

**“EMERGING INDONESIA:
Development & Democracy in Southeast Asia's Largest Middle Income
Country”**

A Special Event with:

Introduction: **Sri Mulyani Indrawati**, Managing Director, The World Bank

Chair: **Stefan Koeberle**, Indonesia Country Director, The World Bank

Panelists:

Dr. Dino Patti Djalal, Ambassador, Republic of Indonesia

David Merrill, President, US-Indonesia Society (USINDO)

Prof. William Liddle, Political Science Dept., Ohio State University

Endy Bayuni, Fellow, East-West Center

Shubham Chauduri, Lead Economist - Indonesia, The World Bank

Scott Guggenheim, Lead Social Development Specialist, The World Bank

February 23, 2011

On February 23rd, USINDO and the World Bank co-sponsored a presentation and panel on Indonesia's emerging economy and governance. The panel was the opening event for a two week World Bank knowledge series focused on Indonesia.

Sri Mulyani Indrawati, Managing Director of the World Bank Group and former Minister of Finance of Indonesia, highlighted the growing importance of Indonesia globally and the potential lessons from Indonesia's development that can be applied to other middle-income economies. As the third largest democracy, largest Muslim-majority nation, and an emerging democracy, Indonesia has examples of reform, democratization, and development to share with the academic and policy communities.

Ms. Sri Mulyani Indrawati reflected that development and democracy remain among the foremost issues in the minds of people around the world. Indonesia began to democratize only 13 years ago, and this democratic process has required that the people be heard, capable institutions be set up, and equal opportunity for people to better themselves be established. These same principles are relevant to the broader agenda of the World Bank and the fight against poverty. The World Bank's new approach to data sharing has also made the development process more open, accessible, and accountable.

Ms. Indrawati briefed that developing countries account for half of the global economy, and the developing and emerging countries are leading the recovery in the global market.

Indonesia, one of these key countries, is one of only nine emerging economies among the G20 members, and is a major client and shareholder at the World Bank. Middle income countries are among the most dynamic in the world, with 120 countries fitting the World Bank's definition of middle income (having a GDP per capita between \$996 and \$12,195). Together these countries account for 69 percent of the world's population and incredibly, three quarters of the world's poor.

Despite their diversity, most countries in this group face three challenges: getting more sustained growth; making this growth more inclusive; and achieving clean and green growth. These countries want to avoid the middle income trap, where they would be unable to generate the sustained growth to achieve high income levels.

The development solution for these middle income countries, Ms. Indrawati shared, is to promote more growth and ensure that growth is inclusive. It is crucial to apply this solution with lessons learned from countries like Indonesia.

Dr. Shubham Chaudhuri

Shubham Chaudhuri, the Bank's Indonesia Lead Economist, provided an economic briefing and outlook for Indonesia. Currently, Indonesia is an emerging dynamic middle income economy floating incredibly well on the back of political stability, democratic consolidation, strong macroeconomic and fiscal management, natural endowments and a growing international

profile in the G-20 and on climate change.

Chaudhuri noted that Indonesia has the potential to rise to the ranks of leading middle income economies. Indonesia is one of only 12 countries that has ever enjoyed 25 years or more of sustained growth at an average annual rate of above 7 percent. While this ended in the 1998 crisis, Indonesia's quick recovery in the span of 8 years is commendable.

Indonesia is now experiencing a decade of robust growth. Its cumulative growth in the last decade is less than only China and India. This growth has been underpinned by prudent fiscal management and a remarkable record of reducing public debt.

Simultaneously, the political transition has included constitutional reform, mandating direct elections, expansion of the free press, and the development of a vocal civil society. Indonesia is one of only four countries in Asia that Freedom House considers free.

Over the past decade, there have been improvements in various dimensions of governance, though perhaps not as much as many hoped. This improvement has not necessarily been uniform, and some issues such as corruption have actually been exacerbated. There has also been a steady reduction in poverty but not as much as people hoped for. In terms of the business environment, the constraints that firms report have changed over the past ten years; concerns used to focus on macro stability and that has shifted to concerns regarding infrastructure and transportation.

Chaudhuri outlined two potential routes for Indonesia's development and the impending challenges to continued growth. The country can either continue to float, as it has for the last ten years, or growth could accelerate. The fundamental question is how to bring about growth acceleration.

One big challenge Chaudhuri outlined was taking advantage of the current demographic window of a non-aging population. There will be a 10-year period where Indonesia will have demographic advantage over India and China, whose populations will start aging earlier.

In addition, Indonesia's growth in the last few years has come from the service sector, so the challenge is to ensure that the services sector does not crowd out the tradable sector where jobs are very high-value-added jobs.

Another challenge is urbanization, which can go askew with gridlock and a lack of access to water, sanitation, and housing.

Finally, there is a growing lower middle class but increasing inequality which needs to be addressed.

The primary priorities ahead for Indonesia are improving infrastructure, job creation, increasing investment (domestic and foreign), and creating a comprehensive social protection program.

Following Chaudhuri's presentation, a panel discussion began.

Ambassador Dino Patti Djalal

Ambassador Djalal began by discussing democratization in Indonesia. He recalled that in 2000 Indonesia was considered a messy state that was threatened by Balkanization. Now ten years later, Indonesia is the third largest democracy, has the largest middle class in South East Asia, and is a successful emerging economy. Indonesia has achieved a balance of democracy and development and has demonstrated that Islam, modernity, women's rights, and democracy can all thrive together.

The Ambassador noted that in the last three elections, 85 percent of the population voted, and 85 percent of Indonesians believe Indonesia is going in the right direction.

Ambassador Djalal reflected that all the great projections about Indonesia are not a given but require hard work and adjustments. Indonesia still faces several challenges: One is to keep the spirit of reform alive. Second is the challenge of how democracy works in a new policy era. Now with direct elections and decentralization, it has been difficult to promote a clearly defined policy plan. A third challenge is the rise of mass authoritarianism. State authoritarianism is gone, but now there is more of this at the mass level. Another issue is the ethnic and religious diversity that causes tension and sometimes even conflict. Finally, bureaucracy remains a challenge.

Despite these challenges, Indonesia has continued to enjoy stability, good growth, and sustained democratization. This success is due to the fact that in the last 11 or 12 years the collective sum of

the good policies has considerably exceeded the sum of the negative policies.

The ambassador compared Indonesia with Egypt.

- He cited the importance of having a reformist leader during a democratic transition such as President Habibie in Indonesia.
- Indonesia kept the ruling elite and worked with them to promote change during the transition, which would be beneficial in Egypt.
- The military in Indonesia became the strongest proponent of reform, and removed itself from politics. Reforming the military will also be crucial in Egypt.
- Free and fair elections are essential to release pent-up frustration.
- The development of civil society is essential. These components gave Indonesia the ability to develop an open, tolerant, pluralistic, moderate nationalism connected with a healthy internationalism.

Professor William Liddle

Professor Liddle of Ohio State University asserted Indonesia has made incredible progress, but there are still some significant challenges that need to be overcome.

Indonesia's success in democratizing has been extraordinary, he commented. Democratization has consolidated to the point where no major political organization or party advocates a system

other than democracy. Decentralization has been Indonesia's other significant achievement in the last decade. There has been a real devolution of political power to the local level and now there are 450 local municipalities which have had their own elections for local leaders.

Liddle cited three remaining challenges facing Indonesia: weakness of rule of law institutions, a need for policy vision, and the growing Islamist social movement.

- He believed corruption remains a major problem evident in the business community, parliament, and judiciary, which has yet to be addressed successfully. He also called for policy vision and decisiveness so that the Indonesian economy does not drift, and that opportunities are not lost.
- He suggested the government initiate an anti-corruption plan or policies, and a plan for infrastructure development, with a timeline.
- He asserted that an important issue is a committed and politically skillful Islamist social movement determined to push Indonesia in a religious direction. He said this movement has taken many forms:

- A push for local governments to adapt Sharia Law. This peaked in 2006 with 30 to 40 local governments instituting Sharia Law.

- The anti-pornography law adopted by parliament. The issue was defined as an Islamist issue versus everyone else.

- The campaign to ban Ahmadiyya. Although this is a serious problem everywhere, it has not historically been a big issue in Indonesia. There have been repeated attacks and the number of attacks keeps going up. The Islamic Defenders Front has put pressure on the President to ban the group.

David Merrill

David Merrill, President of USINDO, and a member of the Joint World Bank-USINDO panel, highlighted the potential areas for growth in the Indonesian education sector.

Skills development, university education, and educational exchanges are all crucial to help Indonesia propel itself to the final level of economic growth. With a U.S. President and an Indonesian President who each studied in the other country and support educational cooperation, the U.S. and Indonesia have a unique opportunity to further relations and education cooperation through the Comprehensive Partnership.

The challenges include:

- The number of Indonesians studying in the U.S. has declined by over 40 percent in the last 12 years
- The number of Americans studying in Indonesia for credit has dropped to 75-150.
- The number and robustness of university partnerships between the U.S.

and Indonesia has declined tremendously.

- The amount of foreign investment in the Indonesian education sector is very low relative to other countries.

Merrill maintained the NGO and university sectors should have a clear role in the education part of the comprehensive partnership. USINDO, the Association of Public and Land-grant Universities, the East West Center, the Institute for International Education, and others have therefore formed a Joint Council for Higher education Partnership, which will provide a space for foundations, universities, and NGOs to participate to address these issues, in collaboration with the governmental programs toward these ends.

The Council will work on such tasks as:

- reducing the cost of an American education for Indonesians by finding existing US-based scholarships, increasing utilization of Government of Indonesia overseas education funding in the USA, and working with US universities on special programs for groups of Indonesians.
- exploring the viability of student loans. The U.S. Export Import Bank is authorized to consider US education as an export, and if a student loan program can be fashioned that is workable, it may be eligible for Ex-Im support.
- building the capacity of Indonesian universities to take U.S. students and helping these universities expand their programs from cultural and anthropology focuses to include climate change and other relevant programs.

Dr. Scott Guggenheim

Scott Guggenheim, the Lead Social Development Specialist at The World Bank, spoke on the community and local structure in Indonesia. Although Indonesia is large and unpredictable, Indonesian elites really understand community development.

Guggenheim said decentralization was successful from a political side but service delivery at the local level has not improved. The perceptions of corruption and injustice are very high, and the polarization present in the early 2000s is beginning to reappear. A strategy to redress these and other issues where decentralization has fallen short needs to be put in place. A new approach to policy that changes things at the grass roots level needs to be developed.

Dr. Endy Bayuni

The panel concluded with remarks from Endy Bayuni, East-West Center Fellow and former editor of the Jakarta Post. Bayuni spoke on the role of civil society and the strengths and weaknesses of the free press in Indonesia. Freedom of expression has been crucial to Indonesia's democratization and reformation.

In the last twelve years, Indonesia has strengthened the institutions for democracy and has had three successful elections. President Yudhoyono won an overwhelming majority of the vote, but his party's portion still necessitated a coalition government. Coalition governments are a challenge because

they often block reform programs; Indonesia needs to learn to manage a coalition government effectively. Only 14 bills passed through the legislature in the first year of the current term, because everyone was too busy politicking. Several reforms require more attention. The military reform has gone well and has come the farthest but needs further reform. In addition, reforms of the bureaucracy and judiciary still need to be made.

Despite these challenges, Indonesia has committed to democracy. India has been a good model for Indonesia; India is democratic, developing slowly but has delivered consistent economic growth.

Indonesians now understand that there is no alternative to democracy, and embrace freedom of expression. They openly complain about politicians' performances, the rate of reform and progress, and the growing inequality. Although Indonesia is a work in progress, it is on the right path.