretionary spending before unemployment rises sharply.

They may postpone home purchases before construction slows.

They may reduce investment before business formation declines.

They may increase precautionary savings before consumer confidence falls.

Household behavior can therefore reveal stress before headline macroeconomic indicators fully register it.

17.20. The Five-Scenario Matrix

The five scenarios can be summarized as follows.

Scenario One: Global Demand Shock.

Primary channel: Exports → investment → employment.

Main buffer:
Domestic demand, exchange-rate flexibility, fiscal support.

Key vulnerability:
Export and commodity concentration.

Scenario Two:
Rupiah and Capital-Flow Shock.

Primary channel:
Capital flows → exchange rate → inflation → financing costs.

Main buffer:
Foreign reserves, credible monetary policy, market depth.

Key vulnerability:
Global risk repricing and imported inflation.

Scenario Three:
Energy and Food Shock.

Primary channel:
Input costs → prices → real income → fiscal pressure.

Main buffer:
Strategic reserves, targeted support, fiscal capacity.

Key vulnerability:
Import dependence and subsidy costs.

Scenario Four:
Fiscal Space Shock.

Primary channel:
Lower revenue + higher spending → financing needs → risk premium.

Main buffer:
Revenue capacity, debt management, fiscal credibility.

Key vulnerability:
Limited fiscal space and rising interest costs.

Scenario Five:
Synchronized Shock.

Primary channel:
Multiple shocks → feedback loops.

Main buffer: Institutional coordination and diversified buffers.

Key vulnerability: Correlation and amplification.

17.21. The Seven-Layer Resilience Defense

The stress test suggests seven layers of national resilience.

Layer One: External Reserves.

Foreign-exchange reserves provide time.

Layer Two: Fiscal Space.

Revenue and prudent debt management provide policy capacity.

Layer Three: Monetary Credibility.

Credible monetary policy helps anchor inflation and expectations.

Layer Four: Financial-System Strength.

Banks and financial markets absorb part of the shock.

Layer Five: Productive Capacity.

Competitive firms and diversified industries maintain output.

Layer Six: Household Resilience.

Savings, social protection, employment, and real wages protect consumption.

Layer Seven: Institutional Coordination.

Government agencies, Bank Indonesia, regulators, and markets must respond coherently.

The defense is strongest when all seven layers work together.

A country with strong reserves but weak households remains vulnerable.

A country with strong households but weak fiscal space remains constrained.

A country with strong fiscal space but weak productivity may stabilize without transforming.

Resilience is therefore systemic.

17.22. The Policy Response Curve

The timing of policy matters.

Too early, and policy may waste scarce resources.

Too late, and the shock may become embedded.

The ideal response depends on the type of shock.

For temporary external volatility:

Use buffers.

For persistent structural weakness:

Use reforms.

For household distress:

Use targeted protection.

For productivity weakness:

Use investment and institutional reform.

For financial instability:

Use liquidity and market-stabilization tools.

For fiscal stress:

Protect priority spending while strengthening revenue and expenditure quality.

The key distinction is:

LIQUIDITY SUPPORT
versus
STRUCTURAL ADJUSTMENT.

Liquidity can buy time.

It cannot replace reform.

17.23. The Policy Space Test

Every shock consumes policy space.

If monetary policy begins the crisis with credibility, it has more room.

If the fiscal balance begins from a sustainable position, fiscal support is easier.

If foreign reserves are adequate, exchange-rate adjustment can be smoother.

If banks are well capitalized, credit can continue.

If households have savings, consumption can remain more stable.

This produces a general rule:

THE BEST TIME TO BUILD RESILIENCE IS BEFORE THE SHOCK.

Buffers created during good times become insurance during bad times.

17.24. The Difference Between Stress and Crisis

The five scenarios demonstrate why the word “crisis” must be used carefully.

A stress episode may involve:

Slower growth.

Currency depreciation.

Higher inflation.

Higher interest rates.

Lower investment.

Wider deficits.

Weaker household consumption.

These are serious developments.

But they do not automatically constitute systemic crisis.

A crisis emerges when the normal mechanisms of adjustment begin to fail.

A financial crisis occurs when financial intermediation is severely impaired.

A fiscal crisis occurs when the government cannot credibly finance its obligations under sustainable conditions.

An external crisis occurs when external financing and reserves become insufficient to stabilize adjustment.

An economic collapse would require a much broader breakdown.

The distinction is essential.

Otherwise, every recession becomes a collapse.

Every depreciation becomes a currency crisis.

Every fiscal deficit becomes a debt crisis.

And every slowdown becomes evidence of systemic failure.

That would make the Economic Tsunami framework analytically useless.

17.25. The Collapse Threshold

Chapter 2 defined collapse as a systemic condition rather than a dramatic headline.

The stress test can now make the threshold more operational.

Collapse would require deterioration across several dimensions simultaneously:

Growth capacity.

Financial stability.

Fiscal sustainability.

External resilience.

Institutional functioning.

Household economic security.

A temporary shock in one dimension is not enough.

A persistent deterioration across several dimensions is more serious.

A feedback loop that prevents recovery is more serious still.

The key test is therefore:

Can the system still correct itself?

If yes, the economy may be under severe stress but still functioning as an adaptive system.

If no, the risk moves toward systemic crisis.

17.26. What Would Change the Diagnosis?

The stress-test framework also identifies the evidence that would materially change the book's diagnosis.

Evidence of stronger resilience would include:

Stable or rising productivity.

Sustained real-wage growth.

Broad-based employment gains.

Strong tax-revenue performance.

Stable debt dynamics.

Deep domestic financial markets.

Diversified exports.

Stable foreign reserves.

Contained banking stress.

Strong household savings.

Improved regional convergence.

Evidence of rising vulnerability would include:

Persistent productivity stagnation.

Falling real wages.

Repeated fiscal slippage.

Sharp increases in financing costs.

Rapid reserve depletion.

Persistent capital outflows.

Severe banking stress.

Large and prolonged employment losses.

Rapid deterioration in household balance sheets.

Increasing regional divergence.

The value of the framework is therefore that it remains falsifiable.

It does not assume the answer.

It identifies the evidence that would move the diagnosis.

17.27. The Prabowo-Era Stress Test

The economic architecture examined in Part IV can now be subjected to the same five scenarios.

Industrial policy is tested by a global demand shock.

Can new industries remain competitive when external demand weakens?

Downstreaming is tested by a commodity-price shock.

Does domestic value added provide resilience or remain tied to commodity cycles?

Danantara is tested by a financial-market shock.

Can state capital remain disciplined when market conditions deteriorate?

Food and energy policy are tested by supply shocks.

Can strategic security be maintained without excessive fiscal cost?

Fiscal policy is tested by synchronized shocks.

Can the government protect priority spending without undermining fiscal credibility?

Human-capital policy is tested by labor-market adjustment.

Can workers move from declining sectors into higher-productivity activities?

The purpose is not to judge the architecture in advance.

The purpose is to determine where its success would depend on execution.

17.28. The Five Critical Dependencies

Across all five scenarios, five dependencies repeatedly appear.

First:

Productivity.

Without productivity, resilience becomes increasingly expensive.

Second:

Fiscal capacity.

Without revenue, countercyclical policy becomes constrained.

Third:

External buffers.

Without reserves and diversified external financing, adjustment becomes more difficult.

Fourth:

Household resilience.

Without savings, social protection, and productive employment, macroeconomic stress becomes social stress.

Fifth:

Institutional credibility.

Without credible institutions, relatively manageable shocks can generate larger confidence effects.

These five dependencies form the core of the Economic Tsunami stress-test framework.

17.29. The Resilience Equation

The analysis can be condensed into one equation:

RESILIENCE
=
BUFFERS
+

PRODUCTIVITY
+
DIVERSIFICATION
+
INSTITUTIONAL CREDIBILITY
+
HOUSEHOLD CAPACITY.

Buffers absorb the initial shock.

Productivity restores growth.

Diversification reduces concentration.

Institutional credibility prevents amplification.

Household capacity protects demand and mobility.

Remove any one of these and the system becomes more dependent on the others.

This is why resilience cannot be purchased solely through reserves.

Nor through fiscal stimulus.

Nor through monetary policy.

Nor through industrial policy.

It is produced by the interaction of institutions, markets, firms, households, and public policy.

17.30. The Economic Tsunami Framework Revisited

The metaphor can now be made precise.

A tsunami has:

An initial disturbance.

A transmission mechanism.

Wave amplification.

Multiple impacts.

Different exposure levels.

A recovery phase.

An economic tsunami follows a similar structure.

The initial disturbance may be external.

The transmission may occur through trade, finance, energy, food, or confidence.

Amplification occurs through feedback loops.

The impact differs across regions, firms, and households.

Recovery depends on institutional capacity and productive adaptability.

The analytical chain becomes:

SHOCK
→ TRANSMISSION
→ AMPLIFICATION
→ DISTRIBUTIONAL IMPACT
→ POLICY RESPONSE
→ ADAPTATION
→ RECOVERY.

This is the framework that connects the entire book.

17.31. The Five Questions That Matter Most

After seventeen chapters, five questions now stand above the rest.

Question One:

Can Indonesia continue growing at a pace sufficient to raise productivity and living standards?

Question Two:

Can the state preserve enough fiscal space to respond to shocks without undermining long-term investment?

Question Three:

Can industrial policy create diversified, productive, internationally competitive firms?

Question Four:

Can households experience sufficient real-income growth to sustain consumption and mobility?

Question Five:

Can institutions prevent temporary shocks from becoming persistent feedback loops?

The answers will determine whether the Economic Tsunami remains a metaphor for risk or becomes a description of a much deeper economic transformation.

17.32. Chapter 17 Revisited

The stress test does not predict collapse.

It does something more useful.

It identifies the mechanisms through which stress could become systemic.

The first scenario showed how global weakness can reach exports, investment, and employment.

The second showed how financial-market volatility can move through the Rupiah, inflation, and financing costs.

The third showed how energy and food shocks can affect households and fiscal space simultaneously.

The fourth showed how slower growth and higher costs can constrain the government's ability to respond.

The fifth showed why several individually manageable shocks can become more dangerous when they arrive together.

The central lesson is therefore straightforward:

Indonesia's resilience will not be determined by the absence of shocks.

It will be determined by the ability of the economic system to absorb, transmit, adapt, and recover from them.

That ability depends on buffers.

But buffers alone are not enough.

It depends on productivity.

But productivity alone is not enough.

It depends on fiscal capacity.

But fiscal capacity alone is not enough.

It depends on financial stability.

But financial stability alone is not enough.

The deeper source of resilience is the interaction among them.

The Economic Tsunami question has therefore evolved.

At the beginning of the book, the question was:

Is Indonesia collapsing?

After seventeen chapters, the more useful question is:

How much stress can Indonesia absorb before the mechanisms of adjustment begin to fail?

That is a question that can be tested.

It can be measured through growth.

Productivity.

Real wages.

Fiscal space.

Debt.

Revenue.

Reserves.

Capital flows.

Investment.

Employment.

Poverty.

Inequality.

Regional convergence.

And household resilience.

The next chapter moves from scenarios to trajectories.

Chapter 18 asks:

What could change the trajectory?

Because stress testing does not end with identifying risks.

It must also identify the variables that can alter the path.

The difference between vulnerability and resilience is ultimately the capacity to change course before the shock becomes irreversible.

Figure 17.1 — THE FIVE-SCENARIO ECONOMIC STRESS-TEST FRAMEWORK

GLOBAL DEMAND SHOCK
→ EXPORTS → INVESTMENT → EMPLOYMENT

RUPIAH & CAPITAL-FLOW SHOCK

→ CAPITAL FLOWS → EXCHANGE RATE → INFLATION → FINANCING

ENERGY & FOOD SHOCK

→ INPUT COSTS → PRICES → REAL INCOME → FISCAL PRESSURE

FISCAL SPACE SHOCK

→ REVENUE / SPENDING → FINANCING NEEDS → RISK PREMIUM

SYNCHRONIZED SHOCK

→ MULTIPLE CHANNELS → FEEDBACK LOOPS → SYSTEMIC STRESS

RESILIENCE DEFENSE

BUFFERS • PRODUCTIVITY • DIVERSIFICATION • CREDIBILITY • HOUSEHOLD CAPACITY

PART VIII — WHAT SHOULD BE DONE?

CHAPTER 18

THE REFORM AGENDA

From Stabilization to Transformation

Indonesia does not need a reform agenda because its economy is collapsing.

It needs one because resilience alone is not enough.

The previous chapters have shown an economy capable of absorbing shocks, maintaining growth, protecting financial stability, and reducing poverty while still carrying substantial structural weaknesses.

Productivity growth remains a central challenge.

The middle class remains under pressure.

Regional convergence is incomplete.

Tax capacity remains relatively limited.

Public-investment efficiency matters as much as public-investment volume.

The economy remains exposed to external demand, commodity cycles, capital-flow volatility, and global financial conditions.

These are not necessarily signs of systemic failure.

They are signs that the next stage of development requires a different policy emphasis.

The question is no longer simply whether Indonesia can stabilize the economy.

It is whether Indonesia can transform the sources of economic resilience.

Stabilization protects the present.

Reform changes the future.

A stabilization policy can prevent a recession.

A reform can increase the economy's productive capacity.

A subsidy can protect purchasing power during a shock.

A reform can increase household earning capacity.

A public investment project can improve infrastructure.

A better public-investment system can improve the return on future projects.

A tax measure can raise revenue.

A stronger tax administration can permanently increase fiscal capacity.

The reform agenda developed in this chapter therefore follows one principle:

DO NOT ONLY ABSORB SHOCKS.

REDUCE THE ECONOMY'S EXPOSURE TO THEM.

The IMF and World Bank have emphasized revenue mobilization, public-investment efficiency, deregulation, trade openness, human capital, social protection, private-sector investment, productivity, and fiscal resilience as important elements of Indonesia's medium-term reform challenge (IMF, 2026a; World Bank, 2026a).

The challenge is not the absence of ideas.

It is sequencing, implementation, institutional capacity, and measurable outcomes.

18.1. The Reform Question

A reform agenda can easily become a list.

Tax reform.

Education reform.

Infrastructure reform.

Industrial reform.

Governance reform.

Trade reform.

Financial reform.

Social-protection reform.

But a long list does not automatically create transformation.

Reforms interact. Some are prerequisites for others. Some reinforce each other. Some can conflict if implemented without coordination.

A disciplined reform framework therefore begins with five questions:

What problem is being solved?

What mechanism changes?

Who implements it?

How is success measured?

What happens if implementation fails?

The sequence is:

PROBLEM → REFORM → MECHANISM → IMPLEMENTATION → INDICATOR → FEEDBACK → ADJUSTMENT.

The objective is not perfect policy. It is a policy system capable of learning.

18.2. The Five Reform Priorities

The reform agenda can be organized into five portfolios.

FOUNDATION: fiscal capacity, monetary credibility, financial stability, food and energy resilience.

ENGINE: productivity, human capital, infrastructure, competition, technology, private investment.

DISTRIBUTION: better jobs, real wages, housing, health, education, social protection, regional opportunity.

RESILIENCE: diversified trade, deeper finance, strategic supply chains, household buffers, external reserves.

GOVERNANCE: transparency, accountability, data, evaluation, implementation capacity.

This hierarchy prevents the chapter from becoming a catalogue of disconnected recommendations.

Foundation makes reform financeable.

The engine makes growth productive.

Distribution determines who participates.

Resilience determines how the system absorbs shocks.

Governance determines whether the other four can work.

18.3. Reform One — Build a Higher-Revenue State without Creating a Higher-Cost Economy

Fiscal resilience begins with revenue.

Indonesia's tax-to-GDP ratio remains relatively low by international standards, and the IMF identifies revenue mobilization as a priority for creating fiscal space for high-quality spending (IMF, 2026a).

The objective should not simply be to collect more taxes.

It should be to increase sustainable revenue capacity while minimizing unnecessary distortions.

Three layers matter.

Administration: improve taxpayer registration, compliance-risk management, data integration, digital systems, and enforcement.

Tax-base expansion: reduce gaps created by informality, under-reporting, weak third-party information, and narrow bases.

Tax-policy design: review exemptions, incentives, thresholds, and rates according to their economic and distributional effects.

The reform should be measured through tax revenue-to-GDP, compliance rates, filing rates, arrears, administrative cost, time required for compliance, revenue volatility, and taxpayer experience.

A stronger tax state is not simply one that collects more.

It is one that collects more predictably, fairly, and efficiently.

18.4. Reform Two — Turn Public Spending into Productive Capital

More public spending does not automatically mean more development.

The return depends on project selection, feasibility, procurement, implementation, maintenance, local capacity, monitoring, and evaluation.

The IMF's 2026 work on public investment emphasizes that higher public investment can contribute to long-term income convergence when implemented efficiently, while also noting that public investment alone cannot close the development gap (IMF, 2026a).

The governing equation is:

SPENDING VOLUME × SPENDING QUALITY = DEVELOPMENT IMPACT.

Indonesia should strengthen the entire project cycle:

Identification → Feasibility → Selection → Budgeting → Procurement → Construction → Operation → Maintenance → Evaluation.

The objective is not to eliminate consumption spending or social protection.

It is to make the return and fiscal implications of each category explicit.

18.5. Reform Three — Make the Private Sector a Second Engine of Growth

The state can mobilize capital, build infrastructure, establish strategic priorities, and provide public services.

But durable high-quality growth requires a dynamic private sector.

The policy equation is:

PUBLIC CAPITAL + PRIVATE CAPITAL + COMPETITION = PRODUCTIVE INVESTMENT.

This requires reducing unnecessary permitting delays, overlapping licenses, regulatory uncertainty, weak contract enforcement, financing constraints, and logistics costs.

The most important indicator is not the number of regulations removed.

It is whether firms become more productive after the rules change.

The reform should therefore be judged through investment, productivity, job quality, firm entry, firm survival, export performance, and domestic supplier participation.

18.6. Reform Four — Deregulate without Deregulating the Rules

Good deregulation removes unnecessary barriers.

It does not eliminate legitimate standards.

The objective is better rules: predictable, transparent, proportionate, enforceable, competition-friendly, and digitally accessible.

A useful principle is:

REGULATE RISK, NOT ACTIVITY.

High-risk activities require strong oversight.

Low-risk activities should not face unnecessary administrative burdens.

This can improve both investment conditions and government capacity.

18.7. Reform Five — Rebuild the Human-Capital Pipeline

Indonesia's demographic opportunity is time-limited.

The working-age population structure cannot automatically produce a demographic dividend. It must be converted into productivity.

The chain is:

HEALTH → LEARNING → SKILLS → EMPLOYMENT → PRODUCTIVITY → WAGES → TAX BASE.

Human-capital reform should focus on learning outcomes, foundational skills, completion, transition to employment, employer satisfaction, earnings, and training relevance.

Universities, vocational institutions, industry, technology firms, local governments, and professional associations need stronger connections.

The objective is not more credentials.

It is more economically valuable capability.

18.8. Reform Six — Make Job Quality a Primary Economic Indicator

Employment can improve while economic security remains weak.

Indonesia should therefore monitor real wages, labor productivity, formal employment, underemployment, job stability, social-protection coverage, career progression, and worker transitions.

The central question should be:

Are workers moving into more productive activities?

Industrial policy, vocational programs, digital strategies, and downstreaming should all be evaluated partly through the quality of employment they create.

Job creation should become a productivity strategy rather than a quantity target.

18.9. Reform Seven — Turn Downstreaming into Industrial Capability

Downstreaming can create value, but processing alone does not guarantee industrial transformation.

The progression should be:

RESOURCE → PROCESSING → MANUFACTURING → SUPPLIERS → TECHNOLOGY → DESIGN → BRAND → GLOBAL MARKET.

Programs should be evaluated through domestic value added, technology transfer, local supplier participation, worker productivity, export diversification, research and development, energy efficiency, environmental performance, and regional value capture.

DOWNSTREAMING SHOULD BE A BRIDGE TO PRODUCTIVITY, NOT THE FINAL DESTINATION.

18.10. Reform Eight — Build Competitive Supplier Ecosystems

Large projects create wider economic value when domestic firms connect to them.

Supplier ecosystems can create SME opportunities, skills, technology transfer, logistics, maintenance, engineering, and professional employment.

The chain is:

ANCHOR INVESTMENT → LARGE FIRMS → DOMESTIC SUPPLIERS → SMEs → SERVICES → SKILLS → LOCAL INCOME.

This is how industrial policy can become regional development policy.

18.11. Reform Nine — Deepen Trade Openness While Diversifying Risk

Strategic resilience should not be confused with isolation.

The objective is:

OPENNESS + DIVERSIFICATION.

Indonesia should seek more export destinations, more products, more value-added exports, more services exports, more investment partners, and broader global-value-chain participation.

The goal is not dependence on one market, commodity, or geopolitical relationship.

A resilient trade position remains open while maintaining multiple options.

18.12. Reform Ten — Make the Financial System Deeper

A resilient economy needs more than stable banks.

It needs diversified sources of finance: banks, bonds, equity, pension funds, insurance, private capital, and long-term institutional investors.

The reform agenda should strengthen local-currency financing, hedging instruments, corporate bond markets, equity participation,

institutional-investor capacity, financial inclusion, consumer protection, and market transparency.

The objective is not financial complexity.

It is financial choice.

A deeper financial system gives households and firms more ways to absorb shocks.

18.13. Reform Eleven — Protect the Middle Class Through Productivity, not Only Subsidies

Middle-class resilience requires both protection and earning capacity.

Short-term instruments include targeted transfers, temporary assistance, food support, health protection, and employment support.

Long-term instruments include better jobs, higher productivity, skills, affordable housing, financial inclusion, and asset accumulation.

The distinction is essential.

Permanent subsidies can protect consumption.

Productivity growth can increase economic security.

The objective is:

PROTECTION + PRODUCTIVITY.

18.14. Reform Twelve — Rebuild Regional Convergence

Regional opportunity differs across Indonesia.

The reform agenda should focus on connectivity, human capital, local institutions, private investment, and urban and rural productivity.

Different regions require different economic strategies.

Manufacturing regions need different interventions from agricultural or tourism regions.

Remote regions may require connectivity before private investment becomes commercially viable.

Fiscal transfers should increasingly connect to service quality and development outcomes while preserving the institutional role of intergovernmental transfers.

One national policy cannot optimize every regional economy.

18.15. Reform Thirteen — Make Social Protection More Portable

Workers move.

Jobs change.

Industries restructure.

Technology changes occupational demand.

Climate and other shocks can disrupt livelihoods.

A modern social-protection system should follow people rather than only jobs.

Important components include health protection, employment insurance, old-age security, skills support, temporary income support, accurate beneficiary databases, and rapid shock response.

The principle is:

PROTECT PEOPLE WHILE ALLOWING THE ECONOMY TO CHANGE.

18.16. Reform Fourteen — Strengthen Governance and Accountability

No economic reform survives weak institutions indefinitely.

Governance affects investment, procurement, tax collection, public spending, SOE performance, industrial policy, infrastructure, financial markets, and social protection.

The reform agenda should strengthen transparency, auditing, disclosure, conflict-of-interest rules, performance reporting, independent oversight, procurement integrity, and data quality.

PUBLIC OWNERSHIP REQUIRES PUBLIC ACCOUNTABILITY.

18.17. Reform Fifteen — Turn Danantara into a Measurable Investment System

State capital should be judged through measurable performance.

Relevant indicators include return on invested capital, economic value added, dividend contribution, productivity, private capital mobilized, technology transfer, employment quality, export performance, fiscal risk, and portfolio concentration.

The question is not the size of assets under management.

It is the additional economic value created by the state-capital architecture.

Commercial investments require commercial performance criteria.

Public-purpose investments require explicit public-value metrics.

The distinction should remain visible.

18.18. Reform Sixteen — Make Food and Energy Security Economically Efficient

Food and energy security are strategic objectives, but security has a cost.

For food, resilience depends on production, storage, logistics, irrigation, seeds, fertilizer, market information, and diversified supply.

For energy, it depends on domestic supply, strategic reserves, transmission, grid reliability, fuel diversification, renewables, efficiency, and strategic imports.

The objective is:

SECURITY + AFFORDABILITY + FISCAL SUSTAINABILITY + PRODUCTIVITY.

Security achieved at excessive economic cost can weaken other forms of resilience.

18.19. Reform Seventeen — Use Data as Infrastructure

The modern state cannot operate efficiently without reliable data.

Data is required for tax administration, social protection, health, education, infrastructure, investment, regional planning, financial supervision, and economic analysis.

Digitalization requires more than software.

It requires data standards, interoperability, cybersecurity, institutional ownership, human skills, user support, and governance.

DIGITAL GOVERNMENT = DATA + SYSTEMS + INSTITUTIONS + PEOPLE.

18.20. Reform Eighteen — Give Productivity an Institutional Owner

Productivity policy is fragmented across fiscal policy, industry, labor, education, trade, finance, regional development, and macroeconomic management.

Indonesia could strengthen an institutional mechanism responsible for measuring productivity, identifying bottlenecks, coordinating ministries, monitoring reforms, publishing indicators, and evaluating interventions.

The institutional form can vary.

The principle is more important:

PRODUCTIVITY NEEDS AN OWNER.

18.21. Reform Sequencing — 0–2 Years

The first horizon is stabilization and bottleneck removal.

Priorities:

Fiscal credibility.

Revenue administration.

Financial stability.

Targeted social protection.

Food and energy buffers.

Public-investment appraisal.

Regulatory bottlenecks.

Digital-government foundations.

Trade and investment frictions.

The objective is to create the institutional and fiscal conditions for deeper reform.

The first two years should therefore focus on reforms that increase policy capacity and remove constraints to investment.

18.22. Reform Sequencing — 3–5 Years

The second horizon is productivity acceleration.

Priorities:

Human capital.

Vocational and industry links.

Infrastructure quality.

Industrial supplier ecosystems.

Financial-market deepening.

SME upgrading.

Technology adoption.

Export diversification.

Regional productivity.

The objective is to move from stabilization to broad-based productivity growth.

The key indicators should include labor productivity, real wages, private investment, domestic value added, skills utilization, and regional convergence.

18.23. Reform Sequencing — 5–10 Years

The third horizon is structural transformation.

Priorities:

Innovation.

Higher-value manufacturing.

Services exports.

Global-value-chain upgrading.

Technology capability.

Asset accumulation.

Regional convergence.

Institutional learning.

The objective is to create an economy in which productivity growth becomes increasingly self-sustaining.

The ten-year test is whether Indonesia has more productive firms, higher real wages, deeper capital markets, stronger human capital, greater household security, broader export capability, and stronger fiscal capacity than at the beginning of the reform cycle.

18.24. The Reform Portfolio

The full agenda can now be organized into five portfolios.

PORTFOLIO ONE — FISCAL RESILIENCE: Revenue, spending quality, debt management, public-investment management.

PORTFOLIO TWO — PRODUCTIVITY: Human capital, technology, infrastructure, competition.

PORTFOLIO THREE — PRIVATE-SECTOR DYNAMISM: Deregulation, trade, FDI, SMEs, finance.

PORTFOLIO FOUR — HOUSEHOLD SECURITY: Jobs, real wages, housing, health, education, social protection.

PORTFOLIO FIVE — STRATEGIC RESILIENCE: Food, energy, industrial capability, regional diversification, financial resilience.

The portfolios are interconnected rather than independent.

18.25. The Reform Scorecard

A reform agenda requires measurable indicators.

Fiscal: tax revenue-to-GDP, primary balance, interest burden, public-investment efficiency.

Productivity: labor productivity, total factor productivity, firm productivity dispersion, innovation expenditure.

Human capital: learning outcomes, skills utilization, graduate employment, health outcomes.

Jobs: real wages, formal employment, high-productivity job share, SME employment.

Private investment: domestic investment, FDI, new business formation.

Trade: export diversification, services exports, global-value-chain participation.

Regional: regional productivity, wage convergence, infrastructure access.

Households: savings, debt service, middle-class mobility.

Social protection: coverage, targeting accuracy, shock responsiveness.

The scorecard should reveal bottlenecks rather than produce a single national grade.

18.26. The Reform Feedback Loop

Reform must be adaptive.

If a tax reform increases compliance but creates excessive compliance costs, it should be adjusted.

If an industrial incentive attracts investment but creates weak domestic linkages, it should be redesigned.

If a subsidy protects households but becomes fiscally expensive, targeting should be revised.

If infrastructure has low utilization, project selection should change.

The reform loop is:

IMPLEMENT → MEASURE → EVALUATE → LEARN → ADJUST → IMPLEMENT AGAIN.

Economic policy is an iterative process.

18.27. What Should not Be Done

A reform agenda also requires restraint.

Indonesia should avoid permanent emergency policies, unmeasured subsidies, open-ended guarantees, industrial protection without performance criteria, public investment without rigorous appraisal, debt-financed consumption without durable returns, state ownership without accountability, regulation without evidence, digitalization without interoperability, training without labor-market demand, and growth targets without productivity strategies.

Short-term activity is not identical to sustainable development.

18.28. The Implementation Problem

The hardest part of reform is implementation.

Indonesia is a large decentralized country. Policies operate across national government, provinces, districts and cities, SOEs, private firms, banks, schools, hospitals, and households.

The implementation gap can therefore become larger than the policy gap.

A reform that works in Jakarta may produce different results in a remote district.

A national regulation may be interpreted differently across local institutions.

A digital system may work for large taxpayers but remain difficult for small businesses.

Implementation capacity must therefore be treated as an explicit economic variable.

The question is not only whether a policy is well designed.

It is whether institutions can deliver it consistently.

18.29. The Central Reform Trade-Off

Every reform creates trade-offs.

Opening markets can expose inefficient firms to competition.

Reducing subsidies can increase short-term prices.

Increasing taxes can affect disposable income.

Tightening regulation can reduce risks while increasing compliance costs.

Public investment can require higher near-term spending.

Industrial policy can require temporary support.

Social protection requires fiscal resources.

The answer is not to eliminate trade-offs.

It is to make them explicit:

What is gained?

What is sacrificed?

Who bears the adjustment?

Who receives the benefit?

How long is the transition?

How are vulnerable households protected?

This is what turns reform into an institutional process rather than a slogan.

18.30. The Reform Agenda and the Prabowo Era

The economic architecture examined in Part IV provides a substantial policy platform.

The reform question is how that platform becomes durable economic capacity.

The sequence is:

POLICY PRIORITY
→ INSTITUTIONAL DESIGN
→ IMPLEMENTATION
→ PRIVATE RESPONSE
→ PRODUCTIVITY
→ HOUSEHOLD OUTCOME
→ FISCAL RETURN
→ LONG-TERM RESILIENCE.

This applies to downstreaming, food security, energy security, infrastructure, state capital, human capital, trade, and financial deepening.

The appropriate evaluation standard remains:

What problem is being solved?

What mechanism is expected to work?

What resources are required?

What risks are created?

What measurable outcome should follow?

How quickly should evidence appear?

What happens if it does not?

The framework evaluates policy through mechanisms and outcomes rather than rhetoric or assumptions.

18.31. The Reform Equation

The chapter can be condensed into:

FISCAL CAPACITY
+
PRODUCTIVITY
+
PRIVATE INVESTMENT
+
HUMAN CAPITAL
+
TRADE OPENNESS
+
INSTITUTIONAL QUALITY
+
HOUSEHOLD RESILIENCE
=
SUSTAINABLE TRANSFORMATION.

Fiscal capacity finances productive public investment.

Public investment improves infrastructure.

Infrastructure increases private investment.

Private investment creates jobs.

Jobs increase household income.

Income expands the tax base.

Human capital increases productivity.

Productivity increases wages.

Higher wages strengthen consumption and savings.

Savings deepen financial markets.

Financial depth supports investment.

Trade openness expands markets.

Institutional quality reduces uncertainty.

The system becomes more resilient.

18.32. From Economic Tsunami to Economic Resilience

The book began with a question:

Is Indonesia collapsing?

The evidence examined across the preceding chapters does not reduce the economy to a binary.

Indonesia has vulnerabilities.

It also has buffers.

It has structural weaknesses.

It also has substantial capacity.

It faces external shocks.

It also possesses domestic demand.

It has fiscal constraints.

It also has reform options.

It has middle-class pressure.

It also has significant human and entrepreneurial potential.

The reform agenda should therefore not be built around fear.

It should be built around capacity:

Capacity to collect.

Capacity to invest.

Capacity to innovate.

Capacity to compete.

Capacity to protect.

Capacity to adapt.

Capacity to govern.

Capacity to learn.

The objective is not merely higher GDP.

It is a more productive, inclusive, and shock-resistant economic system.

18.33. Chapter 18 Revisited

The reform agenda can now be reduced to ten priorities:

One: strengthen revenue mobilization.

Two: improve public-investment quality.

Three: expand productive private-sector investment.

Four: raise human capital and job quality.

Five: turn downstreaming into broader industrial capability.

Six: deepen trade and financial openness while diversifying risk.

Seven: strengthen household and social resilience.

Eight: accelerate regional convergence.

Nine: strengthen governance, accountability, and data systems.

Ten: build an institutional system capable of continuously measuring and adjusting reform.

These priorities do not guarantee success.

They create mechanisms through which economic capacity can improve.

The objective of policy is not to eliminate uncertainty.

It is to increase the economy's ability to operate under uncertainty.

This is the meaning of resilience.

The question is no longer only whether Indonesia can survive the next economic tsunami.

It is whether Indonesia can use the period between shocks to build an economy that is less vulnerable when the next wave arrives.

That is the final test.

Chapter 19 will move from WHAT SHOULD BE DONE? to HOW SHOULD IT BE IMPLEMENTED?

It will examine implementation architecture: who does what, in what sequence, with what resources, under which accountability mechanisms, and against which measurable outcomes.

Because identifying what should be done is only the beginning.

The harder question is how to make it happen.

Figure 18.1 — THE REFORM ARCHITECTURE

FOUNDATION
Fiscal Capacity • Financial Stability • Food & Energy Resilience
↓
ENGINE
Productivity • Human Capital • Infrastructure • Private Investment
↓
DISTRIBUTION
Jobs • Real Wages • Housing • Health • Education • Regional Opportunity
↓
RESILIENCE
Trade Diversification • Financial Depth • Household Buffers • Strategic Supply Chains
↓
GOVERNANCE
Transparency • Accountability • Data • Evaluation • Adaptive Implementation
↓
SUSTAINABLE TRANSFORMATION

CHAPTER 19

FROM ECONOMIC RISK TO ECONOMIC RESILIENCE

The Implementation Architecture

Indonesia does not lack economic strategies.

It has national development plans, fiscal frameworks, industrial policies, investment programs, social-protection systems, infrastructure priorities, digital strategies, education programs, and a long-term ambition to become a high-income economy by 2045.

The harder question is implementation.

A reform can be economically sound and still fail to produce results if institutions cannot execute it.

A budget can be large and still produce weak development outcomes if projects are poorly selected.

An industrial policy can attract investment and still create limited domestic value if supplier linkages remain shallow.

A tax reform can change regulations and still produce little additional revenue if administration and compliance do not improve.

A training program can graduate thousands of people and still fail economically if the skills do not match actual labor demand.

A social-protection program can spend heavily and still leave households exposed if targeting, portability, and delivery are weak.

Implementation is therefore not an administrative footnote.

It is an economic variable.

The central question of this final analytical chapter is:

HOW DOES INDONESIA TURN REFORM INTENT INTO MEASURABLE ECONOMIC CAPACITY?

The answer requires an architecture.

Not one institution.

Not one ministry.

Not one presidential program.

An architecture that connects policy, institutions, budgets, markets, households, data, measurement, and feedback.

The IMF has emphasized that Indonesia's medium-term resilience depends on protecting policy space, improving revenue mobilization, strengthening public-investment management, supporting private-sector-led growth, and implementing structural reforms in areas such as governance, education, infrastructure, trade, and the business environment (IMF, 2026a).

The World Bank likewise frames productivity, better jobs, private capital, innovation, competition, and stronger economic institutions as central to sustaining higher-quality growth (World Bank, 2025; World Bank, 2026a).

The challenge is now to connect those priorities into an implementation system.

19.1. From Policy to Delivery

Economic policy often begins with an announcement.

A target is established.

A program is launched.

A budget is allocated.

A regulation is issued.

A new institution may be created.

But none of these automatically creates an economic outcome.

The transmission mechanism is longer:

POLICY → INSTITUTION → BUDGET → IMPLEMENTATION → PRIVATE RESPONSE → HOUSEHOLD RESPONSE → PRODUCTIVITY → INCOME → FISCAL RETURN → RESILIENCE.

Every arrow can fail.

If the institution is weak, implementation slows.

If the budget is poorly designed, resources are misallocated.

If implementation is inconsistent, firms delay investment.

If firms do not invest, employment does not improve.

If employment remains low-productivity, wages remain constrained.

If wages remain weak, household resilience remains limited.

If household resilience remains weak, the next shock becomes more damaging.

The implementation architecture must therefore be designed around the entire chain rather than around individual programs.

19.2. The State Cannot Implement Transformation Alone

Transformation requires coordination among multiple actors.

The national government establishes broad policy and fiscal priorities.

Ministries translate those priorities into sectoral programs.

Local governments deliver many public services.

Bank Indonesia manages monetary and financial stability within its mandate.

Financial-sector authorities supervise markets and institutions.

SOEs operate strategic assets and businesses.

Private firms provide investment, employment, technology, and innovation.

Banks and capital markets allocate financial resources.

Universities and training institutions build human capital.

Households make consumption, saving, education, migration, and labor-market decisions.

International investors respond to risk, returns, regulation, infrastructure, and market access.

The implementation architecture must therefore distinguish between:

WHO SETS THE RULES?

WHO PROVIDES THE RESOURCES?

WHO DELIVERS THE SERVICE?

WHO TAKES THE INVESTMENT DECISION?

WHO BEARS THE RISK?

WHO MEASURES THE RESULT?

WHO CORRECTS THE POLICY?

Without this separation, accountability becomes blurred.

19.3. The Five-Level Implementation Architecture

A practical architecture can be organized into five levels.

LEVEL ONE — STRATEGY.

Define the national objective.

Examples include productivity growth, better jobs, fiscal resilience, regional convergence, and strategic economic security.

LEVEL TWO — POLICY.

Translate the objective into specific interventions.

Examples include tax reform, public-investment reform, deregulation, skills reform, industrial policy, financial deepening, and social-protection reform.

LEVEL THREE — DELIVERY.

Determine which institution actually executes the intervention.

This is where national and subnational capacity becomes critical.

LEVEL FOUR — RESPONSE.

Observe how firms, households, investors, workers, and local economies react.

Policy cannot be evaluated only from the government's perspective.

LEVEL FIVE — OUTCOME.

Measure whether productivity, income, employment, fiscal capacity, resilience, and household security actually improve.

The architecture therefore becomes:

STRATEGY → POLICY → DELIVERY → RESPONSE → OUTCOME.

19.4. The Role of the National Government

The central government should concentrate on functions that require national coordination.

These include:

Macroeconomic stability.

Fiscal rules.

National infrastructure priorities.

Tax policy and administration.

Trade policy.

National industrial strategy.

Human-capital standards.

Social-protection architecture.

Financial-system regulation.

National data standards.

Strategic food and energy resilience.

State-asset governance.

The central government should also define measurable national outcomes.

But centralization should not mean that every decision is made centrally.

Indonesia's diversity requires differentiated implementation.

National government should define the destination.

Institutions closer to the problem should have sufficient flexibility to determine the route.

19.5. The Role of Local Governments

Regional implementation is one of the decisive tests of national reform.

Education happens in regions.

Health services are delivered in regions.

Local roads affect productivity.

Permitting affects businesses.

Markets operate through cities and districts.

Labor mobility depends on housing and transport.

Regional governments therefore become part of the national productivity system.

A national productivity strategy that ignores local implementation will remain incomplete.

Regional governments should increasingly be evaluated through outcomes such as:

Learning.

Health.

Infrastructure access.

Investment realization.

Business formation.

Employment.

Local revenue capacity.

Public-service quality.

Regional productivity.

The objective is not to make every region identical.

It is to make opportunity increasingly less dependent on geography.

19.6. The Budget as an Implementation Contract

A budget is more than an accounting document.

It is the financial expression of policy priorities.

Every major reform should therefore have a visible budget logic.

What is the cost?

What is the expected return?

What is the implementation capacity?

What is the recurrent cost after completion?

What is the fiscal risk?

What is the alternative use of the resources?

The IMF's work on public investment emphasizes that increasing investment is most effective when accompanied by stronger investment efficiency and revenue mobilization (IMF, 2026a).

The implication is important.

Indonesia should not ask only:

HOW MUCH ARE WE SPENDING?

It should also ask:

WHAT CAPACITY DOES THAT SPENDING CREATE?

A bridge can create connectivity.

A school can create human capital.

A digital system can create administrative capacity.

A health facility can create productive labor.

A tax system can create fiscal capacity.

A poorly selected project can create none of these sufficiently.

19.7. The Investment Gate

Every major public-investment project should pass through a disciplined sequence.

NEED.

Is the problem real?

OPTIONS.

Is public investment the best instrument?

FEASIBILITY.

Is the project technically and economically viable?

AFFORDABILITY.

Can the state finance construction and operation?

IMPLEMENTATION.

Does the institution have the capacity to deliver?

MAINTENANCE.

Can the asset remain productive after completion?

EVALUATION.

Did the project generate the expected outcome?

This creates a project gate rather than a political event.

The discipline is particularly important when fiscal space is limited.

19.8. The Private-Sector Response Test

A reform should not be evaluated only by government activity.

The private-sector response is equally important.

Suppose licensing becomes faster.

Did investment increase?

Suppose a tax incentive is introduced.

Did productive investment increase enough to justify its fiscal cost?

Suppose an industrial zone is constructed.

Did firms actually locate there?

Did domestic suppliers participate?

Did productivity rise?

Did exports increase?

Did local wages improve?

Suppose vocational training expands.

Did graduates obtain jobs?

Did their wages increase?

Did employers report better skill availability?

These questions convert policy evaluation from input measurement to outcome measurement.

19.9. The Household Response Test

The same principle applies to households.

A macroeconomic reform ultimately reaches people through prices, jobs, wages, services, taxes, transfers, housing, credit, and assets.

A household-centered evaluation system should therefore track:

Real disposable income.

Real wages.

Employment stability.

Debt-service burden.

Savings.

Asset ownership.

Education expenditure.

Health expenditure.

Housing affordability.

Social-protection coverage.

Mobility into higher-productivity employment.

The economy is not resilient if macro indicators improve while household capacity to absorb shocks deteriorates.

19.10. The Data Architecture

Implementation requires an information system capable of answering three questions:

WHAT IS HAPPENING?

WHY IS IT HAPPENING?

WHAT SHOULD CHANGE?

This requires interoperable administrative and statistical data.

Tax data.

Employment data.

Education data.

Health data.

Investment data.

Trade data.

Social-protection data.

Regional fiscal data.

Corporate data.

Financial-market data.

Infrastructure data.

The objective is not to collect data indiscriminately.

It is to connect data to decisions.

A government may possess enormous quantities of data and still make poor decisions if information remains fragmented across institutions.

Data becomes infrastructure when it reduces uncertainty and improves allocation.

19.11. The Performance Dashboard

A national reform dashboard should not become a single political score.

Its purpose should be diagnostic.

A useful dashboard could contain five layers.

MACROECONOMIC STABILITY:

Inflation, fiscal balance, debt, reserves, financial conditions.

PRODUCTIVITY:

Labor productivity, total factor productivity, investment efficiency, innovation.

HOUSEHOLDS:

Real wages, employment quality, savings, debt burden, mobility.

FIRMS:

Investment, productivity, business formation, exports, domestic supplier participation.

REGIONS:

Regional productivity, poverty, infrastructure access, human capital, service quality.

The dashboard should show:

Baseline.

Target.

Current result.

Deviation.

Responsible institution.

Corrective action.

This transforms monitoring into management.

19.12. The Accountability Clock

Reforms operate on different time horizons.

Some indicators can move within months.

Others require years.

This distinction prevents premature conclusions.

A tax-administration reform may affect filing behavior relatively quickly.

Human-capital reform may require many years before productivity effects become visible.

Infrastructure may take years to construct and longer to influence regional productivity.

Industrial capability may require a decade of supplier and technology development.

A credible implementation system should therefore define:

90-DAY SIGNALS.

2-YEAR OUTPUTS.

5-YEAR OUTCOMES.

10-YEAR STRUCTURAL EFFECTS.

The clock should match the economics of the reform.

19.13. The 90-Day Signal

The first measurement horizon is not final success.

It is implementation movement.

Examples:

Regulations simplified.

Data systems integrated.

Projects appraised.

Procurement initiated.

Beneficiaries verified.

Training curricula revised.

Investment barriers identified.

Performance contracts established.

These are implementation signals.

They do not prove economic success.

But they reveal whether the machinery has started moving.

19.14. The Two-Year Output

The two-year horizon should measure whether implementation has produced observable operational changes.

Examples:

Higher tax compliance.

Faster licensing.

Improved project completion.

Greater social-protection coverage.

More relevant vocational placement.

Increased investment realization.

Improved digital-system interoperability.

Reduced logistics bottlenecks.

The two-year test asks:

IS THE SYSTEM WORKING DIFFERENTLY?

19.15. The Five-Year Outcome

Five years is long enough to evaluate deeper economic effects.

Indicators may include:

Higher labor productivity.

Higher real wages.

More formal employment.

Greater domestic value added.

Higher private investment.

More diversified exports.

Improved regional productivity.

Better learning outcomes.

Stronger fiscal capacity.

Greater household savings.

The five-year test asks:

IS THE ECONOMY PRODUCING DIFFERENTLY?

19.16. The Ten-Year Structural Test

The ten-year test is fundamentally different.

It asks whether the structure of the economy has changed.

Are firms more productive?

Are workers earning more?

Are exports more diversified?

Is the tax base broader?

Are regional disparities narrower?

Is the middle class more secure?

Are capital markets deeper?

Are households accumulating more assets?

Are strategic dependencies lower?

Can the economy absorb external shocks with less disruption?

The ten-year test asks:

IS THE ECONOMY MORE RESILIENT BY DESIGN?

19.17. The Stop, Scale, Redesign Rule

Not every reform should automatically continue.

Implementation requires three possible decisions.

STOP.

If the evidence shows that the intervention is ineffective, fiscally costly, or producing unacceptable distortions.

SCALE.

If the intervention produces measurable benefits at acceptable cost and can be expanded without undermining quality.

REDESIGN.

If the objective is valid but the mechanism is not producing the expected outcome.

This is one of the most important disciplines in economic policy.

A program should not survive indefinitely simply because it has already received political or budgetary commitment.

19.18. The Cost of Policy Lock-in

Policy lock-in occurs when an intervention continues because changing it is institutionally difficult.

It can happen with:

Subsidies.

Tax incentives.

Industrial protection.

Public projects.

SOE structures.

Training programs.

Administrative systems.

Regulations.

The longer a weak policy remains in place, the more beneficiaries and institutions can become dependent on it.

Evaluation therefore has to be institutionalized before lock-in becomes politically expensive.

19.19. The Reform Risk Register

Every major reform should carry a risk register.

At minimum:

Fiscal risk.

Implementation risk.

Market risk.

Distributional risk.

Environmental risk.

External risk.

Institutional risk.

Technology risk.

Political-economy risk.

The objective is not to eliminate risk.

It is to make risk visible before it becomes systemic.

This is especially important for large state-investment programs, strategic industries, guarantees, infrastructure projects, and policies involving contingent liabilities.

19.20. The Principle of Reversibility

Some economic decisions are reversible.

Others are not.

A temporary pilot can be reversed.

A permanent subsidy is harder to unwind.

A regulatory sandbox is reversible.

A large capital project is not.

A tax administration experiment can be adjusted.

A poorly designed long-term guarantee can create obligations for years.

Policy should therefore distinguish:

REVERSIBLE DECISIONS.

IRREVERSIBLE DECISIONS.

HIGH-COST-TO-REVERSE DECISIONS.

The larger and more irreversible the commitment, the stronger the evidence required before implementation.

19.21. Coordination without Centralization

Coordination does not mean one institution controls everything.

It means institutions share objectives, information, timelines, and accountability.

A fiscal authority may focus on sustainability.

A monetary authority focuses on price and financial stability within its mandate.

Sectoral ministries focus on development objectives.

Local governments focus on service delivery.

Financial regulators focus on market integrity and resilience.

The challenge is to prevent policy contradictions.

For example:

Fiscal expansion should consider inflation and financing conditions.

Industrial policy should consider trade commitments and competition.

Energy policy should consider fiscal costs.

Social protection should consider labor-market incentives.

Infrastructure should consider maintenance.

State investment should consider contingent liabilities.

Coordination is therefore a mechanism for reducing policy friction.

19.22. The Reform Delivery Unit

A reform architecture may require a small, technically strong coordination function.

Its purpose would not be to replace ministries.

Its purpose would be to track cross-ministerial bottlenecks.

Such a unit could maintain:

A reform registry.

A milestone calendar.

A risk dashboard.

An implementation scorecard.

A cross-government issue log.

A public reporting schedule.

Its effectiveness would depend on access to information, analytical capacity, and clear authority to escalate unresolved bottlenecks.

The institutional design can vary.

The principle is simple:

CROSS-CUTTING REFORMS NEED CROSS-CUTTING COORDINATION.

19.23. The Role of Independent Evaluation

Government should not be the only evaluator of government programs.

Independent evaluation can provide a second layer of evidence.

Universities.

Research institutions.

Audit institutions.

Professional organizations.

International institutions.

Civil society.

Independent economists and policy researchers.

Different institutions can evaluate different dimensions.

Did the program achieve its objective?

Was it cost-effective?

Who benefited?

Who paid?

Were there unintended effects?

Could the same outcome have been achieved more cheaply?

Independent evidence does not replace government responsibility.

It strengthens it.

19.24. The Political Economy of Reform

Every reform changes incentives.

Some groups gain.

Some groups lose.

Some firms benefit from greater competition.

Others lose protection.

Some households gain from targeted assistance.

Others may lose generalized subsidies.

Some regions gain from infrastructure.

Others may receive fewer resources.

Some state enterprises may gain investment.

Others may face restructuring.

These distributional effects cannot simply be wished away.

Successful reform requires a credible explanation of:

WHY THE CHANGE IS NECESSARY.

WHAT THE TRANSITION WILL COST.

WHO WILL BE PROTECTED.

HOW LONG THE ADJUSTMENT WILL LAST.

WHAT BENEFITS ARE EXPECTED.

HOW RESULTS WILL BE MEASURED.

Transparency is therefore part of implementation capacity.

19.25. Communication as Economic Infrastructure

Economic communication affects expectations.

Investors need to understand policy direction.

Households need to understand major price or subsidy changes.

Businesses need regulatory certainty.

Workers need clarity about skills and employment programs.

Regional governments need predictable fiscal frameworks.

Markets need credible information.

Communication should therefore distinguish:

POLICY.

FORECAST.

TARGET.

SCENARIO.

ACTUAL RESULT.

These are not the same.

A target is not an outcome.

A forecast is not a guarantee.

A scenario is not a prediction.

Clear distinctions reduce unnecessary uncertainty.

19.26. The Resilience Test

The implementation architecture should ultimately be judged by the economy's response to shocks.

Consider the following sequence:

SHOCK → POLICY RESPONSE → MARKET ADJUSTMENT → HOUSEHOLD IMPACT → RECOVERY → ADAPTATION.

A resilient system should reduce amplification.

For example:

A currency shock should not automatically become a banking crisis.

An energy shock should not automatically become a fiscal crisis.

A food shock should not automatically become a poverty crisis.

A trade shock should not automatically become a mass-employment crisis.

A fiscal shock should not automatically become a public-investment collapse.

The purpose of reform is therefore not to prevent every shock.

It is to prevent shocks from cascading through the system.

19.27. The Economic Tsunami Framework Revisited

At the beginning of this book, the metaphor of an economic tsunami was deliberately provocative.

A tsunami has a wave.

An economy has transmission mechanisms.

A tsunami has an impact zone.

An economy has vulnerable households, firms, regions, and sectors.

A tsunami can be amplified by geography.

An economic shock can be amplified by leverage, weak institutions, concentrated exports, fragile households, or shallow financial markets.

A tsunami can be slowed by physical barriers.

An economy can be protected by reserves, fiscal space, financial regulation, diversified trade, social protection, and institutional credibility.

But the analogy has a limit.

A tsunami is a physical event.

Economic crises are institutional and behavioral processes.

They can be influenced by expectations, policy choices, adaptation, investment, and learning.

That is why resilience can be built.

19.28. The Resilience Architecture

The entire book can now be compressed into seven layers.

LAYER ONE — MACROECONOMIC CREDIBILITY.

Stable inflation.

Credible fiscal policy.

Sustainable debt.

Adequate reserves.

Stable financial institutions.

LAYER TWO — PRODUCTIVE CAPACITY.

Infrastructure.

Technology.

Human capital.

Competitive firms.

Industrial capability.

LAYER THREE — MARKET DEPTH.

Banks.

Capital markets.

Insurance.

Pensions.

Trade networks.

Investment channels.

LAYER FOUR — HOUSEHOLD SECURITY.

Jobs.

Real wages.

Savings.

Assets.

Health.

Education.

Social protection.

LAYER FIVE — REGIONAL CAPACITY.

Connectivity.

Local institutions.

Public services.

Regional investment.

Urban and rural productivity.

LAYER SIX — STRATEGIC RESILIENCE.

Food.

Energy.

Supply chains.

Trade diversification.

Strategic reserves.

LAYER SEVEN — GOVERNANCE AND LEARNING.

Data.

Transparency.

Accountability.

Evaluation.

Institutional coordination.

Adaptive policy.

Together:

CREDIBILITY + PRODUCTIVITY + MARKET DEPTH + HOUSEHOLD SECURITY + REGIONAL CAPACITY + STRATEGIC RESILIENCE + GOVERNANCE = ECONOMIC RESILIENCE.

19.29. What Success Would Look Like

Success should not be defined by the absence of bad news.

No economy can eliminate shocks.

Success would instead mean that:

Growth becomes more productivity-driven.

Real wages rise with productivity.

Investment becomes more efficient.

Private capital contributes more strongly to growth.

Exports become more diversified.

Human capital improves.

Regional productivity gaps narrow.

Fiscal capacity strengthens.

Households accumulate greater buffers.

Financial markets deepen.

Strategic dependencies become more manageable.

Institutions respond faster to emerging risks.

Policy becomes more evidence-based.

The economy does not become invulnerable.

It becomes harder to destabilize.

19.30. The Final Implementation Question

The central lesson of this book is not that Indonesia should choose between growth and resilience.

It needs both.

Growth without resilience can create fragility.

Resilience without growth can create stagnation.

Fiscal discipline without investment can weaken future capacity.

Investment without discipline can weaken fiscal credibility.

Industrial policy without competition can create inefficiency.

Competition without social protection can create excessive adjustment costs.

Trade openness without diversification can create concentration risk.

Social protection without productivity can become fiscally difficult to sustain.

State ownership without accountability can create contingent liabilities.

Private investment without institutions can remain below potential.

The objective is therefore balance through institutions.

The implementation architecture must connect:

STABILITY → PRODUCTIVITY → INVESTMENT → JOBS → HOUSEHOLD SECURITY → FISCAL CAPACITY → RESILIENCE.

That is the economic transformation challenge.

19.31. The Final Test

The book began with a question:

Under President Prabowo, is Indonesia collapsing?

After examining growth, households, productivity, fiscal capacity, debt, taxation, industrial policy, state capital, trade, financial markets, energy, food, poverty, inequality, middle-class pressure, and stress scenarios, the more useful question becomes different.

Not:

IS INDONESIA COLLAPSING?

But:

IS INDONESIA BUILDING THE CAPACITY TO BECOME MORE RESILIENT?

That question can be measured.

It can be tested.

It can be challenged.

It can be updated.

And it can change.

The answer should never be based on one statistic, one political speech, one market movement, one fiscal year, or one economic shock.

It should be based on the direction of the system.

Are productivity and real wages rising?

Is fiscal capacity strengthening?

Is public investment becoming more efficient?

Are private firms becoming more competitive?

Is the middle class becoming more secure?

Are regions converging?

Are strategic vulnerabilities declining?

Are institutions learning faster?

Are policy corrections occurring when evidence changes?

If the answer to these questions becomes increasingly yes, Indonesia's resilience is becoming structural rather than temporary.

If the answer becomes increasingly no, the country's vulnerabilities may be accumulating beneath apparently stable headline indicators.

That is the deeper meaning of economic resilience.

It is not the absence of risk.

It is the capacity to absorb risk, adapt to change, recover from shocks, and continue improving.

The economic tsunami is therefore not the end of the story.

It is the test.

The real objective is to build an economy that can face the next wave without allowing the wave to determine its future.

FINAL FRAMEWORK

RISK → EXPOSURE → VULNERABILITY → SHOCK → TRANSMISSION → POLICY RESPONSE → ADAPTATION → RECOVERY → LEARNING → RESILIENCE.

And beyond resilience:

RESILIENCE → PRODUCTIVITY → PROSPERITY → INCLUSION → NATIONAL CAPACITY.

That is the transformation Indonesia must ultimately measure.

Not only how much the economy grows.

But how much economic capacity it builds while growing.

Figure 19.1 — THE ECONOMIC RESILIENCE IMPLEMENTATION ARCHITECTURE

LEVEL 1
MACROECONOMIC CREDIBILITY
Stable inflation • Fiscal credibility • Sustainable debt • Adequate reserves

↓

LEVEL 2
PRODUCTIVE CAPACITY
Infrastructure • Technology • Human capital • Competitive firms • Industrial capability

↓

LEVEL 3
MARKET DEPTH
Banks • Capital markets • Insurance • Pensions • Trade • Investment channels

↓

LEVEL 4
HOUSEHOLD SECURITY
Jobs • Real wages • Savings • Assets • Health • Education • Social protection

↓

LEVEL 5
REGIONAL CAPACITY
Connectivity • Local institutions • Public services • Regional investment • Productivity

↓

LEVEL 6
STRATEGIC RESILIENCE
Food • Energy • Supply chains • Trade diversification • Strategic reserves

↓

LEVEL 7
GOVERNANCE & LEARNING
Data • Transparency • Accountability • Evaluation • Coordination • Adaptive policy

↓

OUTCOME
ECONOMIC RESILIENCE
Absorb shocks • Adapt • Recover • Learn • Continue transforming

CHAPTER 20

INDONESIA: COLLAPSE, CORRECTION, OR TRANSFORMATION?

20.1. The Final Test

The book began with a question.

A deliberately uncomfortable question.

A question that could not be answered by political loyalty, political opposition, market optimism, or economic pessimism.

The question was:

IS INDONESIA COLLAPSING?

Twenty chapters later, the question remains important.

But it is no longer sufficient.

To answer it responsibly, the evidence must be considered as a system.

Growth.

Productivity.

Jobs.

Purchasing power.

The middle class.

Fiscal capacity.

Debt.

Taxation.

Public investment.

Industrial policy.

State capital.

Trade.

The Rupiah.

Financial markets.

Energy.

Food.

Poverty.

Inequality.

Regional development.

Social protection.

And the country's capacity to absorb shocks.

The evidence does not point in only one direction.

Indonesia has vulnerabilities.

It also has buffers.

It has structural weaknesses.

It also has institutional capacity.

It faces external shocks.

It also has a large domestic economy.

It faces fiscal constraints.

It also retains policy instruments.

It has middle-class pressure.

It also continues to create jobs and reduce poverty.

It has productivity challenges.

It also possesses significant potential for productivity-enhancing reform.

This is why the conclusion cannot be reduced to a slogan.

The appropriate analytical task is to distinguish three possible states:

COLLAPSE.

CORRECTION.

TRANSFORMATION.

They are not political labels.

They are economic conditions.

20.2. The Original Question

The word “collapse” carries enormous weight.

It should therefore be used carefully.

An economy does not collapse simply because growth slows.

It does not collapse because the currency depreciates.

It does not collapse because fiscal deficits increase.

It does not collapse because poverty remains.

It does not collapse because inequality rises temporarily.

It does not collapse because one industry performs poorly.

It does not collapse because markets become volatile.

These are signs of stress.

They can become serious.

But stress is not automatically systemic breakdown.

The analytical distinction established throughout this book is therefore essential:

SLOWDOWN ≠ STRUCTURAL STRESS ≠ CRISIS ≠ COLLAPSE.

Collapse would require something substantially more severe.

Multiple economic systems would have to become persistently dysfunctional.

Financial intermediation could fail.

Fiscal capacity could become severely impaired.

Essential imports could become difficult to finance.

The currency could lose monetary credibility.

Payment systems could become dysfunctional.

Productive capacity could contract persistently.

Unemployment could rise sharply and remain elevated.

Institutions could lose the capacity to respond.

Households and firms could lose confidence in the basic functioning of the economic system.

A single bad indicator cannot establish such a condition.

The system must be examined as a whole.

20.3. The Collapse Test

The first possible interpretation is:

COLLAPSE.

In analytical terms, collapse would mean a persistent breakdown across several critical economic systems.

The relevant dimensions include:

MACROECONOMIC STABILITY.

FISCAL CAPACITY.

FINANCIAL INTERMEDIATION.

EXTERNAL LIQUIDITY.

PRODUCTIVE CAPACITY.

HOUSEHOLD SECURITY.

INSTITUTIONAL FUNCTIONING.

A genuine collapse would therefore involve multiple failures reinforcing each other.

Fiscal weakness would restrict government response.

Financial stress would restrict credit.

Currency instability would increase import costs.

Import stress would affect production.

Production weakness would reduce employment.

Employment weakness would reduce household income.

Lower income would weaken consumption.

Lower consumption would weaken firms.

Falling activity would reduce tax revenue.

Lower revenue would further weaken fiscal capacity.

The feedback loop would become self-reinforcing.

That is the economic meaning of systemic collapse.

The evidence examined in this book does not justify treating every current weakness as equivalent to such a condition.

The IMF's January 2026 assessment described Indonesia as resilient amid adverse shocks, with growth expected around 5 percent and inflation expected to remain within its target range, while emphasizing downside risks from trade tensions, uncertainty, and global financial volatility (IMF, 2026a).

That evidence does not eliminate risk.

It establishes an important distinction between vulnerability and systemic breakdown.

20.4. The Correction Test

The second possible interpretation is:

CORRECTION.

An economy undergoing correction is experiencing significant adjustment without losing its fundamental institutional and productive capacity.

Correction can be uncomfortable.

It can involve:

Slower growth.

Currency depreciation.

Higher financing costs.

Lower asset valuations.

Changes in fiscal priorities.

Industrial restructuring.

Labor-market adjustment.

Household pressure.

Corporate restructuring.

Regional divergence.

Reduced profitability in some sectors.

These developments can impose real costs.

But they do not necessarily represent economic collapse.

A correction can actually be part of economic adjustment.

The central question is whether the adjustment restores balance or creates deeper structural weakness.

A currency adjustment can improve external competitiveness.

Or it can become destabilizing if foreign-currency liabilities are excessive.

Fiscal consolidation can strengthen credibility.

Or it can weaken growth if badly designed.

Industrial restructuring can improve productivity.

Or it can preserve inefficient firms if competition is suppressed.

Subsidy reform can improve fiscal efficiency.

Or it can create excessive household stress if protection is inadequate.

The outcome depends on policy design and implementation.

20.5. The Transformation Test

The third possibility is:

TRANSFORMATION.

Transformation is different from correction.

Correction restores balance.

Transformation changes capacity.

A transformed economy does not merely survive the same shocks better.

It becomes structurally different.

Its firms are more productive.

Its workers possess more valuable skills.

Its infrastructure produces higher returns.

Its financial markets provide deeper pools of capital.

Its exports are more diversified.

Its tax base is broader.

Its households possess greater buffers.

Its regions have stronger productive capacity.

Its institutions learn faster.

Its policy system responds more effectively to evidence.

Transformation is therefore not a single policy.

It is a cumulative process.

PRODUCTIVITY.

HUMAN CAPITAL.

PRIVATE INVESTMENT.

FISCAL CAPACITY.

TRADE.

FINANCIAL DEPTH.

HOUSEHOLD SECURITY.

REGIONAL CONVERGENCE.

GOVERNANCE.

These elements reinforce one another.

20.6. What the Growth Evidence Tells US

The first major conclusion of this book is that Indonesia has maintained economic growth.

The World Bank's June 2026 assessment projected growth of 5.0 percent in 2026 and 5.2 percent in 2027–28, while emphasizing that productivity reforms are important for sustaining momentum and creating better jobs (World Bank, 2026a).

But the five-percent question remains.

Is growth sufficiently productive?

Is it sufficiently job-rich?

Is it sufficiently inclusive?

Is it sufficient to support the country's high-income ambition?

Growth is therefore necessary but not sufficient.

GDP can expand while productivity growth remains weak.

Investment can increase while regional inequality persists.

Employment can rise while job quality remains limited.

Consumption can remain resilient while middle-class security becomes more fragile.

The relevant transition is:

GROWTH → PRODUCTIVITY → JOBS → WAGES → HOUSEHOLD SECURITY.

If the chain becomes stronger, growth becomes more transformative.

If the chain remains weak, headline growth can conceal structural limitations.

20.7. What the Household Evidence Tells US

The household is where macroeconomic performance becomes personal.

A GDP number does not pay a household's rent.

A reserve figure does not directly finance a child's education.

A stable banking system does not automatically create a secure career.

Economic resilience must therefore eventually reach households.

The evidence is mixed.

BPS reported that Indonesia's poverty rate fell to 8.07 percent in March 2026, with 22.93 million people classified as poor. Rural poverty remained higher than urban poverty, at 10.67 percent compared with 6.34 percent (BPS, 2026c).

That is meaningful progress.

But poverty reduction does not eliminate economic insecurity.

The distributional picture also remains complex.

The national Gini ratio was 0.368 in March 2026, lower than in March 2025 but higher than in September 2025. The expenditure share of the bottom 40 percent was 19.22 percent (BPS, 2026d).

The lesson is straightforward.

Indonesia can make progress on poverty while still facing challenges involving inequality, middle-class security, regional opportunity, and mobility.

Those are not contradictory findings.

They describe different dimensions of economic welfare.

20.8. What the Productivity Evidence Tells US

Productivity is the central dividing line between temporary improvement and durable transformation.

The World Bank's Indonesia Growth and Jobs work identifies market power, regulatory barriers, limited diffusion of know-how, skills gaps, and a concentration of workers in lower-value activities among the constraints on productivity and higher-quality job creation (World Bank, 2026a).

The IMF similarly identifies productivity growth, human capital, trade openness, infrastructure, governance, and the business environment as central structural-reform areas (IMF, 2026a).

This matters because productivity determines what an economy can afford.

Higher productivity supports:

Higher wages.

Higher profits.

Higher investment.

Higher tax revenue.

Higher public-service capacity.

Greater household saving.

Greater fiscal resilience.

The productivity problem is therefore not simply an efficiency problem.

It is a national-capacity problem.

20.9. What the Fiscal Evidence Tells US

Indonesia's fiscal position is neither unlimited nor inherently dysfunctional.

It is constrained.

That distinction matters.

The state must finance infrastructure, education, health, social protection, defense, food security, energy security, and other public priorities while preserving debt sustainability and investor confidence.

The fiscal question is therefore not:

CAN THE GOVERNMENT SPEND?

It clearly can.

The deeper question is:

WHAT DOES THE GOVERNMENT'S SPENDING CREATE?

Fiscal transformation requires three simultaneous improvements:

REVENUE CAPACITY.

SPENDING QUALITY.

FISCAL CREDIBILITY.

The IMF has emphasized stronger revenue mobilization, careful spending execution, protection of fiscal buffers, and limits on quasi-fiscal activities as important elements of Indonesia's fiscal framework. It has also emphasized governance and accountability around state-investment structures (IMF, 2026a).

Fiscal resilience is therefore not simply about keeping deficits low.

It is about creating sufficient fiscal capacity to respond to shocks without sacrificing future productive investment.

20.10. What the Financial Evidence Tells US

The financial system provides another important test.

As of September 2026, Bank Indonesia maintained the BI-Rate at 5.75 percent while continuing measures aimed at exchange-rate stability, inflation control, and financial-market deepening (Bank Indonesia, 2026a).

Official reserve assets stood at US$146.5 billion at the end of August 2026, equivalent to 5.4 months of imports or 5.3 months including government external-debt service, according to Bank Indonesia (Bank Indonesia, 2026b).

These buffers matter.

But buffers are not the same as immunity.

The purpose of reserves is not to prevent every currency movement.

The purpose of financial policy is not to eliminate every market correction.

The objective is to prevent temporary shocks from becoming systemic dysfunction.

That distinction is central to the book's resilience framework.

20.11. What the Industrial Evidence Tells US

Downstreaming is one of the clearest examples of the difference between policy activity and structural transformation.

A resource can be processed domestically.

But processing is only one stage.

The deeper industrial sequence is:

RESOURCE → PROCESSING → MANUFACTURING → SUPPLIERS → TECHNOLOGY → DESIGN → BRAND → GLOBAL MARKET.

If downstreaming creates only processing capacity, its transformation potential remains incomplete.

If it creates domestic suppliers, skills, technology, innovation, exports, and productivity, the structural effect becomes much larger.

The same principle applies to state capital.

The question is not how large the state portfolio becomes.

The question is what additional productive capacity it creates.

20.12. What the Regional Evidence Tells US

Indonesia is not one economy.

It is a portfolio of regional economies.

Java.

Sumatra.

Kalimantan.

Sulawesi.

Bali and Nusa Tenggara.

Maluku.

Papua.

Each region has different resource structures, human capital, connectivity, institutions, and market access.

A national growth rate can therefore conceal substantial regional variation.

The long-term transformation test requires broader convergence in opportunity.

Not identical economic structures.

Not identical income levels.

But increasingly comparable access to:

Education.

Health.

Connectivity.

Markets.

Finance.

Technology.

Employment.

Entrepreneurship.

Regional convergence is therefore part of national resilience.

20.13. What the External Evidence Tells US

Indonesia cannot choose its global environment.

Trade tensions can increase.

Commodity prices can change.

Capital can move.

Energy markets can become unstable.

Geopolitical uncertainty can rise.

Financial conditions can tighten.

But Indonesia can influence its exposure.

The strategic formula developed throughout this book is:

OPENNESS + DIVERSIFICATION + PRODUCTIVITY + INSTITUTIONAL FLEXIBILITY = EXTERNAL RESILIENCE.

The goal is not isolation.

It is optionality.

More markets.

More products.

More investment partners.

More domestic capability.

More financial depth.

More strategic buffers.

The stronger the options, the less one external shock can determine the national trajectory.

20.14. Collapse, Correction, Transformation

The three analytical categories can now be placed side by side.

COLLAPSE means persistent systemic dysfunction.

CORRECTION means substantial adjustment with institutional and productive capacity remaining operational.

TRANSFORMATION means that adjustment is converted into durable improvements in economic capacity.

The categories can also be understood dynamically.

An economy may move from stress into correction.

A correction can either deepen into crisis or become an opportunity for transformation.

A transformation can fail if institutional learning stops.

Resilience is therefore not a permanent state.

It is a continuing process.

The question is not which label should permanently describe Indonesia.

The question is which direction the system is moving.

20.15. The Most Important Distinction: Stocks and Flows

Economic analysis often confuses stocks and flows.

A stock is accumulated capacity.

A flow is current movement.

GDP growth is a flow.

Debt is a stock.

Tax revenue is a flow.

Fiscal capacity is partly a stock of institutional capability.

Investment is a flow.

Infrastructure is a stock.

Employment is a flow.

Human capital is an accumulated stock.

Foreign reserves are a stock.

Capital inflows are a flow.

This distinction matters because an economy can have strong stocks while experiencing weak flows.

It can also experience strong flows while allowing underlying stocks to deteriorate.

Transformation occurs when favorable flows continuously strengthen productive stocks.

20.16. The Real Measure of Resilience

Resilience is often misunderstood as the ability to avoid volatility.

That is too narrow.

A resilient economy can experience volatility.

It can experience a currency adjustment.

It can experience a recession in a major trading partner.

It can experience commodity-price shocks.

It can experience political transitions.

It can experience fiscal pressure.

What matters is whether the system can absorb the shock without losing its capacity to recover and improve.

The resilience sequence is:

ABSORB → ADAPT → RECOVER → LEARN → IMPROVE.

The final word is important.

IMPROVE.

A system that merely returns to its previous condition after every shock may be stable.

A system that learns from each shock becomes progressively more resilient.

20.17. The Role of Presidential Leadership

A presidency matters.

Political leadership can establish priorities.

It can accelerate reforms.

It can delay reforms.

It can change budget allocations.

It can influence institutional appointments.

It can reshape industrial policy.

It can affect investor expectations.

But a national economy is larger than one presidency.

Economic outcomes emerge from interactions among:

Government.

Parliament.

Local governments.

Bank Indonesia.

Financial regulators.

SOEs.

Private firms.

Banks.

Investors.

Workers.

Households.

Universities.

Civil society.

Global markets.

Institutions therefore matter because they convert temporary political priorities into durable or reversible economic outcomes.

The central question is not whether one president determines everything.

It is whether the institutional system can convert policy decisions into durable economic capacity.

20.18. The Role of Society and Markets

Economic transformation is not produced by government alone.

Firms decide whether to invest.

Workers decide whether to acquire skills.

Households decide whether to consume or save.

Investors decide where to allocate capital.

Universities decide what capabilities to develop.

Entrepreneurs create new businesses.

Communities determine how local institutions function.

Consumers influence which firms survive.

Markets therefore participate in national transformation.

The state creates conditions.

Society responds.

Markets allocate.

Institutions coordinate.

Households adapt.

Transformation emerges from the interaction.

20.19. The Evidence Does not Stand Still

One of the most important lessons of economic analysis is that conclusions must remain open to new evidence.

A country can move from one condition to another.

A reform can succeed.

A reform can fail.

An external shock can change the trajectory.

A technological breakthrough can create new opportunities.

A fiscal mistake can create new vulnerabilities.

A productivity reform can take years before its effects become visible.

This means the book's conclusion should not be treated as a permanent verdict.

It is an analytical position based on evidence available at a particular point in time.

The appropriate discipline is:

MEASURE.

COMPARE.

REASSESS.

UPDATE.

20.20. What Would Change the Conclusion?

The framework developed in this book is falsifiable.

Evidence would materially change the diagnosis if multiple indicators moved persistently in the same direction.

Toward systemic breakdown:

Sustained loss of fiscal access.

Persistent financial-system dysfunction.

Severe external-liquidity deterioration.

Persistent collapse in productive capacity.

Major and prolonged employment deterioration.

Breakdown of essential public-service delivery.

Loss of institutional capacity to respond.

Toward transformation:

Sustained productivity acceleration.

Higher real wages.

Stronger private investment.

Broader tax capacity.

Higher-quality employment.

Greater export diversification.

Improved regional convergence.

Stronger household balance sheets.

More effective institutions.

Better shock absorption.

The framework therefore does not depend on defending a predetermined conclusion.

It depends on observing the evidence.

20.21. The Prabowo-Era Test

The economic period under President Prabowo should ultimately be evaluated through mechanisms and outcomes.

Not only through announcements.

Not only through budgets.

Not only through investment commitments.

Not only through political narratives.

The relevant sequence is:

POLICY PRIORITY → INSTITUTIONAL DESIGN → IMPLEMENTATION → PRIVATE RESPONSE → PRODUCTIVITY → HOUSEHOLD OUTCOME → FISCAL RETURN → RESILIENCE.

This sequence creates an analytical discipline.

If a policy is announced but not implemented, the chain stops.

If it is implemented but does not change private behavior, the chain weakens.

If investment occurs but productivity does not rise, the transformation remains incomplete.

If productivity rises but household income does not improve, distribution becomes a problem.

If income rises but fiscal capacity does not improve, public-service capacity may remain constrained.

If all these mechanisms reinforce one another, structural transformation becomes possible.

20.22. The Question Beyond 2045

Indonesia's long-term ambition is often expressed through the year 2045.

But a date does not create development.

Institutions do.

Productivity does.

Human capital does.

Investment does.

Innovation does.

Trust does.

The year 2045 is therefore not the transformation.

It is a horizon.

The real transformation occurs through thousands of decisions made before that horizon.

A teacher improving learning.

A firm adopting technology.

A worker acquiring new skills.

A local government improving service delivery.

A bank financing a productive enterprise.

A ministry improving procurement.

A tax authority improving compliance.

An investor financing a new factory.

A university developing relevant research.

A household accumulating assets.

These decisions compound.

Economic transformation is ultimately a compounding process.

20.23. The Seven Questions That Should Remain

After the final page, seven questions should remain visible.

ONE:

Is productivity rising faster than before?

TWO:

Are real wages rising with productivity?

THREE:

Is fiscal capacity expanding without excessive economic distortion?

FOUR:

Are public and private investments producing measurable returns?

FIVE:

Are households becoming more capable of absorbing shocks?

SIX:

Are regions becoming more productive and connected?

SEVEN:

Are institutions becoming better at learning and correcting policy?

If these questions are measured consistently, economic policy becomes less dependent on rhetoric.

It becomes more dependent on evidence.

20.24. The Final Answer to the Original Question

So, is Indonesia collapsing?

The evidence examined in this book does not justify treating the word “collapse” as a simple description of Indonesia's economic condition.

There are significant vulnerabilities.

There are real structural challenges.

There are households under pressure.

There are fiscal constraints.

There are productivity weaknesses.

There are regional disparities.

There are external risks.

There are institutional challenges.

But there are also buffers.

There is continued economic activity.

There is domestic demand.

There is financial-system capacity.

There are external reserves.

There is poverty reduction.

There is substantial investment potential.

There is human capital.

There is entrepreneurial capacity.

There are policy instruments.

And, critically, there remains room for reform.

The evidence therefore leaves the analytical question open to direction rather than forcing a predetermined verdict.

Indonesia can experience correction without collapse.

It can experience stress without systemic breakdown.

And it can convert stress into transformation if reforms increase productive capacity, strengthen institutions, protect households, deepen markets, and improve policy learning.

The decisive variable is not the existence of risk.

It is the quality of the response.

20.25. The Final Message

The future of Indonesia will not be determined by one presidency.

Not by one budget.

Not by one exchange rate.

Not by one commodity.

Not by one investment project.

Not by one economic indicator.

It will be determined by the cumulative quality and consistency of decisions made across institutions, markets, firms, households, and society.

A resilient Indonesia is not an Indonesia without problems.

It is an Indonesia capable of solving problems without allowing them to become systemic.

A transformed Indonesia is not an Indonesia without shocks.

It is an Indonesia capable of turning shocks into institutional learning and productive improvement.

That is the difference between surviving history and shaping it.

20.26. The Last Equation

The entire book can now be reduced to one final framework:

RISK → EXPOSURE → VULNERABILITY → SHOCK → TRANSMISSION → POLICY RESPONSE → ADAPTATION → RECOVERY → LEARNING → RESILIENCE → PRODUCTIVITY → PROSPERITY → INCLUSION → NATIONAL CAPACITY.

The first half describes the challenge.

The second half describes the opportunity.

The difference between them is not fate.

It is institutions, decisions, incentives, capability, and learning.

20.27. Epilogue — the Next Wave

There will be another wave.

It may come from global trade.

It may come from financial markets.

It may come from energy.

It may come from food.

It may come from technology.

It may come from climate.

It may come from demographics.

It may come from a shock that cannot yet be identified.

The question is not whether Indonesia can predict every wave.

It cannot.

The question is whether Indonesia can build an economic system capable of facing uncertainty without surrendering its future.

That is the ultimate meaning of resilience.

The goal is not to eliminate the tsunami.

The goal is to build an economy in which the next wave does not determine the destination.

Indonesia's future will therefore remain unfinished.

That is not a weakness.

It is the condition of every developing economy.

The future will be created through choices.

Through investment.

Through productivity.

Through institutions.

Through education.

Through entrepreneurship.

Through accountability.

Through social trust.

Through policy learning.

Through the willingness to correct what does not work.

The question that opened this book can therefore remain open.

IS INDONESIA COLLAPSING?

The evidence requires neither complacency nor panic.

It requires measurement.

It requires vigilance.

It requires reform.

And above all, it requires the institutional capacity to learn.

Because the most important economic advantage of a nation is not that it never makes mistakes.

It is that it can recognize them, correct them, learn from them, and become stronger.

The economic tsunami is not the conclusion.

It is the test.

The future is what Indonesia builds after the wave.

FINAL STATEMENT

The future of Indonesia will not be determined by one presidency, one budget, or one economic indicator—but by the quality and consistency of decisions made across institutions, markets, and society.

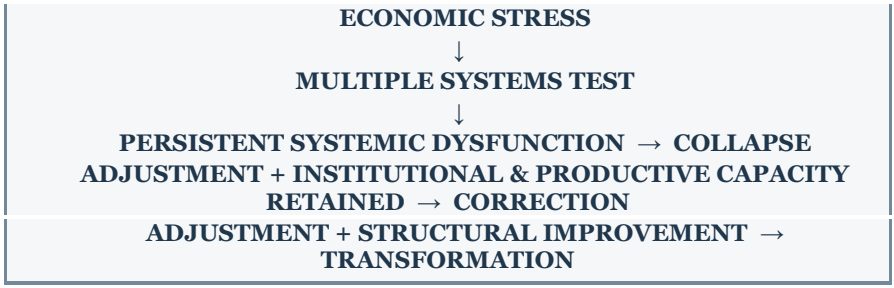
And that future remains measurable.

It remains contestable.

It remains changeable.

It remains open.

Figure 20.1 — COLLAPSE–CORRECTION–TRANSFORMATION DECISION FRAMEWORK



Analytical framework, not a political verdict.

APPENDICES

REFERENCE DATA, POLICY TIMELINE, METHODS & GLOSSARY

APPENDIX A

INDONESIA'S KEY ECONOMIC INDICATORS

Standardized reference tables use four fields wherever possible: Indicator, Reference period, Value, and Unit / note. This prevents mixing dates, units, targets, and outcomes.

A.1 Core Economic Dashboard

Indicator	Reference period	Value	Unit / note
Real GDP growth	2024	5.03	Percent, year-on-year
Real GDP growth	2025	5.11	Percent, year-on-year
GDP at current prices	2025	23,821.1	Rp trillion
GDP per capita	2025	83.7	Rp million
GDP per capita	2025	5,083.4	US$
Export growth	2025	7.03	Percent, year-on-year
GFCF growth	Q4 2025	6.12	Percent, year-on-year
Java GDP contribution	2025	56.93	Percent of national GDP

Source: BPS-Statistics Indonesia (2026a–2026b).

A.2 Prices, Monetary Conditions & External Buffer

Indicator	Reference period	Value	Unit / note
BI-Rate	23 Sep 2026	5.75	Percent
Deposit Facility	23 Sep 2026	4.75	Percent
Lending Facility	23 Sep 2026	6.50	Percent
Official reserves	End-Aug 2026	146.5	US$ billion
Reserve adequacy	End-Aug 2026	5.4	Months of imports
Reserve adequacy incl. govt. debt service	End-Aug 2026	5.3	Months of imports

Indicator	Reference period	Value	Unit / note
Rupiah	22 Sep 2026	17,855	Rp per US$
Rupiah change	22 Sep vs end-Aug 2026	−0.78	Percent, point-to-point

Source: Bank Indonesia (2026a; 2026b).

A.3 Poverty & Distribution

Indicator	Reference period	Value	Unit / note
Poverty rate	Mar 2026	8.07	Percent
Poor population	Mar 2026	22.93	Million persons
Urban poverty rate	Mar 2026	6.34	Percent
Rural poverty rate	Mar 2026	10.67	Percent
National poverty line	Mar 2026	669,235	Rp/person/month
Food component	Mar 2026	74.70	Percent of poverty line
Non-food component	Mar 2026	25.30	Percent of poverty line
Gini ratio	Mar 2026	0.368	Index
Bottom 40% expenditure share	Mar 2026	19.22	Percent

Source: BPS (2026c; 2026d).

APPENDIX B

FISCAL & DEBT INDICATORS

B.1 APBN 2025 — Original Budget

Fiscal item	Reference period	Value	Unit / status
State revenue	2025 budget	3,005.1	Rp trillion
State expenditure	2025 budget	3,621.3	Rp trillion
Budget deficit	2025 budget	616.2	Rp trillion
Budget deficit ratio	2025 budget	2.53	Percent of GDP
Central-government expenditure	2025 budget	2,701.4	Rp trillion
Transfers to regions	2025 budget	919.9	Rp trillion
Tax and customs revenue target	2025 budget	2,490.9	Rp trillion, approx.

Source: Ministry of Finance, APBN 2025.

B.2 APBN 2025 — Realization

Fiscal item	Reference period	Value	Unit / status
State revenue	2025 realization	2,756.3	Rp trillion, approx.
State expenditure	2025 realization	3,451.4	Rp trillion, approx.
Budget deficit	2025 realization	695.1	Rp trillion, approx.
Budget deficit ratio	2025 realization	2.92	Percent of GDP, approx.
Tax revenue	2025 realization	1,917.6	Rp trillion, approx.
Customs and excise	2025 realization	300.3	Rp trillion, approx.
Non-tax state revenue	2025 realization	534.1	Rp trillion, approx.
Transfers to regions	2025 realization	849.0	Rp trillion, approx.

Source: Ministry of Finance (2026).

B.3 Historical Fiscal Deficit

Fiscal year	Deficit / GDP	Unit
2020	6.14	Percent
2021	4.57	Percent
2022	2.35	Percent
2023	1.61	Percent
2024	2.30	Percent
2025	2.92	Percent

B.4 Debt & Fiscal Sustainability

Indicator	Reference period	Value	Unit / status
General-government debt	2024	40.2	Percent of GDP; IMF estimate
General-government debt	2025	≈41.0	Percent of GDP; IMF estimate
General-government debt	2026	≈41.3	Percent of GDP; IMF projection
Primary balance	2026	−0.6	Percent of GDP; IMF projection
Statutory annual deficit limit	Ongoing	3.0	Percent of GDP
Statutory debt ceiling	Ongoing	60.0	Percent of GDP

Source: IMF (2026a) and Indonesian fiscal framework.

APPENDIX C

SELECTED POLICY TIMELINE

Date / period	Event	Analytical significance
20 Oct 2024	Prabowo Subianto inaugurated as President	Beginning of the new presidential policy period
2024	GDP growth 5.03%; deficit 2.30% GDP	Baseline entering new administration
Jan 2025	APBN 2025 entered implementation	Initial fiscal framework
2025	GDP growth 5.11%	Growth remained near five-percent range
2025	Downstreaming, food and energy security, strategic investment and state-capital agenda	Core Part IV policy themes
2025	Danantara state-capital architecture developed	State-investment governance dimension
2025	Fiscal deficit ≈2.92% GDP	Fiscal execution reference
2026	BI-Rate 5.75% in September	Monetary/exchange-rate framework
End-Aug 2026	Official reserves US$146.5B	External liquidity buffer
Mar 2026	Poverty 8.07%; Gini 0.368	Distributional reference
2026	World Bank productivity and jobs agenda	Structural-transformation emphasis

Sources: BPS; Bank Indonesia; Ministry of Finance; IMF; World Bank. Timeline is selective, not exhaustive.

APPENDIX D

METHODOLOGICAL NOTES

D.1 Source Hierarchy

Priority	Source category	Primary use
1	Official Indonesian statistics / administrative sources	Empirical baseline
2	Bank Indonesia	Monetary, financial, external-sector evidence
3	Ministry of Finance / government institutions	Fiscal and policy evidence
4	BPS-Statistics Indonesia	Growth, poverty, inequality, labor, HDI
5	IMF	Macroeconomic and fiscal assessment
6	World Bank	Development, productivity, poverty, structural analysis
7	Other multilaterals	Comparative/thematic evidence
8	Peer-reviewed research	Theory and empirical literature
9	Credible market / industry sources	Specialized evidence
10	Secondary commentary	Context, with attribution

D.2 Core Analytical Distinctions

Distinction	Rule used in the book
Target vs outcome	A target is not evidence that it has been achieved.
Forecast vs fact	Forecasts are identified as projections.
Scenario vs prediction	Stress scenarios describe mechanisms, not predicted events.

Distinction	Rule used in the book
Nominal vs real	Nominal values are not treated as purchasing-power measures without price adjustment.
Percentage vs percentage point	Rate changes use percentage points where appropriate.
Stock vs flow	Debt/reserves/assets are distinguished from annual flows.
Association vs causation	Causal claims are limited where identification is not established.
National average vs regional outcome	National indicators are not assumed to represent every region.

D.3 Stress-Test Framework

Stage	Core question
Shock	What disturbance occurs?
Transmission	Through which channel does it enter?
Amplification	What makes the shock larger?
Distributional impact	Who is affected?
Policy response	Which institutions can respond?
Adaptation	How do firms, households and institutions adjust?
Recovery	Does activity return toward capacity?
Learning	Does the system improve afterward?

D.4 Limitations

Some 2026 indicators are preliminary or subject to revision. Different institutions may use different definitions. Forecasts can change. Policy effects may occur with substantial lags. National averages can conceal regional variation. Macro resilience does not automatically imply household resilience. Institutional quality is also difficult to summarize in a single quantitative indicator.

APPENDIX E

GLOSSARY OF ECONOMIC TERMS

Term	Definition
Aggregate Demand	Total planned spending on goods and services in an economy.
Aggregate Supply	The economy's capacity to produce goods and services at different price levels.
Balance of Payments	A statistical record of transactions between residents and the rest of the world.
Capital Adequacy	Capital held by a financial institution relative to its risk exposure.
Capital Flows	Cross-border movement of financial capital.
Current Account	Balance of trade in goods and services plus primary and secondary income flows.
Debt-to-GDP Ratio	Government or public debt expressed as a percentage of GDP.
Deficit	A situation in which expenditure exceeds revenue during a specified period.
Downstreaming	Processing natural resources toward higher domestic value-added activities.
Economic Resilience	Capacity to absorb shocks, adapt, recover, and continue improving.
Fiscal Capacity	State capacity to raise and deploy public resources sustainably.
Fiscal Deficit	Excess of government expenditure over revenue during a fiscal period.
Fiscal Space	Room to conduct fiscal policy without undermining fiscal sustainability.
Foreign Direct Investment	Cross-border investment involving a lasting interest and significant influence.
Foreign Exchange Reserves	Foreign-currency assets held by a central bank or monetary authority.
GDP	Market value of final goods and services produced within an economy during a specified period.

Term	Definition
GDP per Capita	GDP divided by population.
Gini Coefficient	Statistical measure of income or expenditure inequality, generally ranging from 0 to 1.
Gross Financing Needs	Financing required to cover fiscal deficits and maturing debt.
Human Capital	Knowledge, skills, health, and capabilities contributing to productivity.
Inflation	Sustained increase in the general price level.
Interest Burden	Government interest payments relative to a relevant fiscal base.
Investment	Expenditure that adds to productive capacity.
Middle Class	Socioeconomic group defined differently across frameworks; this book emphasizes security, income, consumption, assets, and mobility.
Nominal GDP	GDP measured at current prices.
Primary Balance	Fiscal balance excluding interest payments.
Productivity	Output generated per unit of input.
Purchasing Power	Quantity of goods and services that income can purchase at prevailing prices.
Real GDP	GDP adjusted for price changes to measure production volume.
Real Wage	Wage income adjusted for changes in the price level.
Risk Premium	Additional expected return demanded to compensate for perceived risk.
Soft Budget Constraint	Expectation of financial support when an organization lacks sufficient own resources.
Structural Transformation	Sustained shift of resources toward higher-productivity activities, firms, sectors, and regions.
Tax-to-GDP Ratio	Tax revenue expressed as a percentage of GDP.

Term	Definition
Technical Efficiency	Ability to produce maximum feasible output from a given set of inputs.
Total Factor Productivity	Output growth not directly explained by measured growth in conventional inputs.
Trade Diversification	Expansion of products, destinations, services, and value chains to reduce concentration risk.
Value Added	Additional economic value created by production, measured as output minus intermediate inputs.
Vulnerability	Degree to which an economy or agent is exposed and susceptible to harm from a shock.
Yield	Return generated by a financial asset, commonly expressed as a percentage of price or principal.

APPENDIX REFERENCE NOTE

The appendices are a companion to the analytical chapters. The indicators establish the empirical baseline; fiscal tables establish the resource constraint; the timeline establishes policy sequence; methodological notes establish analytical discipline; and the glossary establishes common terminology.

FACTS → DATA → ANALYSIS → POLICY → IMPLEMENTATION → RESILIENCE.

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REFERENCES

REFERENCE STANDARD

This reference list preserves the book's evidence hierarchy while tightening bibliographic precision. Official Indonesian sources are prioritized for domestic facts; multilateral institutions are used for international comparability and external assessment; peer-reviewed and foundational literature supports theory and analytical mechanisms.

- Primary domestic evidence: Government of Indonesia, Ministry of Finance, Bank Indonesia, BPS-Statistics Indonesia, OJK, and Bappenas.
- International evidence: World Bank, IMF, Asian Development Bank, OECD, United Nations agencies, IEA, WTO, and ASEAN.
- Academic evidence: peer-reviewed journals and established books/methodological references.
- Projection discipline: forecasts and staff projections are retained as projections, not converted into realized outcomes.
- Reference integrity: titles and publication metadata are standardized; uncertain or generic placeholders from the earlier draft have been removed.

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Y. REFERENCE INTEGRITY & CROSS-AUDIT STANDARD

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- Duplicate editions or generic placeholders should not be retained merely to increase bibliography length.

• Where a source is updated periodically, the reference should identify the relevant edition or reporting period.

Evidence hierarchy

GOVERNMENT DATA → CENTRAL BANK DATA → FINANCIAL-SYSTEM DATA → MULTILATERAL EVIDENCE → PEER-REVIEWED LITERATURE → SECONDARY CONTEXT

Reference use principle

REFERENCES ARE PART OF THE EVIDENCE. THE EVIDENCE IS PART OF THE ARGUMENT. THE ARGUMENT MUST REMAIN TRACEABLE.