

“The New Indonesia: Current Program and Future Directions”

An Open Forum With

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October 28, 2009

USINDO Advisor **Dr. Dorodjatun Kuntjoro-Jakti** spoke on the advances Indonesia has made in its economic and political development over the past decade, the challenges it still faces, his perspective on the new Administration of President Susilo Bambang Yudhoyono, and lessons learned from the 1997 crisis for Indonesia today.

Dr. Dorodjatun began his discussion with a look back at the 1997 financial crisis, to relate how a currency crisis can become a political crisis, and how currency speculation played a role in the Soeharto administration’s end.

Dr. Dorodjatun returned to government service at the request of President Soeharto in 1997 following the collapse of the Thai Baht. Indonesia faced the same currency risk that brought down the Baht, given the economy’s reliance on short-term debt to finance the budget shortfalls. Within a few months, the rupiah had fallen from an exchange rate of Rp 3,000 to the dollar to Rp 15,000 to the dollar, a depreciation of 85 percent. As a result, GDP declined 18 percent, and the country’s sovereign debt rating

fell to CCC-. The Indonesian economy was deeply hurt, and it would take significant effort to convince investors to once again trust Indonesia’s institutions after such a dramatic collapse.

Initially faced with a currency crisis, the government hoped to use its foreign exchange reserves to defend the rupiah instead of devaluing the currency. However, given the lack of investor confidence in the system, the government could not continue to defend the currency, and was forced to issue approximately Rp 144 trillion to recapitalize banks in order to support the banks following the rapid currency outflows. The cost of the bailout topped US\$50 billion, roughly 40 percent of the country’s GDP. Some 400,000 companies went out of business, mostly large and medium-sized enterprises which were faced with a serious loss of liquidity. This led to an explosion in the unemployment rate and a drastic rise in poverty.

Thus, the currency crisis became a banking crisis, which resulted in an economic crisis and a social crisis, all of

which contributed to the fall of Soeharto in 1998.

However, the crisis opened up an opportunity that Indonesia had not seen in decades by allowing leaders to address some of the major systemic flaws of the political and economic system. It was during this time that democratization and decentralization started, as well as freedom of the press, the rise of new political parties, and the greater influence of NGOs. The crisis ultimately was used by stakeholders to discuss new and innovative solutions to addressing its core issues, and was an experience in politics and governance the country had not had for three decades. Over the next two years, 200 major laws were passed, although this could have been faster if Indonesia had developed a culture of “political staffers” – permanent employees who specialize in certain areas and allow the political process to proceed more efficiently. Ultimately, the crisis was the opening needed for Democracy, Decentralization, and Reform.

However, the process was by no means simple. New laws granting more power to regional governments meant that new governments were being created every week as decentralization spread to the district and city level. Until a threshold was established for political parties, new parties were created every week. With decentralization, the central government began sending money to the regions. The money was distributed via three main funds; the General Allocation Fund used to run the government, the Special Allocation Fund used for special projects, and a Fund from which revenue generated through natural resources is distributed. A fourth special fund

established the Special Autonomous Region Fund for Aceh and Papua. Currently, these types of Funds make up around 35 percent of the federal budget as Indonesia continues its transformation into a Federalist state.

Dr. Dorodjatun was confident that the new cabinet recently announced by President Yudhoyono will do a good job, continuing the work of Democratization, Reformation, and Decentralization established over a decade prior. He believes that Vice President Boediono will continue the policies he undertook as head of the central bank and continue to promote reform of the banking and financial institutions.

Nearly 70 percent of the parliamentarians are new, as are 40 percent of the cabinet members. Thus, there are a lot of new, younger, up-and-coming leaders in the government right now, and they are more technocratic than previous generations. However, these leaders must remember that political education is also important. , and Dr. Dorodjatun stressed the importance of making sure there is a cadre of permanent government staffers with specialization in certain areas who can increase the number of laws passed per year, which is necessary to speed up overall Indonesian reform.

Dr. Dorodjatun sees four main tests for President Yudhoyono’s second term in office and the new cabinet.

First, there is once again a huge amount of short-term capital coming into Indonesia. If investors lose confidence, the capital outflows could again become an issue for stability. The second test will be in how the government reacts if

crude oil prices rise again. Third, with 70 percent turnover in the new parliament, it may be difficult for President Yudhoyono to push through his legislative agenda. Finally, poverty and unemployment remain structural problems that can not be dealt with via ad hoc approaches; they require a targeted set of policies.

Currently, those watching Indonesian politics are looking to 2014 and what will happen as the new generation of political leaders begin to rise up. Dr. Dorodjatun and his cohort are on their way out of government, and the learning curve for the new generation will not be easy. Thus, a relationship with the United States is crucial. Efforts must be made to promote graduate study in the United States so that leaders understand the country. USINDO President David Merrill noted that USINDO is working to remedy the declining number of Indonesians studying in the United States and vice versa through its work to support a bilateral partnership for higher education.

Dr. Dorodjatun ended the Special Forum by taking several questions from the audience about military reform, political party development, and regulatory reform.

On the military, Dr. Dorodjatun noted concerns surrounding illegal trading and recognized that the Navy was unable to effectively do its job patrolling the coastal waters given its limited size. He believes the government should create a Coast Guard for enforcement purposes. He also noted that the army is in the process of reorganizing, but faces the same challenges as the rest of the government in terms of ensuring reforms

are carried out effectively and under solid management. Dr. Dorodjatun believes the new Minister of Defense will continue with the approach of the previous minister and will have a good understanding of the situation. Over the past five years, Indonesia has increased the size of the police force, strengthened the intelligence system, and has better addressed terrorism. Overall, the military is on its way to becoming a respectable establishment once again.

Dr. Dorodjatun also responded to concerns that regulatory reform was being hindered by the difficulties in bringing together competing groups, and a lack of party discipline. He noted the difficulties in party reform, and that political education is necessary. He called on the parties to work with NGOs on modernizing the political party system and parliament, and to promote a big-picture, long-term outlook for Indonesian reforms, rather than focus on special issues. Dr. Dorodjatun also argued that political parties, even those with possible ties to extremist groups, should be allowed to operate and their principles debated freely, fairly, and out in the open rather than being driven underground.

The lack of sound auditing principles among the provinces, especially concerning the grants from the federal government, is also an issue that must be addressed. Currently, there is no outside audit being done on grants provided from the central government to the provinces. The State Audit Board should be strengthened, but the BPK is not yet able to do so. However, regional governments want to enter the bond market, and in order to do this they will need to have an auditing system in place

and convert from a single-entry to a double-entry system before they can go to the rating agencies. Thus, reform may take an additional five to ten years before the provinces have sufficient auditing practices in place to allow them to enter the municipal bond market.