RECOMMENDED POLICIES FOR SUSTAINABLE ECONOMIC DEVELOPMENT IN INDONESIA[1]

Prof. Dr. Aris Ananta[2]

"Only its collapse convinced them to try something different. Old ideas were overtaken and overwhelmed. It has happened before-- and could again"
(Robert J. Samuelson, 1993)

1. "Crisis" and "Recovery"

Booming and prosperity. Joyful expectation of the future. And, suddenly, a crash, a dramatic crash. All were lost in such a short time. They were so unprepared for this event. Then, those who had used to talk about poverty, but did not really experience the poverty itself, were forced to get the feeling of much relative deprivation. They had not fallen to under poverty line, and, indeed, they might be still in a much higher economic situation than the poverty line; but their prospect had been very bleak. It was like the feeling of riding a roller coaster, but without knowing the end of the fast descending journey. They were, to mention a few, the academicians, politicians, bureaucrats, business people, people in NGOs and journalists. They had the political power, and some were involved in decision making to help the "poor" people.

That is what has been happening in Indonesia since the crisis began in August 1997. Meanwhile,

> "The crisis came at the peaceful time. It had resulted in unrivaled suffering, which had exceptional social and political consequences. It toppled the government and revolutionized the role of government in many nations. The legitimacy of existing government was widely questioned. Banking situation was catastrophic. Morale was shattered and fear was nation-wide. Everybody was panicked and hoarding.

[1] Paper presented at "Forum on Indonesia- The First 100 Days of President Abdurrahman Wahid: an Economic Agenda." Singapore: Institute of Southeast Asian Studies, January 17-18, 2000.

[2] Visiting Lecturer at National University of Singapore (NUS), Professor of Emeritus at Faculty of Economics University of Indonesia (FEUI).

> The prevailing hardship had caused strikes, riots, communist propaganda and frustration on the industrial system. Violence occurred in both urban and rural areas. Some demonstrations had resulted in death and injuries. Attacks on civil liberty were mounting, particularly directed at minority. Some meetings were broken up, prohibited; demonstrators were arrested, and strikers were suppressed by violence."

Is that also a description of the current Indonesian crisis? Probably, but it is the situation of the world great depression during the 1930's, described by Hill (1988) and Enzler (1939). Yet, the current crisis hitting Indonesia had not been anticipated by most people. The crisis has certainly shocked everybody. Well, has it shocked them enough to make the reforms such that if they are successful in the recovery, they will be in a sustainable path and will not return to a similar, or worse, crisis? Are they ready to change things that have brought to the crisis?

About two hundreds years ago Malthus (Flew, 1970) predicted that the destiny of people would be only around subsistence level, if people did not want to try something new, different. When people were better off, they would have many children and few would die. As a result, the number of population boomed. Scarcity of food resulted. Wars, famines, natural disasters, and epidemics then forcefully checked the rapid growth of population. The number of population would become small. Prosperity returned. But, then, the same cycle would be repeated. There were too many people. Then, war, famine, natural disaster, and epidemic followed again. Unless something innovative was done, the nature would check the growth of population. Malthus suggested that something should be done before the nature did it. In the modern times, the suggestion is to consciously reduce population growth through family planning.

Root (1998) has also learnt that social chaos, war, and sometimes revolution had preceded rapid growth in East Asia. The Cold War had brought the East Asia into the most politically uncertain regimes in developing countries at that time. The governments had to work within highly acute political risk; and right decision were needed to simply to survive. This is consistent with the gloomy lesson from the Great Depression, as concluded by Hill (1988), that the Great Depression was ended only with the war. There had been many large drastic domestic and international changes, but the depression had continued throughout the decade. Countries that had quickly recovered still suffered the impact until the onset of the second World War.

Certainly, a war is not the recommended policy for Indonesia. Neither is social chaos. But, Indonesia has been driven into crisis and almost chaos. Therefore, innovative approaches should be invented before the nature forces economy to find something different. Without innovative recommendation, the economy will be then just a series of booms and busts.

Further, the current "recovery" may not show real improvement in the economy. As Krugman (1999) mentioned, "recovery" may occur despite the absence of improvement in the fundamental. So is for Indonesia. What Indonesia needs is not simply that the economy is returning to the pre-crisis level. If it does, then the Indonesian loses so much. The opportunity cost of two or three years during the "great recession" is too much. Indonesia should be able to go out from the crisis and end up with a much better fundamental than before the crisis. The crisis must be turned from crisis into opportunity; and, this is the opportunity of the Indonesian to have a much better economic development—one that is centered on its people.

This paper is an on-going exercise to contribute some innovative ideas for reforms on Indonesian economy. The recommendations presented here are not necessarily new, some are actually repetitions of old ideas, but a fresh look at them may be beneficial to work toward long run, sustainable economic development — one which will not fall to another crisis once the economy starts recovering.

The recommendations are put in the context of the long run, sustainable economic development, and not simply growth. There can be so many aspects of policy recommendation for sustainable economic development, but this paper focuses to three factors (people-centered development, economic institution, and "integration" with the world economy) considered to be more fundamental in contributing to sustainable economic development. In a more technical terminology, the three factors are the necessary conditions, while the others are the sufficient ones It does not mean that others are not important, but these three aspects should be given more attention in producing economic policies toward long run, sustainable economic development.

The existing text books on development economics and macro-economics theories do not seem to be able to explain, even to prescribe the medicine, the current Indonesian, Asian, and global crisis. Much thought should be exercised and "dreamt". When the "four tigers" started the export promotion strategy in the 1960s, the literatures on economic development was dominated by import-substitution strategy; yet, they started something different from the literatures—the export promotion strategy. Something innovative is urgently needed. It is not impossible that, perhaps, something lie "economics revolution" by Keynes in the 1930s can be pursued.

Therefore, hopefully, ten years from now the teaching of economics, especially in development economics and macroeconomics, will be much different from today. The current crisis can be converted into an opportunity to produce a much better, sustainable, development paradigm.

2. People-centered development

2.1 Concept

Long before the current economic crisis, some economists had argued for alternatives to GNP oriented growth. Income per capita and national income growth rate had been the preoccupation of most policy makers. Discussions on economic success had hinged on the measurement of income per capita and income growth. So far, until July 1997, the orientation seemed to be all right. East Asia and Southeast Asia economies remained strong. Income per capita had been growing fast.

Now, during the crisis, questions have often been asked: can and will the economies of East and Southeast Asia return to the pre-crisis growth rates? When will they achieve the same growth of national income again? After that, will they grow faster? Will they have the "miracle" back?

Then, once they get the "miracle" back, will they keep the "miracle" for a long time? In other words, will they then have a sustainable growth, that they will not once again tumble into a similar crisis in the future?

How about an alternative? Rather than placing national income as the sole criterion, progress can be measured with a combination of some other criteria, such as health and education. UNDP (United Nations Development Programme, 1992) has started this tradition since early 1990s, with what they call as Human Development Index (HDI). There may be some weaknesses in this index, but the UNDP's initiative to use HDI as an alternative policy should have been followed by much more concrete steps in formulating and developing economic policies in many countries even before the crisis. For example, what criteria should be used to measure "recovery"?

Though policies pursuing a high index such as HDI may result in a relatively slower economic growth rate, the policies may promise a more sustainable growth. In terms of the current crisis, such policies – engaging in the so called people centered development – will help avoiding the risk of falling to the same crisis once the country has successfully overcome it. It should be warned, though, that the people centered development is not an anti-growth concept. Indeed, long-term and sustainable growth is the objective of the people-centered development. And certainly, economic growth is needed to pursue people centered development.

This section is not to propose the use of HDI, but the introduction of HDI to policy implementation should be seen as a challenge to the conventional national income oriented growth, especially during such a crisis. The paper argues for the need of reorienting the development in Indonesia, that is to employ the people-centered development. HDI is an illustration of a criterion to measure people-centered development. Of course, more precise criteria must then be developed by modifying or even changing the HDI.

A faster improvement in the index, with slower growth of GNP, may be much better than faster growth of GNP with lower improvement (or even, deterioration) in the index. A faster improvement of the index will better guarantee the sustainability of the economic development. Of course a fast increase of the index of people centered development which goes hand in hand with fast growth rate of national income will be very desirable.

The new elected government in October 20, 1999 should explicitly orient the development to the people. The new economic order, beginning in 1966, had actually started with much attention to the investment in human capital, reflected for example in the intensive program on education, health, and family planning. The new economic order has recorded success in reduction of poverty, and in the area of health and education.

Yet, it had not explicitly mentioned that the development should be people-centered. Worse, especially in the last ten years of the new order, the development had seemed to be away from people. Preoccupation with the achievement of "excellent" macroeconomic indicators had been the feature of Indonesian economic policies during the 10 years before the crisis.

The measurement of economic development still hinged too much on the conventional macro-economic indicators, such as GDP, inflation rate, interest rate, and current account balance. People-centered development does not ignore those macroeconomic indicators; it simply stresses that macroeconomic indicators should be supplements to indicators which measure monetarily unquantifiable progress in economic development. In other words, measurement of economic development should be changed so that income is only one indicator of economic development. The success of the recovery should not be viewed from the resumption of the economic growth and macro-economic indicators only.

This people-centered development sees that human capital is the basic fundamental in the economy. It also emphasizes the importance of the welfare of population as consumers. In the economic jargon, the people-centered development attempts to maximize the utility of the people, rather than simply to maximize the income because income is only one of the constraints to maximize utility. The people-centered development also considers the large number of Indonesian population as a great potential domestic market—the domestic market should be targeted more than foreign market. The concept argues for domestic market led development. This policy can then reduce the risk from international economic fluctuation.

2.2 Monetary, production, and human capital reforms

Because of the crisis, the countries, especially those worst hit by the crisis, soon realized the need for a drastic reform on their monetary sector. The crisis was often seen as merely a financial crisis. Indonesia is not an exception. Endeavor in this respect has been tremendous, though until this paper is prepared in January 2000, the monetary sector has not been successfully reformed.

In addition to the monetary sector, the government of Indonesia has also worked on the real, the production, sector, though it seems that the attention given to the production sector is not as large as to the one in the monetary sector. Some believe that the monetary crisis has caused the crisis in the production and they argue that once monetary crisis can be overcome, the production will automatically return to the boom era. Others, however, maintain that the crisis in production may be independent of the monetary crisis, though the monetary crisis may have triggered the appearance of the production crisis.

Equally serious attention must be given to the reform on production sector, including cost-cutting effort covering things such as elimination of many "informal" fees, elimination of special privileges, and reduction of red-tape bureaucracy. A success in monetary reform will not bring back Indonesia to the "miracle" unless the production sector is also drastically reformed.

Unfortunately, a much more fundamental reform has not been touched seriously in Indonesian economic policies. Human capital is often seen outside the scope of economic policies. Yet, it may not be an exaggeration to say that human capital reform is the most fundamental reform Indonesia needs at this present time. It does not mean that Indonesia should neglect its monetary and production reforms; rather, the reform on human capital development must be given equal, if not more, weight in economic policy making.

2.3 Human capital development

Human capital can be seen in a very general concept. However, it can also be directed to three essential elements of human capital: education, health, and freedom from fear.[i] Which one is more important among the three? It is hard to say, and, perhaps, they are equally important.

The government can spend more money to make sure that crime rates are decreasing; that it is safe for people to travel and to do business; that it is safe for people do business without fear of being illegally taxed by irresponsible persons; and that there are no more rioting, lootings, and intimidations. With the freedom from fear, people do not need to hire their own "security guards" or "backing" from powerful persons. Freedom from fear should become public goods, which can be enjoyed by everybody including the poor, rather then enjoyed only by those who have the money. Indonesia should strive toward a "freedom-from-fear based economy."

With the creativity most Indonesian have, this freedom from fear will induce the Indonesian to work harder and more creatively for all levels of business—the small, medium, or the large. This freedom from fear is the most fundamental need of the Indonesian people, especially the poor. Financial assistance is not so important thing for the small and medium sized enterprises. Unfortunately, the freedom from fear has never been mentioned in many economic policies, including the one on Social Safety Net programs.

The next human capital investment is in the area of health. The policies should not be focused on curative action, but more on preventive and promotive action. The monetary oriented development will call a "progress" if one person gets sick and spend money to cure it, simply because the expenditure has increased and then the Gross Domestic Product has risen. A growth in pharmaceutical industry because of the growing number of people getting sick is an indication of rising economy in the conventional, monetary oriented approach. On the other hand, in people-centered development, being healthy itself is a measure of development, without necessarily having to be able to convert the healthiness into monetary equivalence. Getting sick is a minus in the people-centered development.

In the people-centered development, being healthy is an end by itself; though it also realized that being healthy would imply more productive labor force and less expenditure for medication and traditional curative health services. This can be called as "health-based economy," an economy that is based on its healthy labor force. Therefore, all health related programs should be prioritized on preventive and promotive, rather than curative, efforts.

The last component of human capital investment, is the education. This is what is now so frequently discussed "knowledge-based economy." The education is not limited to formal education; but is geared to the achievement of well-informed society. The members of the society will be knowledgeable on many aspects of their life. Further, with this knowledge, the freedom from fear and the excellent health status can be turned into monetary benefit; though the monetary benefit is not the main objective of the development.

3. Domestic-market led development

In the sixties and seventies policies on import substitution had been dominant in many developing countries. The idea is to substitute the import. A country should try to produce everything by herself. This policy is supposed to reduce, or even eliminate, the dependency on international market, and hence, international economic fluctuation. Along side with this policy, the government should produce policies to protect "infant" industries. "Love" for domestic production is promoted.

This strategy was the principal route toward industrialization for almost two hundreds years since the emergence of England as the first industrial power in the world. When USA was just independent, president Jefferson also followed this strategy. He made an embargo for the British' imports. German created protective tariff to push her industrialization in the mid-nineteenth century. Further, all European powers and Japan had followed this strategy as they realized that military strength depended on industrial strength.

However, it turned out the import substitution strategy and the accompanying infant industry policies had resulted in much inefficiency in many developing countries in the second half of the twentieth century. The domestic prices became very high. Consumers suffered and could not afford the high cost of this strategy. Therefore, during the eighties many developing countries turned into export promotion strategy, which had been successfully implemented by Taiwan, South Korea, Hong Kong, and Singapore – the four emerging dragon economies. These four countries seemed to have implemented the export promotion strategy, rather than import substitution strategy.

Under the export promotion strategy, import is fine as long as the country can export too. The most important thing is the ability to export more and more. With the foreign exchange, the country can buy anything she wants. With this policy, a competitive environment, even with the global market, will be created. Efficiency will emerge.

This outward looking strategy has been actually as old as the

Wealth of Nations by Adam Smith. He argued that small home markets had to export its products to achieve economies of scale. Along with this argument, it is often said that a big country like Indonesia must also promote and depend on export because its population, though large in number, is still poor. Even, a more extreme view argues that, to earn money, Indonesia has to export manufactured and high "value added" goods with much component of high technology. Indonesia, it is argued, has to gain competitive advantage by exporting "expensive" and "prestigious" goods such as airplanes.

During the current Indonesian crisis, the dependence on international market might have contributed to the severity of the crisis. Indeed, the crisis was triggered by international situation. Many domestic prices had risen because many of them had import components. The Indonesia had just realized how dependent they were on imported materials.

Indeed, studies as old as Chenery (1960), Maizels (1963), and Chenery and Taylor (1968) had shown that there was strong negative relationship between population size and the extent of international trade. Small countries (in terms of number of people) specialized most and depended mostly on international trade. [ii] It is also worth noted that the policies to be out of Great Depression in the 1930's were neither ones on export promotion, but to raise domestic aggregate demand. This is especially true with respect to the USA, which had a very large number of population—who were suffering from the prolonged great depression.

Chowdhury and Islam (1993) have also noted inconclusive evidence on export-led growth. They admit that export had played significant role in the growth of East Asian NIEs; yet they mention that it does not necessarily mean that the growth had depended a lot on international economy. Rather, the high growth rates were attributable to both their ability to exploit the world market and their domestic capacity to increase the supply for export. Internal factors might have worked significantly.

Luckily, few people have started to realize the danger of too much depending on export as a means to recovery and even to achieve sustainable economic development. Tan (1995) mentions several risks associated with export promotion strategy. He finds that countries with a large exposure to international economy had been very sensitive to abrupt, unpredictable, changes in international economic fluctuation, which are beyond the control of the individual countries. The second risk is that the country would eventually lose its initial comparative advantage. The success of the export would make its currency very strong. *Far Eastern Economic Review* (June 10, 1999) produces a cover story challenging the paradigm on export-led growth. It mentions that Asia needed a new source of engine of growth. Asia did not have to crowd the world market with their export; they could turn to the market in their own countries.

The question is now whether the Indonesian has to depend so much on international market. Indonesia has a large number of population, 208 million in the year 2000. People from the lowest 40 % of income are the most potential market. It has 83 million population. Indonesia should do business for these people. Income and price elasticities are low, which mean the a decline in income and a rise in price will not much reduce the quantity demanded.

Indonesia should first prioritize the domestic market, though the goods and services demanded are not those with high prices. Yet, they are the products needed by the society. On the other hand, the most profitable business is not necessarily those with high price which usually needs a long period of investment. In other words, with about 208 million population in the year 2000, the government should encourage business which produce goods and services for low and middle income groups. This business can be indeed very lucrative.

Recently, Thailand has been very innovative is utilizing the huge market. They invented instant rice to capture the huge Asian market, which most (including middle and lower income people) eats rice everyday. The market will become more attractive if, because of the very large-scale production, the instant rice can be cheaper than the ordinary one.

It should also be noted that during the crisis, people lower their consumption pattern. Those who use to spend their holiday abroad now travel within Indonesia and choose shorter distances. Those who use to go by planes now prefer to use cars or trains. Those who used to go to five star restaurants or hotels now choose cheaper ones. Who used to visit cheap restaurants now decide to eat more at home and to bring their own food to work. This phonemenon created a new business opportunities.

People learn to reduce convenience and "gimmick". It may not be easy to change life styles because the Indonesian people have accustomed to enjoy "good life". However, the Indonesians have to learn to adjust to the unfavorable economic conditions. Private companies can help the Indonesian by innovative campaign to sell more basic (functional, or generic) commodities. The government and scholars can help disseminating this issue as part of social education program; it is also an "advertisement" for the generic, functional, products and services for the large, potential, market.[iii]

People can also concentrate on business for "simple" goods and services, needed every day by almost all people. It is not difficult to produce, and highly demanded by the society, especially at the time of crisis. Indonesian should be allowed to try from the "beginning" again, just like the Vietnamese started their business after *Duo Moi* (economic renovation).

The concentration on simple business – such as provision of simple food, simple clothes and simple means of transportation -- will provide people with additional income to survive during the crisis. At the same time, it improves the availability of goods and services for daily needs. Price of these goods and services will decline. It is a source of earning and at the same time it helps the people, especially the lower income group, to better satisfy their daily needs.

The most important, and also profitable, business is perhaps doing simple business in providing cheap and easy services in health, education, and freedom from fear. During the crisis, most people need these services. In addition, with the large number of population, this business can be very promising in Indonesia.

Indeed, it may be interesting to note what Enzler (1939, p. 164) observed during the 1930's Great Depression:

> But it sometimes happened that individuals and families who had lived with phantom happiness amid the days before the depression benefited by a <u>return to simplicity</u> [underline by the author). Women began to do their own work, gave up parties, hair dresses, shampoos, manicures, or at least became their own beauty technicians. They were sometimes able to develop vocational talents and thus fill the hours with worthwhile activities. The sense of values in both men and women sometimes grew into closer attune with truth. Happiness in the simpler things, in group games, neighborly visits and socials, a return to activities which bind persons close inn friendship and sincere hospitality were a part of the quest for quieter, less blatant pleasures which the pinch of the economic shoe sometimes occasioned.

Domestic market led development also stresses the importance of strengthening food production. Historically, agriculture has been the big source of funding, from which industrialization was financed. Agriculture was also the place of the consumers of the industrial output. Without strong agriculture, the industrialization must depend on foreign resources and market. Without skilled labor, they have to import skilled labor. Without sufficient market, they have to export the output. The policy of industrialization seems therefore to be hand in hand with the policy of export substitution, which depends much on international resources and market.

However, because food is the most important commodity for the people and it becomes politically sensitive commodity, industrialization should not be done at the expense of agricultural development. The recommendation here is to turn to the domestic market. Indonesia must strengthen the agricultural sector. The domestic market has been looking forward to the availability of high quality food in sufficient quantity, accessible, and low prices. The agricultural sector will also create market for low prices goods and services, which will promote industrialization aimed at fulfilling the needs of lower income people including those in agriculture sector. With this orientation, Indonesia does not have to depend too much on foreign resources and market.

Yet, Indonesia does not have to protect the domestic producers. Foreign investors are also allowed to produce goods and services for this attractive market of low income people, including those in agriculture sector. Let they compete with international producers as they are also allowed to go the international market if they want.

The fact the Indonesia is largely surrounded by water hints that aqua-culture may also be developed. There are potentials of growing plantation under the water – and they may be very healthy too. Agri- and aqua-business can be seen as promising investment toward domestic-market led development.

In short, priority to domestic market is also in line with people-centered development strategy. Not only does this policy help the domestic producers to grow, but it also provides goods and services needed by the majority of the population. It is the consumers, rather than the producers, who drive the economy; it replaces motto on *Aku Cinta Produksi Indonesia* (I love Indonesian products) with one on *Aku Cinta Konsumen Indonesia* (I love Indonesian consumers)

It should be noted, that the policy to prioritize domestic market does not mean that export and import should be discouraged or regulated. There must still be free export and import. Indonesia should let the market decide whether and how much to export and import. Indonesia must not return to import substitution policies. But, production for domestic market, rather than for international market, can be used as the leading, sector, in sustainable economic development.

It should be mentioned here that domestic market led development is neither against big business. Big business is not an evil, though priority should be given to small and medium sized enterprises. If big business is regarded as an evil, the small and medium sized business will never become big business.

4. Economic institution

Economic progress does not proceed in a vacuum. Economic and institutional factors do interact. One affects another. In other words, the endogeneity of institution is crucial in economic policy. The inertia of institution relative to economic variables is one important aspect of this endogeneity.

Institutions are guides to human interaction; they rule the behavior in economic activities. It is analogous to the rules of game in competitive sport. Institutions differ if, for example, transaction is carried out in Indonesia or in the United States of America. It may be formal (rules that human being devise) and informal (such as conventions and codes of behavior). Institutions affect the economic activities through its impact on the cost of exchange and cost of production.

Existence of institutions reduces uncertainty because the "actors" in the economy know the "rules" of the game and can anticipate what others will play. Unstable and unclear economic institutions result in high uncertainty – it results in a high cost economy. Strong economic institutions, one that is conducive to efficient economic activities, is clearly very important to build a sustainable economic development.

In the absence of strong economic institutions. uncertainty looms; speculative and unproductive businesses will boom. Though the economy, measured with monetary oriented indicators, may be growing, it may be a fragile economy. Indeed, North (1990, pp. 107 and 110) observe that institutions played a fundamental role in the long-run economic performance; and, therefore, developing countries were poor because the institutions did not encourage productive activities.

Worse, development of strong economic institutions cannot be done over night: the written rules can be changed quickly, but the implementation may take much longer. In this regard, it is interesting to note what Lawrence Summers, the deputy secretary of treasury of the government of the USA, said in October 14, 1998 about the crisis. He said that the problems had been enhanced by the deep institutional and political problems in countries such as Indonesia and Russia. The economic success turned out to have outpaced their institutional capacity to carry out core functions (such as tax collection and bank regulation) and to carry out main reforms. Summers also said the problem was even more severe because it had been spread with unprecedented speed and force by the new information technologies and financial instruments.

Good governance is one important issue currently raised with regard to enhancing institutional capacity. Root (1998) finds that countries in Southeast and East Asia which practice good governance were more likely to have higher per capita private sector investment. With the lesson from Southeast and East Asia, he reveals that an emphasis on good governance would make a country well integrated to the world economy as well as no longer dependent on international aid.

There are three elements of good governance: rule of law, transparency, and accountability. The main purpose of good governance is to build confidence and trust about the government among the community, business sector, and investors. It is then not surprising that good governance is a very important element in economic recovery and even for the achievement of long-run sustainable growth. Beckman (1999) observed that the severity of the crisis was positively correlated with the degree of cronyism, corruption, poor legal structure, poor corporate accountability, and weak general ethics. Indonesia is the hardest hit and it has the highest degree of those things.

Root (1998) learns that one important key of the success of the "East Asian miracle" was the existence of the ability to change, including ability to understand when the change should be made. The success of these countries depended much on the transformation of key institutions which formulated and implemented development policies. Unfortunately, ability to introduce new organization, new rules, and new procedures, had not been incorporated in the calculation of total productivity growth. Therefore, he argues, that institutional change had been systematically underestimated in economic literatures.

The knowledge-based economy helps the creation of transparency, accountability, and rule of law. The role of the government in providing information for everybody is crucial in the improvement of equity in development. Public finance policies in the area of information creation and dissemination are thus becoming very important in enhancing the economic institutions.

It is clear, that bad governance which is now widely discussed is an indication of the absence of strong institution supporting the booming economy so far Indonesia had enjoyed. The bad governance has produced a high cost economy.

Strong institution must be created, to be able to support the economic reforms. The new information technology, a new institution which has unavoidably invaded Indonesian economy and made the crisis worse, must be made an asset which can help Indonesian economy leaving the crisis and follow the path of sustainable, people centered, development.

Further, economic policies must be made by giving enough consideration to the existing economic institutions. Macro-economic modeling may make their conclusions depending on several scenarios of institutional development. The macroeconomic analysis should take into account how the traditional macro economic policies affect and are affected by institutional factors.

Finally, it may be interesting to consider some institutional reforms suggested by Beckman (1999,pp. 373-378) for Asian countries. First is the decent payment the public servants. He argues that the salary should not be seen as a recurrent expenditure, but as a capital expenditure. The "user pays" mechanism (those who use the service must pay) must be eradicated, and be replaced with a contract involving an attractive sum of salary. If he or she does not do as mentioned in the contract, the contract can be canceled or it may not be renewed. Along with the knowledge-based economy, all the rules and procedures must be made very clear and transparent. Customers, for example, can read it from the hard copy or simply downloading from the computer. Those who are not capable should not get the contract.

Second is the enforcement of bankruptcy laws. Bankruptcy is part of accountability. If the business fails it must go bankrupt. The nature of the market will decide whether one fails. The government should let those unsuccessful firms go bankrupt. However, in Indonesia, he says, bankruptcy can be avoided with small cash payment and other gifts.

Third is on separation of bank ownership. The structure of the ownership of Asia's bank is not conducive to sustainable growth. He stresses that though Asia may overcome the current crisis, they may soon return to the same, or worse, crisis, if they do not reform the structure of bank ownership. Currently, owners of a bank are also shareholders of many non-financial business. This structure creates conflict of interest. Thus, the reform is to prohibit owners of bank from being shareholders or even managing non-financial business.

Fourth is the reform on accounting and auditing, to standardize the accounting standard throughout Asia. This reform will reduce, if not eliminate, abuses of accounting practices. With this reform, minority shareholders will also be protected because genuinely independent directors are still few in Asia.

The fifth is the prevention of retiring bureaucrats from taking lucrative jobs in the private sector. These former bureaucrats are demanded because of their connection with the existing bureaucrats. The practice is also a kind of corruption – to be nice when still being bureaucrats and get the fruits when retiring. The United States of America prohibits its senior officials from working in sectors that are very related to their former responsibility in the bureaucracy.

The last is reform on mass media. Censorship of mass media may not come only from the government, but also from the owners. Reporting in the media may create conflict of interest with the other business of the owners. This imperfection of local media has contributed to the current crisis. A separation of ownership may be considered or that there is a limitation for the owner of mass media on having shares in other businesses.

The independence of local business media must go hand in hand with better salary for the journalists. Some journalists in China, Thailand,

and Indonesia are willing to accept "envelopes" (with money inside) not to report negative stories of firms. Better salaries coupled with possibility of losing the jobs if not doing the job well will reduce, if not eliminate, temptation to receive the "envelopes."

4. Integration with the World Economy

4.1 Integration: unavoidable, but..?

The 1990s have witnessed a rapid trend of globalization. Everything can almost be found everywhere in the world. Rising flow of goods, capital, and labor have been seen almost everywhere and almost everybody has preached for the more globalization and integration of the world economy. Yet, abruptly, the Asian, including Indonesian, economy was hit by the crisis. Suddenly, people ask whether this trend of globalization and integration of the world economy is good or bad. It may seem that countries going deeper into globalization are worst hit by the crisis. Indonesia is more integrated with the world economy than Philippine and Indonesia is worse hit during the crisis than Philippines

Globalization is here seen as the integration of national economy into the regional and world economy. The full integration will include the integration of all goods and services as well as all factors of production. All goods will be freely traded among nations and factor productions (especially capital and labor) will freely move to the place where they get the best return.

The question is whether Indonesia and the world have gone to the full integration. If not, to what extent they have gone and what sequence, if any, they should take toward the full integration of the world economy. For the case of Indonesia, how should Indonesia join the integration of its economy to the world economy?

Yet, the issue of integration with the world economy cannot be separated from questions on domestic regional economic integration, in particular during the rising "demand" for either full autonomy, federation, or independence.

4.2. Enhancement of domestic regional development

> "Archipelagic in geography, eclectic in civilization and heterogeneous in culture, Indonesia flourishes when it accepts and capitalizes on its diversity and disintegrates when it denies and suppresses it.." (Geertz (1963), as quoted in Hal Hill, 1989, p.4)

Mackie (1980, quoted in Hal Hill) mentioned that with the diversity in its regions, Indonesia had been able to integrate its economy because of its strong development-oriented government, oil and capital inflow, as well as huge investment in both physical and social infrastructure. The regional price variation had declined, indicating an emerging national, integrated, network, an interregional commerce, and a wide interregional labor mobility. This economic integration had also been accompanied with political integration – e.g., the centralization of army authority.

Hall Hill and Anna Weidemann (1989), though, had pointed out some problems regarding regional development in Indonesia. In time of abundance of revenue, the issues might be submerged. Yet, limitation in the central government budget may induce its appearance to the surface. He recommended that Jakarta should come to the regions for ideas, money and initiative. They wrote:

> "The 'unity' of the last 20 years of strong central government has to be complemented more effectively by the 'diversity' which flows from a greater emphasis on regional initiative and self-finance."

The recommendation cannot be more relevant today than in 1989 when mentioned by Hill and Weidemann (1989). The current crisis hitting Indonesia and the step down of Soeharto have loosened all "ties" which formed the "unity." Aspiration to have more "independence" in determining their own destinies are now emerging.

This decentralization of power—whether in the name of full autonomy, federation, or independence--will speed up the decision making in using the regional resources. The local people know more on what they need than the people in Jakarta do. In line with the recommendation on more use of market mechanism, it is therefore also recommended that regional development should be encouraged by allowing the regional societies to decide their own development agenda.

Each economy then will decide what they can best do in their own economy. Because each economy has different comparative advantages and stages of economic development, the pattern of production will also varies. They will decide what specialization they will do. This difference amounts to a large amount of exchanges in goods, capital, and labor. They will engage in free trade of goods with other economies without having to consult with administration in Jakarta. Free capital and labor mobility will also occur among economies. The integration of these economies will benefit each economy as well as Indonesia as whole.

Each economy may use *rupiah* as the currency, but they do not have to prohibit the use of other currencies in their own economies. There is no need for a drive to "*Aku Cinta Rupiah*" (I Love *Rupiah*). Each economy will be very pragmatic in using the currency. The market will decide which currency is used; it may be a mix of currencies. As long it increases the welfare of the society, whatever currencies can be used in the economy.

A rising and different pattern of regional disparity may initially result. Some resource rich economies (Aceh, Irian Jaya, Riau, Jambi, and East Kalimantan) may become very affluent, if they are well managed, and some isolated economies (East and West Nusatenggara) may take a long time to struggle out of poverty. Yet, free flow of goods, capital, and labor with the more fortunate provinces, the isolated economies will no longer be isolated.

With a successful implementation of knowledge-based economy, that the society becomes well informed on most of the things in all economies, a small economy with relatively advanced technology and regional income per capita such as Jakarta does not have to worry on a large inflow of unskilled labor from relatively much poorer economies. People who will come to Jakarta, for example, are only those who are really needed by the economy of Jakarta. Further, the rising power of each economy to determine what they want to do will push the development in each economy and hence reduce the motivation to migrate to other economies.

With this regional development, "money" will not only be in Jakarta; investment will be more wide-spread and population mobility will also rise rapidly. The center of economic gravity will not be limited in the densely populated provinces in Java-Bali, but will also be located outside Java-Bali. Improvement and proper attention in the regional development -- more interactions in both goods/ services and factors of production among regions -- will also reduce the dependence of Indonesian economy on international economic fluctuation.

4.3 Reform on international economic integration

Asian Development Bank (1999) argues that liberalization of capital flow, which will benefit the industrialized countries more than the developing countries, should be accompanied with liberalization of labor flow, which will make the developing countries better off as well. Further, it was ironical that industrial countries had pressed developing countries to allow more, if not free, capital inflow to developing countries; they were at the same time busy with policies to protect their jobs and industries. The Bank concludes that recovery from the current crisis, and then the sustainable economic development, ought to depend on an open global environment – a consistent liberalization in trade, capital flow and labor flow.

For the benefit of Indonesia and other countries, liberalization should be continued, but on a consistent basis. Free movement of goods (free trade), free movement of capital, and free movement of labor should be performed simultaneously and not partially. This consistent liberalization requires the understanding of advanced countries and persistent negotiations from the developing countries. If industrialized countries are reluctant on consistent liberalization, Indonesia may do the same thing. Indonesia may recommend a limited inflow of capital and labor. Otherwise, Indonesia may fall to the same, or worse, crisis, which is neither beneficial for industrialized countries.

Before the crisis, the large inflow of foreign capital and skilled labors to Indonesia might have made capital and skilled labor relatively cheap compared the existing structure of capital and labor market in Indonesia. Coupled with the pressure to raise minimum wages, Indonesian unskilled workers could have become relatively too expensive. Foreign and domestic firms were then likely to be away from the unskilled worker and they preferred to use the capital and skilled labors. The unskilled workers suffered and their flow abroad got high resistance from industrialized countries.

What is meant by consistent liberalization is that there should be no effort to restrict the purchase of "goods, services, and factors of production — be it capital or labor" if demand exists, if people are willing to pay at the existing market prices; there should be no restriction to sell "goods, services, and factors of production" if the supply exist, that is if the owner are willing to sell at the existing market prices. There should be no restriction simply because the goods, services and the factors production move between countries. Restriction can of course be applied if the goods, for example, are dangerous good. In other words, restriction should not be applied simply because the goods, services, capital, and labors are from other countries.

It should be noted here that the free flow is allowed as long as demand and supply exist. The government of one industrialized country may not like to inflow of unskilled labor. However, if the economy still demands those unskilled labor, the government should not prohibit their economy to buy the services from other countries. If the government does not like that import of unskilled workers, they can change the structure of the economy such that it does not need or it reduces the need of foreign unskilled labor. An example, the national unskilled workers are persuaded to take that jobs; the government may initiate the use of more advance technology to replace the use of unskilled labor.

If the industrialized countries are reluctant to perform consistent liberalization, there is no reason for Indonesia to apply partial liberalization. Indonesia does not have to depend on international capital and skilled labor. Indonesia can utilize its large domestic market: the low and middle income consumers can be satisfied without high technology and capital inflow from abroad.

With consistent liberalization, Indonesia and the world must be permitted to pay the same price for the same goods and services, regardless which country produces. The domestic price should be allowed to rise close to that of imported rice. The rising price of domestic price will induce people to better distribute rice and even, to induce them to plant more rice. On the other hand, people can also be educated, through knowledge-based and health-based economy, about healthy and cheaper alternatives to rice consumption.

The same quality of skilled labor working in Indonesia must be paid equally, regardless whether he/she is Indonesian or not. Currently, an "expatriate" working in Indonesia is paid in US dollar with international standard, but Indonesian working in Indonesia is paid in *rupiah* with Indonesian standard. An international expert has a higher rate (and paid in US dollar) than a domestic expert (paid in *rupiah*) though they are working in the same level. It is more rational that the domestic expert, who knows more about the country, be paid higher than the international expert who often knows little about Indonesia.

If the international expert is paid in US dollar, the Indonesian expert must also be paid in US dollar. If the Indonesian expert is paid in *rupiah*, the international expert is also paid in *rupiah*. This is very important especially during this uncertain economic condition. With the same payment, regardless domestic or foreign status, the Indonesian skilled workers can better compete the foreign workers. The "needs" of both skilled workers are already globalized and hence there is no need to make a distinction between local and international expert. If this practice continues, Indonesian will suffer from inflow of skilled workers.

Indonesia should also consider allowing using US dollar, Euro, Yen, or other strong world currencies, for everyday business. This will raise the feeling of economic certainty for the Indonesian people, amidst the high inflation rate and continuously weakening *rupiah*. The government of Indonesia should not have the feeling that their sovereignty is lost if one day people no longer trust *rupiah* at all. Liberalization will mean a smaller number of currencies in the world. This reform needs hard work from the Indonesian part to convince counterparts from other countries, especially those from more industrialized countries. This strategy depends much on the success of policies on domestic-markets led development.

In short, theoretically, from economic point of view, consistent international economic liberalization will benefit all economies, including the industrialized economies. The issue is then more political than economic.

5. Concluding remark

This paper presents policies recommendation for the achievement of long run, sustainable economic development. It does not ignore the importance of short run macro-economic stabilization and financial restructuring, but the paper attempts to put all short run policies in the context long run, sustainable economic development. By doing this, the risk of repeating the same, or worst, crisis, can be reduced; even the crisis can be converted into golden opportunity to make drastic reform toward long run, sustainable economic development. Recovery, for example, does not have to be measured as when Indonesian economy achieves 5 per cent growth rate.

In summary, the recommended policies are:

1. People Centered Development.
   - 1.1 Change of the statistical indicators
   - 1.2 Human capital development:
     - 1.2.1 Freedom-from-fear based economy
     - 1.2.2 Health-based economy
     - 1.2.3 Knowledge-based economy
   - 1.3 Domestic-market led development
2. Strengthening of Economic Institutions
3. Integration with the World Economy
   - 3.1 Domestic regional development
   - 3.2 Consistent liberalization

Lastly, the current crisis provides Indonesia an opportunity to change its development orientation toward a people-centered-development. It may have a slower economic growth, but with strong economic institutions and consistent world economic integration, it will have a more sustainable competitiveness and prosperity.

Selected bibliography

Asian Development Bank. 1999. *Asian Development Outlook 1999*. Hong Kong: Oxford University Press.

Beckman, Michael. 1999. *Asian Eclipse. Exposing the Dark Side of Business in Asia*. Singapore: John Wiley & sons Pte Ltd.

Bryce, Murray D. 1960. *Industrial Development. A guide for accelerating economic growth*. Tokyo: Kogakusha Company, Ltd.

Chowdhury, Anis and Islam, Iyanatul. 1993. *The Newly Industrializing Economies of East Asia*. London: Routledge.

Enzler, Clarence J. 1939. *Some Social Aspects of the Depression.* Washington, DC: The Catholic University of America Press.

Flew, Antony (ed.) 1970. *Malthus. An Essay on the Principle of Population.* England: Penguin Books, Ltd.

Hill, Hall.(ed.) 1989. *Unity and Diversity. Regional Economic Development in Indonesia since 1970.* Singapore: Oxford University Press.

Hill, Hall and Weidemand, Anna. 1989. "Regional Development in Indonesia: Patterns and Issues" in Hill, Hall (1989).

Hill, Kim Quaile. 1988. *Democracies in Crisis.* Boulder and London: Westview Press.

North, Douglass C. 1990.*Institutions, Institutional Change and Economic Performance.* Cambridge, UK: Cambridge University Press.

Robinson, Joan. 1972. "The Second Crisis of Economic Theory" *American Economic Review*, 62, 2, May, p.2 as cited in Whalen (1996).

Root, Hilton L. 1998."Distinctive Institutions in the Rise of Industrial Asia" in *Behind East Asian Growth. The political and social foundations of prosperity.* Edited by Henry S. Rowen. London: Routledge.

Samuelson, Robert J. 1993."Great Depression" in *The Fortune Encyclopedia of Economics.* Edited by David R. Henderson. New York: Warner Books, Inc.

Tan, Gerald. 1995. *The Newly Industrializing Countries of Asia.* Singapore: Times Academic Press.

United Nations Development Programme. 1992. *Human Development Report 1992.* New York, UNDP.

Whalen, Charles J. 1996. "Beyond Neoclassical Thought: Political Economy for the Twenty-first Century," in *Political Economy for the 21st Century.* Edited by Charles J. Whalen. New York: M.E. Sharpe, Inc.

[i] The discussion of human capital as consisting of education, health, and freedom from fear originated from Siti Oemijati Djajanegara and Aris Ananta. *Mutu Modal Manusia: suatu pemikiran mengenai kualitas penduduk* [Quality of Human Capital: a Thought on Population Quality]. Jakarta: Demographic Institute Faculty of Economics University of Indonesia, 1986.

[ii] quoted from Hollis Chenery "Structural Transformation: A program of research" in The State of Development Economics. Progress and perspectives. Edited by Gustav Ranis and T. Paul Schultz, pp. 49-77. Cambridge, MA: Basil Blackwell, Inc, 1988.

[iii] Here is an example of a generic product. A generic car is one without many accessories and "comfort." In other words, the "convenience and comfort" can be sacrificed to have well functioning and cheap cars. Meeting rooms can be made simple, without too much luxury, including things such as lighting and air condition.; it can reduce much maintenance cost.