

# Globalization: Challenges for Indonesia

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Indonesia has gone a long way in liberalizing its economy, but the task is far from complete. Globalization has given the government a strong justification for undertaking market-oriented reforms that can help maintain high and sustainable rates of exports necessary for strong economic growth.

The country's policy of globalization has been based on pragmatism. It is not grounded on ideological considerations; it is based on an objective assessment of what other countries in East Asia have been able to achieve. In addition, there is a strong element of competition at work among the countries in the region to liberalize in order to make their economies more attractive to global investments. Such *competitive liberalization* is itself a powerful factor. The universal trend in the 1980s toward economic liberalization, deregulation and privatization may have provided an additional source of inspiration.

Indonesia's participation and efforts to promote a number of re-

gional cooperation schemes are considered to be an important element of its globalization policy. Re-

only if the economy continues to open up. It argues, however, that developing countries such as In-



gional cooperation helps its participants to take part in global economic integration more effectively as a group of regional economies. It is not surprising, therefore, that in Southeast Asia, AFTA (ASEAN Free Trade Area) and APEC (Asia-Pacific Economic Cooperation) are widely seen as representing—indeed as manifesting—the globalization phenomenon because of the importance of trade and investment liberalization in these organizations' agendas.

In justifying its multilateral commitments, the Indonesian government has argued that the country's industries and companies will become internationally competitive

Indonesia must be given a longer period to adjust than the industrialized countries. This principle is adopted by the WTO and APEC and thus fulfills an important requirement for Indonesia's participation in these groups.

It is exactly because globalization is being used as a justification for economic reform—and used successfully thus far—that the sustainability of the reform program itself will depend to a large extent on the ability of the government and the society at-large to redress the negative public perception of the impact of globalization. Today in Indonesia—and in other ASEAN countries—there is a widely shared

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view that the government has been quite successful in undertaking the *first-order domestic adjustments* in response to globalization.

These adjustments are a continuing process as the government has opted for a gradual rather than a “big bang” approach in undertaking reforms. This gradual approach was taken in order to demonstrate the positive outcomes of the reforms and thus help create ever larger constituencies for the various reform programs.

### Economic backdrop

Since the mid-1980s, Indonesia’s trade and investment regimes have been substantially liberalized.

then can Indonesia fully benefit from developments in the global economy. Thus, in essence, these first-order adjustments aim to increase the attractiveness of the Indonesian economy as a production base for the global market.

Until the onset of the 1997-98 economic and political crisis, the Indonesian economy grew by an average of 7% per annum. The economy experienced a slowdown in the mid-1970s and again in the mid-1980s when the world economy was in a recession. Each time, however, the Indonesian economy was able to come out stronger, as the financial “crises” forced the government to undertake the nec-

However, like many other neighboring countries, it instituted export policy reforms before undertaking import liberalization. In effect, this resulted in what has been accurately called a double distortion policy. Thus, Indonesia’s earlier deregulation measures were not considered substantial because they failed to address the issue of nontariff barriers (NTBs) that affected a large proportion of imports. Close to 1,500 important items—which represented about 35% of the value of Indonesia’s total imports—were subject to some form of NTB, usually a licensing restriction.

The system became a vehicle for rent-seeking activities that led to the emergence of what Mancur Olson has called “distributional coalitions.” The system was also misused to promote the development of industries of questionable economic viability. The October 1986 package was the first serious attack on this system. It included the dismantling of the plastics and steel import monopolies, which were seen as a symbol of the then emerging cronyism.

In the early 1990s the country experienced a “reform fatigue,” or a policy inertia. Efforts to further liberalize trade policy appeared to have come to a halt. The average rate of nominal tariffs remained at the same level during much of this period. Things began to change in the middle of 1994 with the issuance of liberalization measures in the investment field following a poor non-oil export performance and a marked decline in approvals of foreign direct investment.

### Competition and cronyism

These events marked the beginning of a process driven by the need to compete with other countries in East Asia as they also undertook liberalization policies. The government and others in Indone-

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These policies have been introduced in response to what the government perceives to be a trend toward globalization and the international integration of markets. Furthermore, it is believed that the country will gain significant net benefits from its participation in this process. The policy of globalization has necessitated the introduction of a series of structural adjustments in Indonesia’s economy through liberalization, marketization and deregulation, as well as privatization.

The objective of these adjustments is to enhance the economy’s international competitiveness since the government believes that only

essential reforms in order to sustain the country’s economic growth.

Substantial reforms were undertaken in Indonesia from 1986 to about 1990. During this entire period, no less than 20 policy packages to deregulate and liberalize the economy were issued. The dramatic drop in oil prices in 1986 and the currency realignment following the agreement that increased Indonesia’s external debt payments appear to have been responsible for precipitating and fueling a sense of economic crisis that resulted in the more drastic measures.

In East Asia, Indonesia is the only country that began with the liberalization of its capital account.

sia felt that the country was beginning to lose out in the competition for foreign direct investment to such countries as China, Vietnam and India. Indonesia also began to experience declining export competitiveness, which was another possible reason for the slowing down of foreign investments.

In addition, these liberalization measures were to be understood as the government's determination to implement its commitments under AFTA, APEC and the WTO. Further liberalization packages were introduced in mid-1996 and 1997. However, while on the whole significant progress has been achieved in reducing tariffs, a few sectors remain highly protected.

Dismantling of the protection given to these privileged sectors has become a difficult political question. It no longer involves a competition of ideas between different government ministries. Rather, it has become a struggle to dismantle the cronyism that has become so rampant and entrenched. In an increasingly integrated global economy, Indonesia cannot allow itself to maintain a system in which transaction costs are excessive because of a lack of rule-based behavior.

### State-business relationships

Globalization has led the state to give a greater role to the business sector in the development process. The process of economic liberalization, deregulation and privatization since the early 1980s in Indonesia—and in other Southeast Asian countries—has provided greater space for the business sector. This serves the state and regime well as does the more active involvement of the business sector—local and international—helps sustain economic growth and in turn strengthens the legitimacy of the governing regime.

At the same time, however, there

is always a strong tendency on the part of the government to maintain control over the business community. A kind of collusion evolves in which the current regime or political leadership provides privileges to groups of businesses that in turn are expected to help uphold the regime. In the course of this development, independent business entities are being squeezed out. The emergence of crony capitalism in Indonesia and other countries in the region has its origin in the interest of the state to maintain political control over the business sector and to control its financial resources.

ronment of unfair competition. The call for an antimonopoly law or some form of competition legislation is not a new development in Indonesia, but the need for more transparent and certain rules of the game is felt more urgently today. The government has responded slowly to these demands.

### Aftermath of the Asian crisis

The region's economic crisis has shown that maintaining macroeconomic stability has become much more difficult in a globalized world. The issue is not whether or not to open up, and it involves much more than the proper se-



Freedom of economic information will promote state-business relations.

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The business community in Indonesia feels that in pursuing its policy of globalization via several deregulation and liberalization policy packages, the government has to do a great deal more to make Indonesian industries and companies internationally competitive. While some have called for a more proactive policy, including some form of industrial targeting, the general perception is that the policy packages have tended to be reactive and incoherent as well as discriminatory, because they often exclude certain groups or sectors from the deregulation, thus creating an envi-

quencing of the liberalization process. The issue is how to maintain a *workable and credible commitment to open economic policies*.

The task will not be easy. In the economic realm alone, the Indonesian government's agenda is already overloaded. On top of this there is the equally challenging political agenda of managing the process of democratic transition and consolidation. The economy shrank by about 14% in real terms in 1998, and inflation during that year reached almost 80%. This was Indonesia's worst economic performance in the past thirty years.

Indeed, there is a lot of talk about “industrial policy after the East Asian crisis.” Two trends can be identified. One is to move from outward orientation to new internal capabilities that would see the emergence of competition policy replace the role of activist government. This creates an enormous challenge for governments to develop sophisticated new skills in public administration in order to deal with the more complex mandate that shift implies. The other trend is a longing for the old style industrial policy of selective targeting, including a move back from out-

environment and ensures an effective allocation of resources.

Indonesia, however, must still deal with major challenges resulting from globalization and the perceived—and actual—asymmetries it has created.

These include increasing disparities of income and access to economic opportunities between different groups in society, as well as between different regions and between large, medium and small enterprises. These gaps and disparities are caused by a host of factors, but there is a widespread perception that globalization reinforces

the country can respond effectively to these challenges. The burden will not rest with government alone. There clearly is a role for civil society. Thus, a corollary question is how the government and civil society can work hand in hand in dealing with these issues.

The corporate structure and governance mechanisms in Indonesia (and East Asia in general) also have been under scrutiny in the wake of the crisis, and the Asian development model—if indeed there is one—has come under attack. But it does not follow why a reorientation should involve a retreat from a reliance on markets and on the international economy. In fact, it should lead to a strengthening of that orientation.

Indonesia (and Southeast Asia in general) also must develop a new pattern of governance. The vision for a new governance model must assure the full involvement of civil society and a strong and balanced partnership between the three sectors: state, market and civil society. These sectors should not be separated and hierarchical. The recent economic crisis has helped Southeast Asians to discover the role of civil society in development, but they still have some way to go in strengthening it to become an equal partner in a kind of tripartite governance for development and security in the era of globalization. In the case of Indonesia, civil society has been very weak. The main constraint has been political. The fall of Soeharto, however, has opened up a greater space for civil society. 🌐

*A new governance model must assure...a strong and balanced partnership between the state, market and civil society.*

ward orientation to a new rationale for import substitution.

Nonetheless, to date Indonesia and the other crisis-affected countries in the region have not reversed their basic international orientation, and there has not been a clear trend towards major policy reversals in the developing world. And there shouldn't be. Good industrial policy still is an open trade regime that fosters a competitive

and magnifies them.

It is also felt that the government tends to assume that its success in undertaking first-order adjustments allows it to take lightly these “second-order” challenges. But these problems are not going to go away. In fact, it is likely that they will become more severe and complex as the process of international integration deepens. The question for policymakers is how