THE NEW ECONOMY, DEVELOPMENT AND REFORM: AN INDONESIAN PERSPECTIVE

Mari Elka Pangestu

2015 Harold Mitchell Development Policy Lecture
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Abstract
This is the 2015 Annual Harold Mitchell Development Policy Lecture, delivered by Professor Mari Elka Pangestu on March 12, 2015. The Annual Harold Mitchell Development Policy Lecture, of which this is the third, was created to provide a forum at which the most pressing development issues can be addressed by the best minds and most influential practitioners of our time. The 2015 lecture was presented by the Development Policy Centre in collaboration with the ANU Indonesia Project and the Australia–Indonesia Centre. All Harold Mitchell Development Policy Lectures are available from devpolicy.anu.edu.au, under publications.

Professor Mari Elka Pangestu was the Minister of Trade of Indonesia from October 2004 to October 2011. She was appointed to the newly created position of Minister of Tourism and Creative Economy in October 2011. Professor Pangestu is currently Professor of International Economics at the University of Indonesia.
Introduction

I am greatly honoured to be giving the 2015 Harold Mitchell Development Lecture. I have met Harold Mitchell before in person. He came to pay a visit to my office as Chair of the Australia-Indonesia Centre, and I was definitely impressed by you, Mr. Mitchell, as a media legend of Australia and a very successful businessman in the creative economy space of advertising and media.

Since that meeting, I have discovered that Harold is someone who has given back in many ways, including to development issues and to Indonesia, so I would say he is indeed a very rare person.

Given the others who have spoken before me, I hope I can do justice to this lecture series.

I decided that since this series is about development policy, I would like to share my experience of trying to implement policies to develop Indonesia. What I will share today not only reflects an Indonesian perspective – the perspective of a very large and complex developing country – but also my own perspective as an economist who, by accident, became a policy maker.

In my 10 years in government, I was responsible for many aspects of policy making, including reforms in the trade area, responding to crises, and setting up and restructuring bureaucracies and ministries with new mandates, including the creative economy. So I thought that I would speak somewhat on the creative economy, but also talk more generally about how one actually enacts reforms and introduces new policies, like the creative economy.

I was taught by someone, I can’t remember whom, that I should always start my talk with the conclusion, so that you know where I am going. My conclusion is that evidence-based policy making and clear targeting are very important for sustainable development.

Even though we have had hits and misses, I still believe that, whatever we do in policy making, we must be guided by underlying data and analysis, learned from the past experience of other countries or our own. We need to understand what is happening internationally and what the accepted best practices are. Using this information, we can provide informed answers to questions such as: How should you frame your policy? How should you evaluate your policies? How do you know whether they are on target or not? How do you deal with the reality that decisions are not made in a vacuum free of political, vested and other interests? And how do you generate public ownership of the policy and influence a public debate which is often based on misperceptions, ideology, and hard and fast positions? In a democracy, the last two questions are the ones that turn out to be among the most important to deal with, but also the hardest to resolve.

This lecture is divided into three parts. I will start with a brief discussion of recent trends in the global economy and what they imply for policy. All policy makers and governments need to be well informed on what is happening in the rest of the world. No country exists in isolation or autarchy. Understanding the new normal
and the new economy of the world, the external situation that your country is in, is crucial to making good policy. I will then share with you the six lessons in policy reform and policy change for development I have learnt from my experience. Finally, I will illustrate some of these lessons, as well as the new economic challenges, through a discussion of Indonesia’s creative economy, and conclude with some recommendations on the way forward.

The global economy: the ‘new normal’, diversification and the global value chain

The ‘new normal’ has become the term that people use post-global-crisis because things have fundamentally changed since 2009. We are now six years down the road. What is this ‘new normal’?

First, we now have to actually find real sources of growth. There is no more easy money, that is, quantitative easing. Europe and Japan have quantitative easing, but it won’t last long and we should not rely on it. The US is going to withdraw its quantitative easing. Fiscal stimulus can only be a limited source of growth, so we have to go back to basics, which is productivity-driven growth.

Second, low commodity prices are here to stay. Indonesia, like Australia, has a large share of its exports and the structure of its economy based on the export of commodities. 65 per cent of our exports are commodity based, so we have to diversify. This is not the first time Indonesia is asking this question; probably likewise for Australia. We have had oil and commodity booms in the past, and now we are asking the question again: how can we diversify our exports?

Third, China is slowing down and, with structural reforms, entering a new normal of slower growth and exiting the space of labour intensive exports. Is that a space that Indonesia should and could enter? Meanwhile, China is prioritising services and innovation. Other countries, like Indonesia, should be aware: this is a new wave of competition.

Fourth, most importantly of all, the way that trade operates has fundamentally changed because of technology, liberalisation, and regional agreements. In the old days, when I took economics and we learned about production networks, it was about graduating in a step-by-step manner. You graduated from the low product end to the medium end to the higher end. It was a sequential process, and production was fragmented by different parts of the production process. But now trade revolves around the global value chain, where the fragmentation is even finer and is based on tasks, rather than on products. More on this later.

With trade liberalisation under multilateral and regional commitments, tariffs have come down, and non-tariff barriers have become more important. Standards are increasingly becoming the major issue, whether it is environmental standards, technical standards, or other types of standards. Countries now have to meet these standards in order to compete.

Fifth, the type of goods and services demanded and supplied will be affected by demography. We have an aging northeast Asia, and a demographic bonus in
Southeast Asia and India: a younger population that will not get older until about 2025 or 2030. We are also seeing a growing middle class, with the growth pole shifting to Asia. 40 per cent of growth in the world is now coming from emerging economies, and Indonesia happens to be in a good neighbourhood.

Finally, urbanisation will continue to increase. This means we need smart, creative and liveable cities.

The overview I just presented serves to outline the global situation we are facing today. It is an opportunity, but it also speaks to the way that countries must strengthen their competitiveness, and how productivity is going to change.

To understand this, we need to understand how much more fragmented production has become. Diversification is key, because the more diversified your economy is, the more competitive and less vulnerable to shocks (such as commodity prices going down) your economy is going to be.

As Hausmann and Hidalgo (2010) have pointed out, how diversified an economy is depends not only on natural resources, labour or the endowments of that country, but much more on capabilities, skills and technology. Products that need more capabilities will be made by fewer countries, and, as for products – it is increasingly difficult to even define what a product or service is anymore. But what is clear is that countries with a richer set of capabilities will be able to produce more innovative products, so diversification at all levels is very important.

Figure 1 shows a Boeing jet. It shows who is making what and where; 14 companies are involved in manufacturing parts in nine countries.

**Figure 1: Boeing 787 Dreamliner production**

Source: Breuhaus, 2008
Indonesia is not featured in this diagram, but Indonesia’s PT Dirgantara Indonesia (PTDI) manufactures the tip of the wing of the Boeing 747 used by Korean Air (Figure 2). As Indonesians will know, PTDI was an aircraft company that existed 30 years ago as part of ‘strategic industrial targeting’. They continue to manufacture small aircraft and helicopters, but now they are doing a lot of maintenance and produce parts for Boeing as well as Airbus.

**Figure 2: Korean Air Boeing 747; wing tip made by PTDI**

It is important to remember, when looking at these figures, that they are only referencing the manufacturing. The design is also being done somewhere.

Figure 3 illustrates an example that is often used to describe the global value chain: the iPod. When you look at China exporting iPods to the USA in 2009, it looks like China is exporting 10 iPods worth $1,875, and importing only $229 in inputs from the US. But actually the value added in China is only $65, because China is using inputs from Taiwan, Germany, Korea and the rest of the world. China’s value-added is really only 3.4 per cent.

If you look at the retail price of a single iPod, which is much more than $187.50, most of the value is being enjoyed by the US for the creative design and the IPR (intellectual property rights) of an iPod. An iPod is actually a perfect example of a creative product or creative industry because it was created without any new technology. It simply combined three technology platforms that already existed. It took a genius, a creative person called Steve Jobs, to construct the iPod from these three technologies and create a huge amount of value in the process. That’s a perfect example of the creative economy.
So the global value chain today is very different from when I studied patterns of production networks and ‘flying geese’, going from one country to another. It is more complex today due to technology and the cost of access to resources and markets, as well as reform of trade policy.

Figure 4 shows another example, a creative economy example that I borrowed from one of our Indonesian animation producers. This is what the value chain or production function, I suppose, of an animation series looks like.

Figure 4: Hollywood film production chain; blue boxes denote Indonesian involvement

Source: Adrian Elkana, Head of Indonesian Animation Association
The pre-production is really the phase with the highest value because this is where the intellectual property, or IP, is created. Pre-production is where you create the characters and the story, or in other words, that’s where the Mickey Mouses get created. That’s really where the high value is, as well as where the highest proportion of the economic value is, and of course it is the most difficult part. The interesting thing is that it can continue to generate income in many ways after its creation. Mickey Mouse was created 86 years ago and it is still generating revenue from royalties, merchandising and so on today.

In the animation value chain you can see that Indonesian animation companies are already going into digital visual effects, but we started out with work in the production of animation that was outsourced to us. So the next time you see animated films, such as The Expendables III or Godzilla, remember that part of those films were made in Indonesia. The next time you see Garfield, now you know that 50 per cent of it was made in an animation studio in Batam, Indonesia. We haven’t quite got to the pre-production stage, that’s really the hard part. But Korea started out like we did, 8–10 years ago, and so we hope to be going where Korea is going: towards the pre-production stage, because that’s where the value is.

Therefore, in the context of the global value chain, we don’t specialise in goods anymore. Instead, we specialise in tasks. These tasks can be related to design, to graphics or animation, or they can be any part of the services or the inputs of a production.

There is a very important lesson here regarding global value chains: when you export, there is a lot of input content. If you want to increase your exports, your imports will necessarily increase because you want to have the most competitive inputs (whether a physical input or a service) in order to make your export competitive. We have a debate going on in Indonesia right now, and maybe in other countries too, which is somewhat anti-import. However, all the examples given show that if you want to be competitive, you can’t really be anti-import, and you must have an efficient services sector.

Furthermore, there are all kinds of things happening now as a consequence of developments in technology. ICT allows fragmentation, or ‘splintering’ (Bhagwati, 1984), in the form of substantial outsourcing and offshoring. Various authors have commented on the potential of offshoring. Grossman and Rossi-Hansberg (2006) have written on the emergence of a new global market whose effect is to slice the production process into individual tasks that may be performed at locations around the world, while Alan Blinder (2006) has remarked that offshoring might be ”the next industrial revolution”.

Developing countries have started to be the source of offshore service providers, given their price competitiveness. The call centres of many companies from US and Japan, where labour is expensive, are situated elsewhere in the world. When you call AT&T in the US, it could be somebody in India or somebody in the Philippines answering your call in customer service. Animation and software are good examples of sectors where there is a lot of offshoring happening. Figure 5 shows how exports of computer services in selected developing economies have gone up.
This is the new economy. You might have heard of the term ‘technology disruption’. In the past, this was the railway, the steam engine, the invention of mass production and so on. Today it is really the ‘Internet of Things’, big data, mobile internet, the cloud, and automation of knowledge work. Every time you have a technology disruption, it will lead to new business models, new approaches to marketing and connecting, and even new ways of running political campaigns. We are very familiar with this in Indonesia, where social media has formed a very important part of our democratic process and means to ensure transparency; Indonesia has the fourth largest number of Facebook users (65 million people) and is the fourth largest user of Twitter.

The disruptive technologies of today can modernise sectors across the economy and drive major productivity improvements. They can create decent, skilled jobs and reduce poverty. They can benefit small and landlocked economies, as well as large and coastal ones.
Disruptive technologies represent substantial economic value. Woetzel and colleagues of the McKinsey Global Institute (2014) estimated the potential value of the new economy and ‘disruptive technologies’ at up to US$625 billion in annual economic value for Southeast Asia by 2030. Mobile internet in particular is revolutionary; those of you from Indonesia will know this. Mobile banking and mobile payments, social media, information, online selling, and delivery of services are all being facilitated by the mobile telephone. The mobile internet can pave the way for productivity gains and more efficient delivery of vital services. It is a particularly useful vehicle for overcoming Southeast Asia’s geographical barriers and widening access to information, products and services for rural populations. Mobile banking and payments are expanding financial inclusion. Telemedicine can deliver health care to remote areas, and digital learning tools can improve the quality of education and teacher training across the region.

If you look at the export of creative goods (Table 1), there is massive growth and the biggest component is design. This includes fashion as well. What we want to be doing is not just exporting garments; we want to be exporting fashion, with our own brand.

**Table 1: Creative goods: exports, by economic group, 2002 and 2011 ($US m)**

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<tr>
<td>All Creative Goods</td>
<td>198,240</td>
<td>454,019</td>
<td>73,890</td>
<td>227,867</td>
<td>123,169</td>
<td>222,597</td>
<td>1,181</td>
<td>3,555</td>
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<tr>
<td>Art Crafts</td>
<td>17,503</td>
<td>34,209</td>
<td>9,201</td>
<td>23,383</td>
<td>8,256</td>
<td>10,653</td>
<td>45</td>
<td>172</td>
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<tr>
<td>Audio Visuals</td>
<td>455</td>
<td>492</td>
<td>35</td>
<td>90</td>
<td>417</td>
<td>400</td>
<td>3</td>
<td>2</td>
</tr>
<tr>
<td>Design</td>
<td>114,694</td>
<td>301,262</td>
<td>53,362</td>
<td>172,223</td>
<td>60,970</td>
<td>127,239</td>
<td>362</td>
<td>1,800</td>
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<tr>
<td>New Media</td>
<td>17,506</td>
<td>43,744</td>
<td>4,412</td>
<td>14,607</td>
<td>13,071</td>
<td>28,918</td>
<td>23</td>
<td>219</td>
</tr>
<tr>
<td>Performing Arts</td>
<td>2,754</td>
<td>-</td>
<td>250</td>
<td>-</td>
<td>2,478</td>
<td>-</td>
<td>26</td>
<td>-</td>
</tr>
<tr>
<td>Publishing</td>
<td>29,908</td>
<td>43,077</td>
<td>3,357</td>
<td>8,106</td>
<td>26,061</td>
<td>33,650</td>
<td>690</td>
<td>1,321</td>
</tr>
<tr>
<td>Visual Arts</td>
<td>15,421</td>
<td>31,127</td>
<td>3,474</td>
<td>9,456</td>
<td>11,916</td>
<td>21,631</td>
<td>31</td>
<td>40</td>
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*Source: UN, UNDP & UNESCO 2013, p. 162.*

The global value chain today is about competitiveness and openness. It is about building your infrastructure, being able to access internationally competitive inputs and technology, and developing a conducive ecosystem. ‘Ecosystem’ is a word that is frequently used in the creative economy space, where you need to have IPR protection, the right kind of skills, access to financing and markets, and so on.

The global crisis in 2009 sparked a big debate in Indonesia because it was thought that an export orientation tended to expose the vulnerability of a country to external shocks. Therefore the response was “Let’s focus on the domestic market.” This approach is fine if your domestic market is big; but if your domestic market is not big, it is not a good idea. Even if your domestic market is large, reducing vulnerability is not really about import versus export orientation. It is about competitiveness, including being able to compete domestically.
In addition, we are engaged in a debate in Indonesia about how we have to process everything, we have to add value to all our raw materials. But do we want downstreaming for the sake of downstreaming? Or are we more interested in having value added that is sustainable? These are the debates we are having in Indonesia.

If you want to be competitive and encourage productivity-based growth, you must have openness. If you want to be part of the global value chain, you must be able to import services and intermediate goods at a competitive price. So openness is important. You have to allow experts to come and help you with what you don’t know, so movement of people is also important. You need infrastructure and logistics to be efficient. So structural reforms are important. Having a conducive ecosystem is required in order to foster a creative economy.

However, this raises an important question. If we prioritise openness, competitiveness and efficiency, does that mean we don’t care about development, that we don’t care about inclusiveness and equity? The answer is no, because I was taught by my good professors at ANU about specificity of policy. If you have many targets – a competitiveness target, an inclusiveness target, a poverty alleviation target, etc. – you cannot use one policy. You need policies that are targeted for your objectives. You can have separate policies for empowerment and inclusiveness, and you can even (if you think about it carefully) build in or mainstream the issues of inclusiveness and empowerment within the policy framework that you are taking. I will try to give an illustration of this later on, when I talk about policy reforms.

Now, as I said, when I learned economics and good policy, I learned about evidence-based policy making and specificity of policy. However, what I was not taught was how to deal with political pressures or about all the debates and discussion that go on. I’ll talk more about that shortly. But we have to be realistic that nationalist and inward-looking tendencies are everywhere, not only in Indonesia. How do you ‘package’ all those messages about being open, about being competitive, about being part of the global value chain? You must do this effectively, otherwise you are not going to be competitive, and you are not going to have development.

I will talk about policy reforms in the next section, but first a couple of comments on the importance of packaging in this context. My first suggestion is to focus on human capital. Don’t focus on sectors or wanting to have everything ‘made in Indonesia’. Let’s focus on human capital as the new national interest. Governments are bad at picking winners. If we choose a sector or industrial policy approach, even in the creative economy space, governments are bad at picking winners and losers are certainly good at picking the government! So we can have industrial policy, but not organised by sector or industry. Instead, let’s have it on the input side: as facilitation and incentives for R&D, for creative design, for training, etc.

Another example of the importance of packaging and the political economy concerns trade. I read an editorial (Tax–News.com Editorial, 2014), which I thought gave very relevant advice: ‘never say the words ‘free trade’. I have learned that. I was Trade Minister for seven years. We accept that international trade is generally
better free than unfree, but it is more acceptable to talk about ‘fair’ rather than ‘free’ trade.

Six lessons in policy reform and change

The main message I have conveyed so far is that Indonesia needs to remain open. If it is going to grow, it needs to be open. If it is going to be part of the global value chain, to be competitive and responsive to the new economy, Indonesia must be open. That means Indonesia’s leaders must continue structural reforms, and they have to address this new economy and the creative economy. What are the lessons in policy reform and introducing change that I can share with you from my 10 years of experience in government?

In this section of the lecture, I will present six lessons in policy reform and change.

1. Political commitment at the top.

This is obvious and it is true for all countries.

The late Hadi Soesastro coined the term ‘low politics’, referring to the period of reforms pre-democracy. In other words, all you had to do was convince President Suharto and everything would be implemented. It was a top down approach. In 1994, Suharto made his famous statement, ‘Ready or not, whether you want it or not, we are going to globalise’. That was the year we hosted APEC, we had the Bogor Declaration, and it really pushed liberalisation forward.

As you can imagine, being a minister in those days was much easier. In the last 10 years, since democracy, it has become much harder to coordinate and achieve results. Even if you had political commitment, which we did coming in in 2004, enacting change is challenging. We came in with a whole reform agenda and we did undertake to implement most of it, but getting it accepted in parliament and by the wider public was a challenge. It turns out passing the laws and regulations was the easy part. Ensuring consistent implementation and institutionalisation of reforms, including the human resource and bureaucratic reforms needed, was the hard part.

2. Bad times lead to good policies.

Winston Churchill once said, ‘never waste a good crisis’, and Indonesia’s experience attests to this. During good times, we tend to be complacent and enact not-so-good policies. When we have a crisis, there is a push for reforms which have led to good policies.

For instance, when the oil price fell in 1986, 80 per cent of Indonesia’s export was oil based and thus there was a dramatic impact on foreign exchange reserves and budgetary revenues. This led to dramatic deregulation and institutional reforms, including closing down customs. Once it was decided, the customs officials were told to go home and Société Générale de Surveillance (SGS), a Swiss company, was invited to take over customs. It was a very revolutionary policy, but the shock treatment worked and exports and imports were able to flow smoothly. This deregulation, and other reforms that subsequently followed to reduce the costs of exporting and increase transparency and efficiency, and an export oriented
industrialisation policy, led to exports going up. By the 1990s exports of oil had
gone down to 40 per cent of our exports.

During the financial crisis in 1998 and the last financial crisis in 2009, we also
introduced a number of reforms. In 2013, Indonesia was labelled one of the ‘fragile
five’ emerging economies because we had capital outflow due to our deficit. In
response, we rolled back a number of protectionist policies.

3. The role of international commitments and benchmarks.

These international commitments and benchmarks include agreements like WTO
commitments, the APEC 1994 Bogor Declaration, and ASEAN commitments. There
are also international networks. For the creative economy, the UNESCO Creative
City Network helped to identify the guidelines for cities to create a conducive
ecosystem and hub for the creative economy. These guidelines help cities to
understand the policies that are needed – like planning creative public spaces,
establishing a theatre or a museum, and supporting education facilities – for the
particular creative hub that is the strength of that city.

These international commitments, benchmarks and networks are very important.
They can combat vested interests, such as in the case of the national car policy of
Indonesia back in the 1980s, which was a blatant violation of the ‘most favoured
nation’ principle; allowing Korean–made cars to come in fully–built, duty–free,
compared to the Japanese and the American cars which did not receive the same
privileges. As a consequence we were taken to the WTO by the US and the EU. That
was our first experience with the WTO dispute settlement, and we lost.

More generally, in the pre–democratic period, under Suharto, the technocrats used
Indonesia’s international commitments to frame reforms. Today this not so easy
because it is the era of ‘high politics’; a more balanced approach is needed. It would
be politically incorrect to say, ‘we have to change this policy because the WTO told
us to do it’. After the controversial IMF Letter of Intent during the East Asia crisis,
the issue of having to change or reform because of international pressure has to be
played out differently than in the past.


I believe in evidence–based policy making, because I think it is the only way to
depoliticise an issue, undertake the analysis and provide the evidence for the policy
changes and reforms that one is proposing. While I was Trade Minister, we tried to
introduce a process that when you prepare to change a law or regulation, you
complete what it is called a ‘Regulatory Impact Analysis’ (RIA). In the mid–1980s
RIAs were introduced in policy making in Australia. A number of my staff from the
Trade Ministry undertook training with Australia on RIAs and we tried to
implement it whenever we could.

Amongst other things, completing an RIA consists of the critical tasks of: framing
the issue and making it clear; justifying the change or reform and the benefits it
will offer; and packaging it appropriately and making it resonate with the people
who will be affected by the policy. The role of media and other stakeholders is very
important here. The communication strategy must be well thought out, for example, to ensure that the term ‘fair trade’, rather than ‘liberalisation’ or ‘free trade’, is used, and to explain how the policy would create jobs, address small and medium-sized enterprises or development needs, or develop underdeveloped areas.

Having facts, figures and analytics is not just important, but can be very ‘magical’. This is not just because I am an economist by training. When I was given the task of developing the creative economy, the concept didn’t make any sense to anybody until I put numbers to it. It was the same with tourism. We needed to incorporate numbers and analytics so that people took it as ‘serious business’. Of course, you have to ensure that you understand where the numbers are coming from, how to analyse them and what they mean. Then you can confidently say, “Hey, this is serious business. This contributes so much to GDP, job creation and exports etc.” Having a framework also means that you are clear on the objectives and targets, who will be affected by the policy changes, and what the impact will be, so that you can make an informed decision.

Experiencing events that can lead to a big shock to the economy, such as the global economic crisis in 2009, also underlines the importance of evidence-based policy making. Shocks to the economy hurt the poor most, and thus designing well-targeted social safety nets is very important. Based on best practice and the experience of other countries, we determined that cash transfers were the best way to reduce the effect of the removal of the fuel subsidy in 2005 on the poor. How do you actually deliver these transfers? You have to know who the poor are, and so a survey was undertaken by the Central Bureau of Statistics to build a database of those living below the poverty line, by name and address. The mechanism of transfer was through the post office, and an evaluation undertaken after the transfers were implemented concluded that there was little leakage. With more experience, social protection programs have become more tailored to needs and combined with other targets. For instance, as part of the financial inclusion target, cash transfers are now delivered through the banking system.

I will give another example that I personally am very proud of. When I was Trade Minister, I was in charge of the revitalisation of the traditional markets, where the bulk of the population still shop and which absorb an estimated 13 million workers. Initially, the strategy was just to divide the budget allocated by a certain number of markets so all would get the same allocation, and it was a small amount. I introduced a more selective approach. Another thing that did not make sense was that even though 90 or 95 per cent of the people who work in the markets are women, many of whom bring their children into their stalls, and 90 per cent of the people who shop in the markets are women, the bathrooms were not designed to accommodate this in terms of the ratio allocated for women and men. Thus, the guidelines now state that the toilets should be designed to be more in favour of women, and the facilities available at the markets should include a lactation room and a child minding centre. These facilities need not be free; they can be subsidised, but the users should pay a usage fee.
5. Pay attention to process and stages to make reforms stick.

Indonesia is a very complex and large country, and by now is fairly decentralised. You can’t enact reforms immediately across the whole country, so within a particular policy you have to pick certain parts that are easier to do. For instance, the Finance Ministry started tax reforms and better service beginning with the big taxpayers. They created a big taxpayers office. At the Ministry of Trade, when I first became Minister I asked an internal team to identify and review all of the existing import regulations and export regulations, after which some were eliminated, some were made more effective and the overall business process became more transparent. The last step was to have a true one-stop service and to migrate to online systems.

As well as working in phases, you need champions in government and local government to make your reforms sustainable. They should include ministers in charge, who then have to convince the other ministers to support it. Since implementation is at the regional level, local government is very important. In the case of the creative economy, when the national government came out with a blueprint in 2009, the Bandung and West Java governments also came up with a blueprint and identified the creative economy potential for their regions. They were the only regions that did it. Interestingly, Ridwan Kamil, who was the champion from the stakeholders during that process, is now the Mayor of Bandung. As an architect and urban planner, he was one of the first to run with the idea of Bandung as a creative city.

In addition to leaders who are champions, the relevant bureaucrats and the stakeholders must have ownership over the process of reform and of enacting policy. Otherwise, once there is a change in minister or policy maker, they can just undo everything. Therefore to make reforms stick, they have to have ownership, be proud and rewarded for delivering the results, and thus they must be involved from the onset. I found that, besides continuously involving top management, there has to be a mindset change.

Peer pressure with monitoring and targets can also assist in this. For instance, to monitor reforms in the ease of doing business, international benchmarks such as the IFC Cost of Doing Business were used. UNESCO also established a lot of parameters for the creative economy. Once reforms are done, there has to be a process to check whether the reforms were effective and whether the target or service level was achieved. For example, Sri Mulyani, the Finance Minister, engaged a private third party surveying company to survey all the stakeholders that were serviced by the Finance Ministry on the effectiveness of the tax, customs and budgetary reforms the Ministry was undertaking. The results showed significant improvements in satisfaction for customs and tax, but dissatisfaction with internal government and budgetary processes. This showed the Finance Ministry how they were doing and where they need to continue improving.

The last thing I would add is the importance of institutionalising processes. I will give you rice as an example, because it is a hot issue now. We faced a political issue in 2006 with the import of rice. As a result of politicisation of the issue, we were
late in importing rice, so the price went up by 30 per cent and the poverty rate up by 1 per cent. After learning that lesson, we institutionalised the process so that if the price goes up by a certain amount and the stock in BULOG (the state trading company that handles imports)] automatically goes down by a certain amount, automatically the Trade Minister can issue an import license for BULOG.

By institutionalising the process, setting up procedures and making it transparent, you can depoliticise the issue. That’s important because once the champions are gone, you want the process to continue.


Most reforms involve cross-sectoral coordination, so a whole-of-government approach is important, and the evidence base is important for this, not least so that you know who is responsible for what. Because governments change, it is important that stakeholders and the broader society are on board so that they will demand that the new government continues the policy. That’s why it is important for stakeholders, including international partners, to be part of policy making and implementation.

I’ll say more about this in the next section, when I talk about the creative economy.

Indonesia’s creative economy: opportunities and challenges

Finally, I want to discuss the creative economy in Indonesia, and use it to illustrate some of the points I’ve made so far in the lecture about the new global economy and about lessons of reforms and policy change.

In terms of what I learned about the importance of evidence-based policy making when I was responsible for the creative economy, it came down to this. You have to have a clear and strong answer to the question: Why is the creative economy important?

What is the creative economy? The creative economy is really about how value can be created from existing knowledge and technology, including cultural heritage. It is not just the cultural creative industries, but also the media, design, and science and technology-based industries already referred to above. In Indonesia, following the example of the UK, we identified 15 sectors within our creative economy, divided between those that are arts and culture-based (often termed ‘culture industries’), and those that are media, design, and science and technology-based (Figure 6).
After defining the scope, we turned to the process of estimating the importance of the creative economy in terms of economic contribution, job creation and the number of companies. In cooperation with the Central Bureau of Statistics, the national income accounts and various other data sources were disaggregated to come up with the estimated economic contribution of the creative economy to Indonesia (Table 2). Once we did this, there was more of a focus and most importantly we were able to go to the planning agency and related ministries, including the Ministry of Finance, to get resources and budget support.

Table 2: Economic contribution of Indonesia's creative economy, 2013

| Contribution to national economy | 7%  
(641.8 rupiah / US$58 billion) |
| Labour absorption               | 10.7%  
(11.9 million people) |
| Number of companies             | 9.68%  
(5.4 million companies + many SMEs) |

*Source: Central Bureau of Statistics, Indonesia (preliminary figures for 2013)*
After a period of time identifying the scope and interacting with stakeholders, and learning more about the creative economy, we also discovered that there was more to the importance of the creative economy than its economic contribution. There are four other ways that the creative economy adds value (Figure 7).

**Figure 7: Why develop the creative economy?**

![Diagram](image)

First, the creative economy raises the image of the country and contributes greatly to national identity. Creative industries are used by many countries not only for export but also as soft power and nation branding, and to increase the economic value of their cultural heritage (Figure 8).

**Figure 8: Examples of national creative industries**

- Italy: Italian cuisine, fashion
- Korea: K-pop
- Thailand: Thai cuisine
- Japan: manga, J-pop, sushi
- USA: Hollywood, music
- China: Chinese cuisine, museums & exhibitions
Korea is a good example. You can actually preserve your natural and cultural resources by allowing traditional products to be contemporised and made modern, and marketed. You are preserving the culture and having a social and economic impact.

Value added is created from creative ideas and that leads to economic contribution, preserves the resources used (both cultural and natural), enhances local and national branding and identity, and has social impact by enhancing the understanding and acceptance of different cultures. The following examples illustrate the benefits of the creative economy and their interrelationships.

For example, we can see this in Indonesian fashion designers’ use of traditionally woven fabrics in contemporary designs (Figure 9). The value of the woven fabric goes up when it is used in a modern design, and even more so if it is used by a famous fashion brand such as Louis Vuitton.

**Figure 9: Fashion by Cotton Ink, Indonesia Fashion Forward**

![Fashion by Cotton Ink, Indonesia Fashion Forward](image)

Figure 10 shows a Louis Vuitton scarf designed by Eko Nugroho, one of Indonesia’s well known contemporary artists, who was selected by Louis Vuitton to design this scarf. The process of value adding will preserve cultural resources at the same time.

**Figure 10: Scarf by Eko Nugroho for Louis Vuitton**

![Scarf by Eko Nugroho for Louis Vuitton](image)
Another example is the airport in Banyuwangi in East Java that was designed by a famous architect using the traditional Osing architecture with a contemporary design (Figure 11). This initiative was led by the Bupati, or regent, of Banyuwangi, another local champion who has harnessed the power of the creative economy in the form of traditional dance, arts and crafts, festivals and architecture to create value, increase the branding of his region, and attract visitors.

**Figure 11: Blimbingsari Airport (artistic rendering) in Banyuwangi, East Java**

Games and applications, which are creative industries based on digital technology, can also draw on rich cultural resources. There are a number of examples of games and applications created by Indonesians that have gone global. These include picmix, a photo-editing and photo-sharing application designed by an Indonesian app developer; and Infinite Sky, an iPhone game developed by game developer TouchTen, which features a character named after the Javanese folk hero Gatotkaca (or ‘Indonesia’s Superman’) (Figure 12). Both of these apps have been extraordinarily successful. For instance, when it was launched picmix grew faster than Instagram, and has since been downloaded more than 23 million times. Similarly, Infinite Sky became one of the top ten most downloaded iPhone games.

**Figure 12: Examples of popular Indonesian apps and games**

The video game called ‘DreadOut’ (Figure 13), an Indonesian horror video game made by Digital Happiness, a game developer based in Bandung, West Java, is another great example. The creator of this game was working in outsourcing in the games sector when he decided that there should be Indonesian games. So he developed DreadOut, which is based on Indonesian ghosts, and it reflects how Indonesia is very culturally diverse, including its ghosts. Every region has different ghosts.
When we started looking into the creative industries, we also learned that they are based on different business models. Performance indicators are different in every creative industry, and one has to measure the success of each industry in the right ‘market place’. In the gaming world, you have ‘made it’ globally if your game is on a market platform or website called Steam. On Steam, the designer of DreadOut has about 9 million followers, and his financing is done through crowd-funding from his fans. You can do the math: even if a fraction of his 9 million players contribute $1 each, he can raise sufficient funds to continue developing the game.

Evidence and examples are important because they allow a better understanding of the potential of the creative economy. They also help to define and develop the evidence base for policy making in the form of case studies.

So the creative economy has the potential to be a source of sustainable growth for Indonesia which is productivity based, innovative and creative as an answer to the pattern of globalisation that we talked about in the first section of this lecture. In terms of policy, evidence-based policy making – including defining, analysing, case studies and developing an understanding of the business model and issues in the sector – was also important to get buy-in from all stakeholders.

Coordination is also key and perhaps even more so in this space, because it is a ‘new’ space. I learned a lot in the last three years about who the creative people are in Indonesia. We spent a lot of time having focus group discussions, identifying the players in different hubs in Indonesia and encouraging them to organise themselves in communities so that we had a clear partner to engage with. Initially they were allergic to being too involved with government and to organising themselves. I was persistently saying, ‘If you don’t organise yourself, I don’t know what your issues are and I cannot help you. I don’t know how to facilitate you. I don’t know what my target is. You have to create a vehicle to organise yourselves...
and advocate for your issues, priorities and policy changes.’ This is actually also part of evidence-based policy making, to define the policy target better.

Through a time-consuming process, and one which is far from complete, a number of the creative industries created vehicles or strengthened existing associations, such as in the film, photography, video, animation, games, fashion, architecture, performing arts and fine arts sectors. Creative communities have emerged in many places, and they each democratically select representatives to deal with government and other stakeholders.

This process of community building and focus group discussions resulted in about 600 people from the creative communities, representing the 15 sectors, coming together with other stakeholders such as government, local government, private sector and academics. Together, we came up with a blueprint and action plan to develop the creative economy in Indonesia. This blueprint (which you can see in Figure 14) includes:

1) Human resources, which is about formal and non-formal education and growing talent.

2) Access to and developing creative and natural resources.

3) Growing the industry, which is about the appropriate business model and ensuring the supporting industries and services are also developed.

4) Financing and funding, which for creative industries must go beyond the traditional banking sector, such as angel investment, venture capital, and crowd-funding.

5) Access to markets and networks, with each creative industry having different ‘market’ platforms.

6) Supporting infrastructure and technology, such as ICT. And

7) Institutions. This is the ecosystem and coordination of policies that I mentioned earlier, which should involve the relevant ministries, such as education, finance, ICT and legal affairs (because of the IPR issue). A coordination mechanism between the ministries and the local government to address the seven strategic issues was also created.

The process led to the development of blueprints and action plans for the medium term (2014–2019) and long term (2014–2025), which aim to address these seven strategic issues cross-sectorally (Indonesia Ministry of Tourism and Creative Economy, 2014). A similar longer term and five year blueprint and action plan was also developed by each sector.
**Figure 14:** Blueprint and action plan to develop the creative economy in Indonesia

<table>
<thead>
<tr>
<th>Human resources and capital</th>
<th>Creative resources</th>
<th>Growing industry and business</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Education</td>
<td>1. Natural</td>
<td>1. Creative entrepreneurship</td>
</tr>
<tr>
<td>2. Creative talent and skills</td>
<td>2. Cultural</td>
<td>2. Growing the business</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Financing</th>
<th>Access to markets and networks</th>
<th>Supporting infrastructure and technology</th>
<th>Institutions</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Financial institutions and sources of funding</td>
<td>1. Penetration of domestic and international markets</td>
<td>1. Infrastructure (electricity, telecom/internet, physical, online platforms)</td>
<td>1. Conducive business climate</td>
</tr>
<tr>
<td>2. Appropriate access and competitive cost</td>
<td>2. Diversification including going global</td>
<td>2. Technology and R&amp;D to produce creative products</td>
<td>2. Active participation of stakeholders</td>
</tr>
</tbody>
</table>

**Conclusion**

In conclusion, I want to finish with a case study and a story, which focuses on graphic design. Indonesia is currently a major source for one segment of the world’s freelance graphic designers. On the online design–task marketplace, 99designs.com (which was created by two young Australians), Indonesia was the biggest source of designers in 2013 and the second biggest in 2014. By February 2015, the site had more than 129,000 registered designers based in Indonesia. Within Indonesia, the spread of the designers has been most striking in rural Java. For example, in Salaman District, Magelang Regency – which is about an hour from Yogyakarta – the designers are spread across 20 villages, with approximately 100-200 designers in each village. In Parakan District, Temanggung Regency (which is one of the main tobacco-producing regions), there are 60 designers, of whom 4 are already platinum designers on 99designs.com.

The story I want to tell you is about a collective of graphic designers in the village of Kaliabu. Their story, which is featured in *Desainer Kampung* (‘Village Designer’) – a documentary which you can watch on YouTube¹ – illustrates the power of the creative economy to reduce poverty and create value, and encapsulates a number of the principles I’ve discussed throughout this lecture. Most of these designers are self-taught and refer to themselves as ‘logo crafters’, rather than designers. The majority have a relatively low level of education, and design as a supplement to their primary work in farming and construction. They use the internet to pitch logos on sites such as 99designs.com, communicate with clients based overseas, and receive payment. They don’t speak English, and use Google Translate to communicate with clients and pitch to contests. They earn US$200 to $2,000 per

¹ [www.youtube.com/watch?v=b7TiqYlCOz8](https://www.youtube.com/watch?v=b7TiqYlCOz8)
month in a region where the minimum wage is approximately US$100 per month. They are paid through a shared PayPal account. They are self-taught, selected a group leader from amongst themselves and they knew where to go for help by asking a local artist to learn about design.

Their story also shows the importance of basic infrastructure such as electricity, ICT and internet access, and also some of the social benefits of the creative economy. With such developments, there will be less rural-to-urban migration of youth, and social issues such as unemployment, theft and drinking are all reduced when young people are gainfully employed and earning incomes.

However, the Desainer Kampung project is not without challenges. In the documentary, one designer says, ‘you don’t need to go to school. You can become a billionaire without going to school’. Education, learning in the formal and non-formal sectors, and skills-building to adapt to the changing world and technologies will continue to be important. It is possible that these village designers could become obsolete if there was a change in technology, for instance. It is also unclear how the issue of scaling up might be dealt with, and what impact that would have. For instance, what happens if they start making more money and they stop farming? What consequences might this have for other aspects of village life? These are issues and challenges that we must grapple with as part of the building up of evidence for good policies.

To conclude, given the fall in commodity prices, the slowdown of the world economy, and global challenges we are facing, the next source of development for Indonesia is to maximise the potential of the new economy; that is, an economy based on productivity, innovation and creativity. There are four important issues that we have to be aware of.

First, we need to be open, not isolated. Openness will mean access to investment and funding, hardware, software, skills and talent, support services, and technology which are required to foster the sustainable development of the new economy.

Second, countries should not wait until they have sophisticated infrastructure and a highly skilled population to venture into the new economy. Rather, countries should prioritise the provision of basic infrastructure for all.

Third, not all countries need to be ‘innovators’, in the sense of being creators of new technologies. Rather, they must be able to creatively utilise and adapt existing technology.

And fourth, building a healthy ecosystem is important. This includes ensuring reliable access to inputs; competitive talents; access to technology, various financing mechanisms, and markets; a healthy industry structure; and a conducive business climate.

Finally, of the six lessons of reform that I highlighted earlier, I would end by emphasising evidence-based policy making. We relied on it in our trade reforms and our fiscal reforms, and as we developed the creative economy in Indonesia. In
a democracy, it is also important that evidence-based policy making involves non-government stakeholders, as we are experiencing now in Indonesia. It is about ownership and it is also about understanding what good policy is all about, including thinking through its implementation.

It is clear that governments should undertake evidence-based policy making as much as possible to ensure the timing, quality and appropriateness of the policy for achieving your targets. Stakeholders who want to criticise, evaluate or provide input to government policy also need to rely on analyses of the facts and the figures, their impact and issues of implementation. Sometimes the recommendations may not resonate, or even go anywhere, but at least there can be a well-informed public debate. At the end of the day good analysis should be used to empower stakeholders to put pressure on government to do the right thing, and monitor implementation.

Thank you.
References


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