Indonesia - Economic Growth Post-New Order

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ABSTRACT
The relatively short history of the modern Republic of Indonesia has been a history of conflict, revolution, and search for national identity. Economic conditions have been at times disastrous, at others booming, but almost always uncertain. This article seeks to conduct economic analysis regarding conditions that may prove ideal for future economic growth in the country – placed within the context of its past economic history and contemporary economic conditions. The article presents that within the short and medium terms, three main variables determine the state of growth in the economy – foreign direct investment, domestic consumption, and export industry. Within the long term, a strong and ever rising consumer demand needs to be met with greater credit and debit card penetration, as well as the consolidation of e-Payment platforms so as to facilitate the use of more convenient forms of payment, providing greater transaction convenience for both consumers and the rising native and private businesses within the country.

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ECONOMIC HISTORY
In discussing Indonesian economic history, one must address the monumental influence the Dutch East India Company, or VOC, held over the Archipelago from the 17th century onwards. After having conquered the already-settled Portuguese, establishing a capital in Jacatra (later to be known Jakarta), and monopolizing the Malukan spice trade, the company paid out an annual 18% dividend for 200 years.1 In the 17th century alone, almost a million Europeans were sent to work on the trade, netting 2.5 million tons of Asian goods.2 Upon the nationalization of the company in the 19th century, the onionset of the Java war, the Padri war, and the loss of Belgium threatened both the financial health of the company and the Netherlands as a nation. By the 1830s, the newly appointed Governor-General Johannes van den Bosch implemented the cultuurstelsel, or cultivation system – fixed amounts of cash crops such as sugar and coffee were to be given up by Indonesian farmers as a form of tax in order to save the Netherlands from bankruptcy.3 Famines and epidemics were widespread by the 1840s – at this point, the archipelago had largely turned into a Dutch cash-crop plantation.
Following critical public opinion and a resulting ‘Liberal Period’ in the Dutch political climate, private capital flowed into Indonesia’s tin mining, oil extraction, and plantation estate agriculture industries to diversify production and hence reduce the excesses of the cultuurstelsel system – though the decreased land for rice production and growing population caused yet further hardships. Seeing as economic growth in the 19th century was highly linked to global demand of tea, coffee, and cinchona, the Dutch East Indies made enormous profits – incentivizing them into laying the groundwork for Indonesia’s industrial infrastructure, including roads, a railroad network, and telegraph lines. But following the global recession of the late 19th century, the commodity prices upon which the colonies depended collapsed, and tens of thousands suffered famine. The global economy recovered, however – as prices once again rose in the late 1890s, rubber, tobacco, tea, coffee, and other commodities upon which the company prior to the recession thrived upon once again became highly profitable exports, prompting further infrastructure development at the turn of the 20th century. Particular prioritization was given to the building of ports, roads, and bridges. These projects would lay the foundations for the post-

1 (Miller, George (ed.), 1996)  
2 (Ricklefs, M.C., 1991)  
3 (Van Boven, M. W, 2002)  
4 (Ricklefs, M.C., 1991)
colonial infrastructure of the Indonesian Republic.\(^5\)

World War 2 brought a halt to the trade empire – when the Japanese invaded Indonesia, all resources were directed by them as they subsequently took control. While the populace was liberated from the control of the Dutch, the Japanese’s imposition of martial law caused shortages in basic goods such as food and clothing; starvation was once again a fact of life in many parts of the Archipelago. As the war drew to a close, the Japanese left to recover from the Atomic bombs dropped on Hiroshima and Nagasaki, an announcement to a small gathering of Indonesian nationalists on the 17\(^{th}\) of August 1945 by Sukarno and Mohammad Hatta (the Republic’s first President and Vice-President, respectively) declared Indonesia’s independence as a sovereign nation.\(^6\)

Post-war Indonesia is a study in the chaos of a national revolution. The combined pressures of Japanese occupation and a short-lived attempt by the Netherlands to re-establish authority on the Archipelago, the crippling of the post-war manufacturing and export sectors, the devaluation of the still-in-circulation Dutch banknotes into half their value, and the ease with which the counterfeiting of the newly printed national currency ORI (Money of the Republic of Indonesia) could be conducted, ensured that the national economy remained highly volatile. The nation’s troubles came to a head in the 1960s – the culmination of these factors under a newly made government ill-equipped to deal with these ills saw the nation face rampant hyperinflation at an annual 1,000% by Sukarno’s downfall midway through the 1960s; resulting rates of severe hunger and poverty followed. His eventual coup by Suharto, however, saw an era of unprecedented growth for the next thirty years.

The fate of the Indonesian economy during the first few years of Suharto’s New Order seemed intricately tied to a small group of ‘Chicago school’ educated Indonesian economists, now known as the Berkeley Mafia. Economic issues were by them troubleshooted as follows – as a result of inefficient and expensive government spending (Sukarno’s building of costly monuments being a prime example) and the running of an enormous budget deficit, the financing of this deficit through foreign borrowing and domestic money printing, and the nation’s decidedly nationalistic closed-economy policies that ensured its extra-national good and capital flows remained closed, inflation remained at four-digit numbers. As proponents of the Chicago school of free-marketism, they implemented austerity policies aimed to cure the fiscal imbalance while balancing the costs of such a policy with economic growth resulting from inflowing FDI, as well as the thriving export climate due to the floating of the Indonesian rupiah which, due to inflation, was very weak and hence made exports very competitive. Foreign aid was instrumental – significant debt restructuring and aid programmes that primarily addressed private sector inputs and food aid greatly assisted the economic recovery process. Special attention was paid to developing the agricultural sector and basic needs infrastructure, curing a great deal of the famine and restoring public confidence. By the 1970s, Indonesia was in place to receive the full benefits of the quadrupling of oil prices as per the decade’s oil boom.\(^7\) Nominal GDP during this period grew at an unprecedented rate of 7% per annum on average until the subsequent decline in oil prices in 1981; at that point, nominal GDP growth slowed to an average rate of 4.5% per annum. Three major factors allowed the economy to recover to growth rates of over 7% from 1989 to 1997 - the unusually prudent macroeconomic policy response of the government by further opening financial markets to counter capital withdrawals, the depreciation of the rupiah to increase export competitiveness, and the proactive allocation of the returns from the windfall to Suharto’s broad development programme ensuring the growth continued beyond returns from oil.\(^8\) The situation would be turned on its head, however, by the Asian financial crisis of mid-1997.

The policy response to the Asian financial crisis was similar to those used in previous Indonesian responses to economic shocks – the free floating of the exchange rate and fiscal tightening – this time with the addition of an increase in interest rates. These were all designed to reduce the budget deficit, at even greater risk now of worsening due to the real value of debt increasing as the Indonesian currency continued to depreciate. Free floating the exchange rate aimed to reduce pressure on government current accounts, austerity measures were planned to reduce pressure on the government budget, and

\(^5\) (Witton, Patrick, 2003)
\(^6\) (Hannigan, T., 2016)
\(^7\) (Rodrik, D., 2012)
\(^8\) (Woo, W., Glassburner, B. and Nasution, A., 1994)
increases in interest rates were aimed to keep capital within Indonesia, preventing their flight from further depreciating the currency. The rupiah continued to depreciate, however – by November 1997, public debt reached $60bn; by 1998, real GDP contracted by 13.1% as inflation reached heights of 72%. By this point Suharto had been already been forced into resignation, leaving office in May. By 1999, various agreements between the new democratic government and the IMF focused on economic and structural reform stabilized the economy, bringing inflation down to 2% by 1999.9

This brings us to the post-New Order political and economic environment, marked by a democratic election process and ‘big bang’ decentralization that allocated over a third of government spending to sub-national governments. While macroeconomic stability was once again threatened by 2005 oil price hikes, sound government responses ensured Indonesia’s hard-won macroeconomic stability remained in place – though high-short term rates of inflation prevailed throughout 2005 at 17%. The government’s decision to slash oil subsidies to prevent a worsening of the government budget allowed a fiscal space of the highest magnitude since the 70s oil windfall – freeing up resources for following development projects. By 2006, economic conditions were once again stable and positive – despite two crises occurring between 2000 and 2016, the Indonesian economy has retained a growth rate of on average 5% per annum, never having once dipped below 3.643%. As of 2016, annual growth rate was at 5.016% - the prolonged growth period likely being due to the stability of an economic climate marked by low and stable levels of inflation (2.45% as of 2016), prudent management of the budget deficit, recent reforms in strengthening supervision and capital requirements for private banks, high domestic demand (2/3 of GDP as of 2009), and the use of government returns for development projects such as infrastructure.10

**ECONOMIC GROWTH - SHORT, MID, AND LONG TERM**

This section of the article will seek to provide predictive analysis regarding the ideal conditions for economic growth within the short, mid, and long term.

In the short term, there is something to be said for path-dependency – sources of growth within recent years, namely, FDI, prudent fiscal management, cautious monetary policy marked by inflation targeting, strong domestic demand, and strong export demand as per the value of the rupiah, will continue to be prevalent in ensuring future short-term economic growth.

Private investment data indicates an average growth rate of 4-5% from 2013 to 2016, with a peak of 9.1% in 201211. Annual consumption data indicates steady levels of growth of average >5% per annum from 2012 to 2016; with Joko Widowo’s recent infrastructural project initiatives this is likely to continue well within the short-term – that will be discussed in more detail later in the article. Indonesia’s inflation has fluctuated in the 2011 to 2016 period from the 3% to 8% range, with 2016 rates of inflation being the lowest since 2009’s 2.78%, at 3.02% - down from the previous year’s 3.35%. As it is, inflation remains low and stable.13 Indonesia’s exports make up roughly a quarter of its GDP, hovering around 20% since 2012.14 Its largest exports are minerals and raw materials, making up 20% of its total export revenues – hence the responsiveness of export returns to oil prices. During the last five years export revenues have decreased by 3.086% per annum, from 224bil in 2011 to 140bil $ in 2016 – exports making a not insignificant portion of Indonesia’s GDP, this may call into question if not future positive economic growth, then the role of export goods as opposed to the other variables listed in supporting that growth. The Indonesian exchange rate has been depreciating from 2012 – 2016, from 9,638 per dollar to 13,473 per dollar. This presents a balancing act between incentivizing capital inflows and promoting export competitiveness for the Indonesian Central Bank– though recent central bank intervention has been recently made to stem a further downward tide, seeming to favor the former act. The fiscal deficit has remained at an average of around 2% of GDP per annum between 2012 – 2016, but has since widened as tax revenues remain weak (27 of 255 million people are registered taxpayers, while less than 1 million paid income taxes in 2014). This is proving a major concern with Jokowi’s ambitious fiscal stimulus plan to stimulate the economy partly through government spending on

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9 (Tambunan, T., 2010)  
10 (Woo, W., Glassburner, B. and Nasution, A., 1994)  
11 (Focus Economics)  
12 (Focus Economics)  
13 (Inflation.eu)  
14 (theGlobalEconomy.com)
infrastructure – though a recent tax amnesty bill providing a nine-month window for citizens to declare previously unreported assets and pay a low tax rate should prompt tax revenues to increase to shorten the budget gap.\textsuperscript{15} 16 As such, the largest threats to growth rate in the short term are the potentially lackluster states of the government budget, decreasing export revenue growth, and the performance of the rupiah, especially as FDI plays a stronger role in the economy – beyond these three, FDI, prudent monetary policy, low and stable rates of inflation, and strong domestic demand should ensure growth remains stable within the next few years.

Within the mid-term, continued economic growth will depend largely upon the stable performance of the rupiah (namely, that it does not face any significant and sudden depreciation), the extent of proposed infrastructure projects (given that they are a significant source of current and future jobs and inflowing FDI), as well as the strength of domestic demand as incomes rise (and the ability for the productive sectors to meet that demand, which is an important goal of the infrastructure projects).

Indonesian president Joko ‘Jokowi’ Widodo and finance minister Sri Mulyani remain firm on infrastructure development through 2019 – approving a 4,700 trillion-rupiah ($353 billion) budget. Indonesia Financial Services Authority Nurhaida says the funds necessary for 2017 alone amounted to 1 trillion rupiah, though the government was only ready to provide for 37% of the cost – 30% being provided by the financial sector, and the rest by state owned enterprises and local governments. In recent times there have been enormous disparities between developmental infrastructure in Central Indonesia and its outskirts, including regions such as Kalimantan, Sulawesi, and Nusa Tengarar – 52% of villages, as many as a total 39,000 in Indonesia (many of them in the East) have no or little access to landline telephones or electricity; Jokowi has claimed to make the East his priority for infrastructure development. Suffice to say, it is doubtful that the need for FDI in the mid-term is lacking.\textsuperscript{17} GDP continues to grow at an average of 5% per annum – income in particular has been rising exponentially since the turn of the 21st century; in 2000 it was 9.42 million rupiah per annum – by 2016 it was 61.11m rupiah per annum (GNI per capita, adjusted for inflation), with no negative growth experienced.\textsuperscript{18} Income equality remains an issue, however, having reached its peak in 2001 (15.5% of GNI being held by top 1% of population) – it has since decreased significantly, fluctuating between a GINI coefficient of 0.35 and 0.41, 2016 presenting a coefficient of 0.39, down from 2015’s 0.40.\textsuperscript{19} As domestic demand remains a significant component of economic growth in Indonesia, recent growth trends in income favor a positive outlook on demand growth in the medium term – should the trend continue.

Long-term economic predictive analysis, even based on historical trends, in this case poses great difficulty, given the violently (often literally) volatile nature of the Archipelago’s past. This article will seek only to lay out some general variables the author believes will largely be responsible for its condition.

Given the significant government spending and financial market investment on infrastructure projects, there is great pressure for the existence of a large government multiplier, or otherwise large subsequent returns upon and due to the completion of these projects, to avoid fiscal deficit and hence ensure the health of a significant variable in macroeconomic stability. As FDI, a major source of GDP growth in Indonesia, reduces with the completion of the larger infrastructure projects, growth will likely rely more and more on the private investment climate, particularly the ease with which foreign entities may invest and conduct business in the nation, and domestic industry consumption and output, especially given the then higher incomes and greater connectivity and development of untapped parts of Indonesia on its outskirts and in the East. In addition, Indonesia’s continued growth in the long term will depend a great deal on its ability to provide a climate in which innovative industries may develop. The point is not so much that the government need spend on an entirely new development project following its investment in infrastructure, but that in order for Indonesia to take its first steps in carving out its own dynamic competitive advantage, it must be in a position to allow its businesses access to the resources conducive to such innovation.

Basic revenue, for example, from electronic transactions may form a large part of this financial capital. Recent times seem to indicate a strong rise

\textsuperscript{15} (Trading Economics)
\textsuperscript{16} (Focus Economics)
\textsuperscript{17} (The Diplomat)
\textsuperscript{18} (World Wealth & Income Database)
\textsuperscript{19} (Indonesia-Investments, 2016)
is businesses relying on various forms of electronic-based payment platforms and services - three firms in particular are of note: Go-jeek, a transport system akin to Uber 20; Tokopedia, one of Indonesia's largest e-commerce platforms 21; and Traveloka, a plane ticket and hotel reservation service that allows the comparing of service prices 22. All are 'Unicorns' - start-up companies having received large-scale funding from venture-capital firms and thus valued at over $1 billion - and all make use of some form of e-payment scheme. However, only 36% of Indonesians hold a bank account, only 10% make use of non-cash payment schemes, and around 96% of the population do not possess credit cards. In addition, the existences of multiple switching services with little interconnectivity between them and different banks' cards makes it even more difficult for those few who do possess them to make use of them. Not to mention, as different services often provide different e-wallet and e-payment platforms, there is a great deal of inconvenience for the consumer in wishing to make use of multiple services.23

There are signs in recent times of these barriers being worn away - Himbara, the country's group of state owned banks, has announced plans for the consolidation of their ATM services - BI, the country's central bank, has formed a Memorandum of Understanding with several private banks and payments infrastructure services to form a National Payment Gateway, akin to China's Union Pay and UK's LINK, that should further drive up electronic transactions - and recent trends in transaction values show that from September 2015 to August 2016, ATM/Debit purchases have risen by 32.5%, e-money by 30.7%, and ATM/Debit bank transfers by 25.1%, providing a glimpse at the shift from almost entirely cash based consumption to other means of payment. KPMG projects a Compounded Annual Growth Rate of 29% in the e-commerce sector within the same period, projections of economic growth from $7.8 billion to $78.8 billion should allow local e-payment platforms to 'ride the wave' in a similar manner to the US and China-based services that have benefited from their own nations' economic growth. Namely, Indonesia features Hellopay from the Lazarda group, another large e-commerce platform, and Go-pay from Go-Jek.24 A climate of innovation, in no small part stimulated by the convenience with which start-ups receive revenue from consumers and the convenience with which consumers may make purchases, must prevail in order to incite the discovery and subsequent growth of Indonesia's competitive industry(s) in the long run - and so far, policies aiming to further the ease with which electronic transactions may be made seem to be heading in this direction.

CONCLUSION

This article has provided an overview of Indonesia’s economic history, from Dutch occupation to post-New Order regime, as well as its recent economic developments, in an attempt to discover the conditions through which Indonesia may be set on a path of continued economic growth within different time frames. The author has presented that within the short and medium terms, three main variables determine the state of growth in the economy – foreign direct investment, domestic consumption and production, and export industry. So long as reserves remain strong, large amounts of infrastructure development are required, inflation remains low and stable as per prudent monetary policy, the government deficit remains on its low and stable path, and the rupiah does not fluctuate dramatically, Indonesia will likely remain path dependent, and hence its economic growth will remain stable. The long term, however, is a different story entirely – continued economic growth will rely on the extent of the government multiplier after the infrastructure projects have been completed – determining both the productive climate post-development and the existence and/or extent of the government deficit and hard-won macroeconomic stability. If large untapped regions of Indonesia, especially the East, benefit from connective infrastructure, it is likely that domestic consumption and production will be an even more significant variable in economic growth. This article has presented the specific facet of this argument in relation to e-commerce - that for both consumers and firms, it is in their best interests for firms to simplify e-wallet and e-payment schemes and for the government to take actions towards increasing credit and debit penetration in the market. This article does not claim to provide all relevant variables to future

20 (The Jakarta Post, 2018)
21 (Eyerys, 2017)
22 (Antara News, 2017)
23 (Forbes, 2017)
24 (KPMG, 2017)
Indonesian economic growth, but it is hoped that some of the more important have been addressed in the context of the nation’s historical, present, and predicted economic conditions.

REFERENCES


