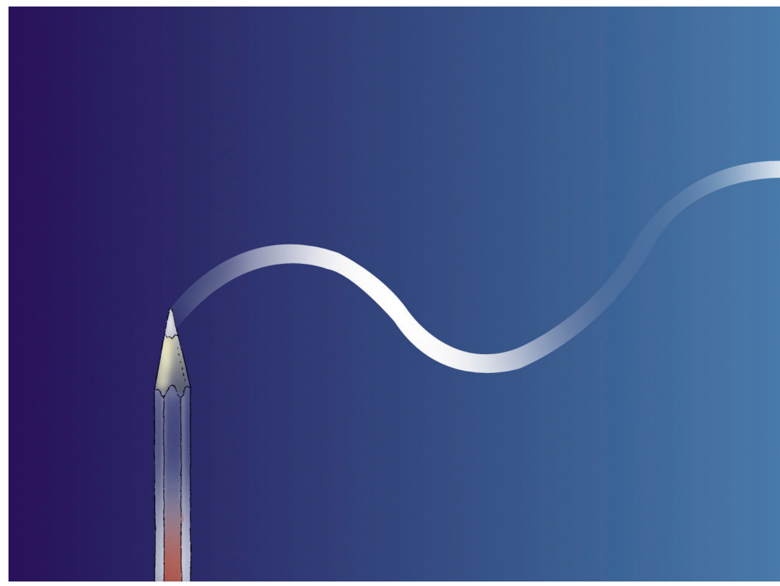
MIST OF CONFUSION: THE HYPE ABOUT INDONESIA'S ECONOMIC GROWTH

A FEW years ago, I was sitting in a swanky bar in South Jakarta popular with expats and Indonesian bureaucrats, sipping red wine for $25 a glass. During a discussion about the state of affairs in the country, my reference to Indonesia as a 'Third World' country triggered an angry reaction by an Indonesian diplomat working for the Ministry of Trade. "Indonesia is no longer a poor country," she rebutted, quoting various studies that placed Indonesia firmly in the group of emerging economies, and went on to argue that the 'I' in BRIC should belong to Indonesia rather than India. The acronym MIST to describe the next tier of large emerging economies had not yet been coined at the time.

Indeed, Indonesia has made a remarkable comeback from being Southeast Asia's economic basket case in 1998 to an emerging market whose economy has been growing annually at more than five percent for several years. In reaction, analysts and journalists alike have been outdoing one another with positive assessments of Indonesia's economic growth trajectory. The writing frenzy recently culminated in an article published in the UK daily *The Guardian*, which claimed that Indonesia's economy may surpass England and Germany in a few years. "It's like people don't want to hear anything else," a foreign journalist based in Jakarta whom I had sent the article told me afterwards, lamenting how she finds it increasingly difficult to pitch stories to newspaper editors that cast doubt on Indonesia's economic miracle.

Yet, Indonesia's economic growth is neither sustainable nor inclusive. An inconvenient fact is that Indonesia's economic growth is mainly driven by a commodity boom fueled by China's appetite for raw materials and global demand for biofuels. China's enterprises are building bullet trains while Indian car and IT companies compete around the world. Indonesia, all the while, manufactures essentially nothing. Most international manufacturing companies moved on to greener pastures a long time ago, while domestic companies are unable to compete internationally with the exception of a few conglomerates run by crony capitalists from the New Order period.

The other main driver of Indonesia's economic growth is domestic consumption. This is mostly driven by easy access to credit cards. Since the mid-2000s, banks have been successful in convincing Indonesians, much like their American counterparts, to buy stuff they don't need, with money they don't have, to impress people they don't know. The amount of credit cards in circulation, which have increased seven to eight percent annually, reached such staggering heights in recent years



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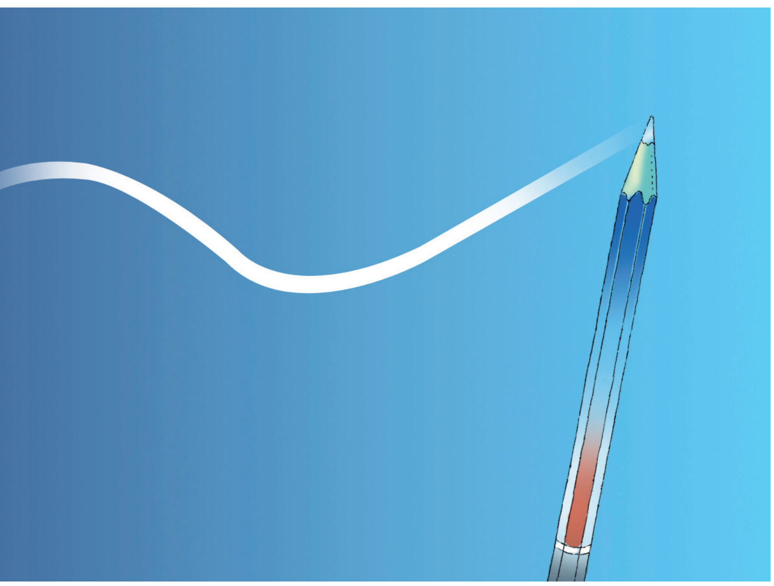
that Bank Indonesia had to introduce new guidelines last year to limit the number of credit cards a single person is allowed to hold. The same guidelines also stipulated that Indonesians earning less than US$330 a month should no longer receive credit cards.

Can Indonesia's economic growth be sustained? Maybe for a few more decades, but even Indonesia's rich natural resources are finite. Already, the nation's oil reserves are dwindling faster than in any other Asian country–and Indonesia became a net oil importer during the last decade–while it is exporting most of its approximately five billion tons of coal reserves to China and India. Worse, the money generated from selling these national assets is not used to help rebalance Indonesia's economy toward high-end manufacturing.

Providing access to cheap credit is an unsustainable growth strategy. Already, Indonesians exhausted from trying to keep up with the Mallarangeng family seem to turn to forms of sarcasm similar to that of debt-ridden Americans. Grinding through Jakarta's infamous traffic jam a few months ago, I spotted several bumper stickers on the back of upmarket vehicles, saying in the local vernacular: "Don't crash into my car, I am still paying it off." Plenty of Indonesians can no longer repay their debts and, therefore, no longer consume. The bludgeoning to death of an Indonesian citizen in 2011 by debt collectors

MICHAEL BUEHLER*



on the payroll of Citibank may be a scary sign of things to come.

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It's politics, stupid!

In their 2012 book, *Why Nations Fail*, Daron Acemoglu and James Robison, professors at the Massachusetts Institute of Technology and Harvard University respectively, show the central importance of political institutions for achieving sustainable and inclusive growth. While economic institutions are important determinants of a country's wealth, political institutions are paramount since they define what economic institutions a country has. In this respect, Indonesia's achievements look bleak.

Since the collapse of the New Order dictatorship in 1998, the government has missed almost every opportunity to turn its economic boom into a positive force for all Indonesians. Serious and comprehensive reforms of Indonesia's political institutions have been anathema to the Susilo Bambang Yudhoyono government and most of the president's political appointees almost from day one in their decade-long reign.

Masked behind pro-poor rhetoric and lukewarm support for symbolic reform agencies such as the Corruption Eradication Commission, Indonesia's elites have used their political power to protect their personal interests and keep the judiciary in shambles. The bureaucracy remains completely unreformed 15 years after the demise of Suharto and corruption continues to be rampant. A serious discussion about Indonesia's systemic corruption problem has never occurred during Yudhoyono's two tenures. Instead, the emphasis has been on arresting 'bad' politicians.

Indonesia's elites have also done everything in their power, the power they do have, to channel the country's riches into their own pockets. The lack of will to develop a truly prosperous Indonesia is most visible in the government's failure to integrate Indonesia's internal market. This has had deleterious effects for the domestic economy. Indonesia, for instance, imports almost half of the salt consumed in the country from places such as Australia, Germany, Singapore and New Zealand because decrepit infrastructure and predatory taxes make it cheaper to import the commodity from the German mines of Berchtesgaden 7,000 miles away than from Indonesia's seashores.

Similarly, the government's failure to curb corruption, rent-seeking and red tape has turned Indonesia essentially into a high-cost economy shunned by manufacturers. While American sneakers would most likely have been produced in Indonesia 15 years ago, this is now mostly done in places such as Vietnam or China. Ironically, Indonesia's steady growth is also a result of the country's detachment from volatile world markets. Due to a lack of robust political institutions undergirding Indonesia's economy, inequality has increased in Indonesia in recent years. At the time of writing, around 120 million Indonesians lived on less than two US dollars a day.

It remains to be seen how long Indonesia's elites can ignore the other side of Indonesia's boom. They would certainly have enough clues in their own lives. The Indonesian trade diplomat who so vigorously advocated Indonesia's place in the BRIC group in our discussion a few years ago has since been posted to the United States. Rather than advocating space- and IT-technologies in the tech clusters of Boston and San Francisco like her fellow trade diplomats from China and India, she is now promoting Indonesian rattan furniture at trade shows in North Carolina.

* MICHAEL BUEHLER IS AN ASSISTANT PROFESSOR OF POLITICAL SCIENCE AT NORTHERN ILLINOIS UNIVERSITY AND AN ASIA SOCIETY ASSOCIATE FELLOW.