

“Contributing Factors to the Economic Growth in Indonesia”

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How the past influences the future of the Indonesian economy.

Abstract: Indonesia, like many other southeast Asian countries, has experienced quite a bit of turbulence economically and politically on its way to the present day. Starting in the early 1980's the Indonesian economy began to come alive after being fairly unknown and unrecognized for pretty much all of the 20th century. Considered the “*New Order*” government, the new officials wanted to change the path Indonesia was going down after having about a decade of fairly slow growth. These economic reforms covered every base of economic policy. Everything was going to be overhauled, the financial system, fiscal policy, trade regulations, and the modernization of the tax system. But this was just the beginning. Though there was political turbulence still, Indonesia experienced rapid growth on the 1980s and 1990s after switching to more a more privatized economy which was recommended by the World Bank. This paper will look at the effects that corruption had on Indonesia's growth and whether it was good or bad.

Corruption Helps Growth

President Suharto had experienced great growth in the 31 years that he was president. Suharto was a dictator, with complete authoritarian control over the country. This is a key factor in the development of corrupt operations within the country. Because since the public sector had a major hold over the economy, the private sector didn't have much room to grow which was caused by the fact that there was lots of rules and regulations to regulate the economy. The only way a private company could grow was by paying government officials so that they would look the other way. Research has confirmed that the higher the overall size of the government's budget relative to the GDP, the more rampant corruption is within a country(1).

Indonesia in the beginning was helped by corruption initially. It gave a way for infant companies to grow by them being protected from competition. And the corruption itself was very centralized making it predictable. Another thing that made it predictable was that transaction costs linked to corruption and red tape could be calculated accurately, and therefore they could be included in accounting documents for countries. There was also structure for the corruption, bribes were paid as dividends to the protectors. Those who deviated from the original plan were punished accordingly.

Even investment for Indonesia was high during this period. With Indonesia having more FDI than other comparable Asian countries for part of the 1990s. Mostly caused by the trade reforms which spurred numerous foreign companies to locate their export processing plants in Indonesia, a development that increased competition in the

manufactured sector in addition to helping raise export levels. To help attract foreign investors Indonesia adopted more open towards such investments. Like many developing countries Indonesia had traditionally viewed foreign private investment skeptically, associating foreign ownership with exploitation rather than with development. As a result a variety of regulations controlled such investments and only a few sectors were open to foreign investment with the degree of foreign ownership restricted. But there ended up being problems because even after foreign investors had established and operated a plant, they expand capacity beyond the originally sanctioned level required further approval. Combined with the import substituting biased trade policies, these restrictions helped create an industrial sector characterized by low labor intensity, high costs, and a lack of international competitiveness.

Everything was going great for Indonesia, with a GDP growth rate averaging 8% from 1985 to 1995. The various reform measures, affecting trade and fiscal policies, resulted in a rapid growth in the industrial sector, which increased contribution to GDP from about 15% in 1985 to over 20% a decade later. Although much of the growth occurred in sectors engaged in the production of manufactured exports, many sectors that met the demands of the domestic consumers also expanded. As a result of the growth of the manufacturing sector, manufacturing employment rose from 5.8 million persons in 1985 to 10.8 million in 1996, an average annual increase of nearly 6%.

Corruption Hurts Growth

Despite these improvements there are still issues to be addressed. As a whole it seems that Indonesia has improved tremendously. Yet internally, there's this thing called corruption happening and although there was improvement, this improvement was hindered and wasn't efficient.

To start the Indonesian poverty line is admittedly low, in fact lower than the oft-quoted World Bank poverty line of US\$1.00/day. Hence even after the substantial improvements in the income levels of the poor, this still left many households facing extremely difficult conditions. To many observers the decline in the measured number of poor did not reflect the reality on the ground, which was that widespread poverty, still characterizes much Indonesia.

During the mid-1990s a number of problems emerged that provided evidence that the ability of the economic team to manage serious macroeconomic problems had been substantially eroded. There was growing evidence that the economy was overheating in early the 1990s and the rapid growth in imports, combined with a slowdown in exports, suggested that the real exchange rate had appreciated. Although the government took some steps to reduce domestic demand, export growth remained weak and Indonesia's debt, especially short-term private debt, continued to rise. The export slowdown, noted earlier, was partly due to a rapid rise in the minimum wage that raised production costs.

The biggest factor to this almost sudden change in the 1990s was the fact that despite the economy being more open, corrupt activities didn't go away. Corruption wasn't centralized anymore, it couldn't be tracked and most importantly it wasn't predictable. FDI began to decrease and after 1994, export growth was declining and labor productivity, which was already poor, became even worse.

Future of the Economy

Corruption is most prevalent where other forms of institutional inefficiency, such as bureaucratic red tape and weak legislative and judicial systems, are present. Also corruption, government regulations, bureaucratic red tape, and even the strength of legislative and judicial systems tend to reinforce each other. The most important factor that corruption affects when considering economic growth is political instability, which accounts for about 53% of the overall effect in a study done by Pak Hung Mo of Harvard University(2). The other factors include the level of human capital and the share of private investment.

For Indonesia to fix their corrupt system they need to consider several good proposals to reduce corruption in Indonesian society such as tougher anti-corruption laws, higher salaries, Corruption in Indonesia: Causes, History, Impacts, and Possible Cures-continued 22 and merit-based promotions for government officials, and the creation of independent “watchdog” groups. However, these reform measures require strong political will from the government in order for them to be fully implemented and enforceable. Reform would be very difficult, since there are many special interests that

stand to lose from a major anti-corruption reform campaign. However, due to the high toll of costs that need to be bear by ordinary Indonesians as a consequences of the corrupt government that the have, it has to be done if Indonesia wants to regain its status as an emerging economy of Asia and even to survive as a nation, since without meaningful reforms, it is feared that Indonesia could disintegrate into many unrecognizable parts within the next few years.

To comment on corruption further and whether it is good or bad is a matter of where the threshold point is. At a certain point corruption can have a more negative impact than positive impact on a country. If too much money is taken out of an economy in the form of bribes and other payoffs then it becomes a real hindrance to a country and its economy. For corruption to work it needs to be centralized, organized and predictable. Even if the corrupt activities aren't taking a lot of money out, but it doesn't have these 3 qualities then it is a negative on a country. The answer to whether corruption is a hindrance or not depends on the situation. In most cases it is not, but there are cases where having a corruption in the political system can be a plus.

References

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