

**ACHIEVING SUSTAINED ECONOMIC GROWTH IN INDONESIA:
A Medium-Term View**

by
Ginandjar Kartasasmita
State Minister for National Development Planning/Chairman of Bappenas

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Ladies and Gentlemen:

There is a long history of cooperation between Indonesian institutions and foreign partners in economic policy research. Over the years this cooperation has contributed a great deal to policy development. What gives me special pleasure though, is the increasing numbers and quality of the Indonesian contributions. The conference agenda highlights these growing numbers of young Indonesian economists and the increasing sophistication of their contribution. The organizers of this meeting are to be congratulated on their efforts in putting together such an outstanding package and I trust that the results will deepen our understanding of the core issues facing Indonesia, both the current difficulties, and the longer run challenges.

I was asked to direct my remarks today to the prospects and challenges facing Indonesia over the medium and longer run and share with you our vision of the Indonesia of the future.

I would like to be candid when I say that I don't feel very comfortable in depicting our medium and long term prospects, while we are so disturbed, even distressed by the present economic condition. However, the history, of the past few decades, is not free of economic difficulties, even crises, either. There were times when our economy seemed to be on the brink of collapse, for example, when the price of oil fell from \$25 to \$10 a barrel. The Pertamina crisis was a calamity that could have bankrupted the economy. There was a time that the national stock of rice was so short that not only the purchase, but also the transportation of imports were at risk and with them economic stability.

However, the current crisis in Indonesia differs from those we have faced in the past. Shocks in the past were more or less problem of government adjustment. Recently the position of the government has strengthened and surpluses in recent years have allowed us to reduce the government's foreign exposure. In this crisis, while the rising costs of loans directly affects the government budget and is creating difficulty, the more serious problem is in corporate finance. With the increased size of private sector and role of market forces (domestic and international) we are encountering challenges that we have never experienced before.

The origins of the current crisis, its magnitude, and the path to recovery are not clear and, at least in the short run, not entirely under our control. Events elsewhere in Asia, and beyond are directly affecting economic outcomes here.

The balance of payments crisis is not the only crisis facing Indonesia. There are serious problems in rural areas due from the effects of “El Nino”. Agricultural growth is at or close to zero nationwide, and many areas are experiencing significant downturns. While the rains have begun, agricultural growth is likely to remain weak. Thus, just when we need it, a strong agriculture sector cannot provide the stimulus to overall economic growth we need.

This twin crisis has made our present economic crisis the most severe in the last 30 years. This is the situation as we enter *Repelita VII*, which is what we mean by mid-term in our

projections. I understand that you have already had a session on the Macroeconomic Environment and Management. I will leave the technical details to those who have the time and expertise to broaden our understanding.

There is an axiom in Indonesia, and I suspect elsewhere, that bad times make good policies. While we do not want to be complacent during good times, it is easy to understand that making difficult choices is easy to postpone, until the bad times arrive, and with them the urgency to change. However, good policies only result if we spend the effort to develop the analysis and planning we will need later. Today, we are unfortunately in the reverse position. While we have to deal with the current problems in Indonesia, we must not let our sense of urgency prevent us from addressing longer run issues.

These are, after-all, the prime mandate of the planning ministry. The issues are enormous, and complex. We have to reduce poverty, improve the delivery of schooling and health, increase the role of regional governments in service delivery, and determine infrastructure requirements and placement. And the decisions we make ultimately determine the environment and landscape that the next generation will inherit.

Development is a cooperative exercise. Making the correct decision with regard to the government's budget is not sufficient, to achieve national objectives. In the absence of effective incentives, private behaviour does not reinforce development efforts and the rate of "sustainable" development is reduced as resources are misdirected. Development paradigms, technology, and social and political awareness continuously evolve and decisions on where and how to intervene to achieve our objectives have to change with them.

The first priority should, of course be coping with the present problem to create the conditions for recovery with renewed strength. Confidence has been lost and the shock to the economy is very great. We face real difficulties over the next year or two and there will be pressure to find easy and self-serving solutions. Typically, these promise much but deliver nothing. The main objective of the recovery program should be to restore the confidence in our economy, which is reflected in the confidence in our currency and stock market.

The key to a successful recovery is staying the course of the reforms already in place, and continuing with further reform measures. However, if people do not perceive that the burden is being shared broadly, they will look for the easy solutions I suggested earlier.

There are two ways to make sure that the burden of adjustment is being shared equitably. First, we must press ahead with policy reforms that level the playing field, are transparent, and are applied fairly and justly. Second, we have to make sure that, we put in place "safety-net" policies designed to reduce the burden on those most in need during the crisis. With these two elements, I believe that there will be a shared sense of sacrifice in the face of the difficulties ahead.

With this we can continue with our development effort to prepare us to enter the next century. The present problems notwithstanding, we still have a solid base for rapid and sustainable growth. We have a large market, able workers, and ample national resources. We have also succeeded in putting much of the basic economic infrastructure in place including the outer regions who will contribute more to our overall growth in the future. Despite the present crisis our management of the economy remains sound and we have a clear sense of where we want to go.

What, then, will economic growth be in Indonesia in the longer run?

Let me share with you a few thought on what I imagine lies ahead in the medium and longer run.

We don't see any reason to believe that the underlying savings rate will decline substantially. In recent years Indonesian national savings rates were among the highest in the world, averaging almost 30% of GDP. With foreign savings providing an additional 2 to 4% of GDP we have been able to generate growth in excess of 7% annually. It is unlikely that we will run a current account deficit of 4%. However, we are likely to return to a position of net inflows, and 2% of GDP may well be sustainable. With this, overall growth will decline between ½and

1% of GDP, but still give us a sustainable growth close to 7% . There are other reasons to believe that we can safely achieve this rate of growth. Large scale industrialization in Indonesia is a relatively recent. In only 10 years the industrial base has approximately tripled. This synergy between domestic industries will continue to grow creating significant productivity gains, and offsetting any slowdown in savings. Second, while income, measured in dollars, has declined dramatically, I am confident that we will recover this loss in the next few years. With this recovery we will again be at the point where the demand for many goods is above the effective income threshold for a rapidly growing share of the population, which creates demand for many domestic industries. Since infrastructure linking key Indonesian markets remains a priority during the downturn, I anticipate that there will be reduced costs and improved awareness, from increased integration. While the short-run prospects are difficult, before we are well into *Repelita VII*, I am convinced that we will have returned to sustainable growth in the 7% range.

There isn't time now to be exhaustive about the tasks required to achieve this growth. Just a few of the most pressing are: pushing ahead with the reform agenda, accelerating human resource development, decentralizing the responsibility for decision making and, continuing our major efforts on poverty alleviation.

In spite of current difficulties the Indonesian economy will continue the trend toward a more outward orientation, "globalization" if you will, and the role of foreign investment and the foreign sector will almost certainly continue to grow. We are committed to our WTO agreement, as well as AFTA and APEC agreements. This is more or less a given. Success in the face of this globalization, and the domestic pressures it brings is another matter and that brings me to the challenges we face.

It goes without saying that continued pursuit of the domestic reform agenda is the most critical element for long run development. At the heart of our current predicament lies serious institutional problems. Lack of transparency not only in public policy but also in the private sector muddled important signals, led to complacency and finally more serious problems. Thus it is critical that both the private sector and the government improve their institutional and human resource base.

The economic restructuring process will undoubtedly transform the private sector, concentrate activity, raise productivity and improve decision making. The privatization of a significant fraction of the industrial activity still under the government's authority will generate more competition and reduce costs.

In education, we need to push changes from the bottom to the top. At the primary level the effort to guarantee an education to every child will continue, curriculum reform will be accelerated and improved local accountability introduced. Our major effort is in the middle and high schools. Here we want to continue to raise participation rates significantly. However, it is in the higher education area that we can have the biggest immediate impact. Thus we are moving to deregulate higher education and are inviting increased foreign participation. Hopefully, the numbers and quality of domestic graduates will continue to improve and help enhance competitiveness in the years to come.

Another area where I believe we have to make significant progress is in the decentralization of decision making. However, the political will to decentralize, although of the utmost importance, is not enough. We need to improve the capacity and capability of the local government institutions and human resources. We have found out (and the World Bank can attest to this) that many programs in regional development have been delayed because of institutional problems. Questions about authority, and accountability are holding up development projects at the local levels.

Finally, I want to add something about poverty alleviation. This has been an area of particular concentration. There has been progress during *Repelita VI*, especially with the IDT program. However, there is still a lot to be done and this must remain an area of highest priority in the middle and long run. Growth is an important objective, but there has to be a sense that the

agenda is equitable. Alleviating poverty is a goal in its own right and I believe that society has an obligation to assist those in need. However, making a concerted effort to reach out to the poor, break their isolation, and make income earning opportunities available improve the perception of equity and generates support for overall development goals.

Obviously there are other important areas and I can not do justice to them all today. I note that your agenda has sessions on infrastructure, domestic competition policy, technology and productivity, and the promotion of small and medium industries. These are critical areas for policy dialogue in the preparation of *Repelita VII*. I look forward to your input in these areas.

In closing, the effort by the US Agency for International Development to create a partnership among Indonesian, and US institutions and the Indonesian government should be hailed as an innovative step and I believe that this forum will contribute to the level and substance of the debate on economic policy in Indonesia in the years to come.

Thank you again for your time and attention.