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Avoiding the Strategic Traps in Indonesia's Pursuit of High-Income Status

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SYNOPSIS

Achieving high-income status by 2045 is an objective on which there has been political consensus among Indonesian leaders in recent years. ***Iis Gindarsah*** *discusses four key challenges that the country's policymakers will have to navigate over the next two decades in pursuit of this goal.*

COMMENTARY

A new long-term development strategy — the Golden 2045 Vision — aims to transform Indonesia into a first-world country by the centennial anniversary of its independence. Launched in late 2023, it seeks to increase the value added to the national economy by moving through the value chain, from raw commodities to building a skilled workforce ready for the digital age and accelerating infrastructure development as well as institutional reform to support a balanced, green, and equitable growth.

Taking office in October 2024, President Prabowo Subianto has pledged to continue this national agenda. However, Indonesia's path towards becoming a developed nation is likely to be a bumpy one. A recent article published by the Council on Foreign Relations highlights four strategic traps that China is facing towards becoming a world leader. These predicaments rooted in realpolitik, namely, the Middle-Income trap, the Tacitus trap, the Thucydides trap, and the Kindleberger trap, may equally apply to Indonesia.

The Middle-Income Trap

This so-called problem occurs when a country attains a certain income and gets stuck at that level, which falls short of the income levels of advanced economies. The middle-income trap has haunted the Indonesian economy for over three decades.

Although the World Bank classified Indonesia as an "upper-middle-income" country in July 2023, Statistics Indonesia (BPS) reported that its middle class — defined as those spending US$132–US$643 per month — has declined from 21.4 per cent of the population in 2019 to 17.1 per cent in 2024.

Escaping the middle-income trap is very much behind the initiation of the Golden Indonesia 2045 vision. The new administration in Jakarta has set forth an ambitious target: driving the archipelagic country's economic growth to around 8 per cent annually within the next five years. The country's development authorities unveiled several additional targets, including a per capita income of US$30,300 and a poverty rate of nearly zero per cent by 2045.

Nevertheless, aspirations for such high growth rates need a reality check. Indonesia's gross domestic product (GDP) on average expanded by only 5 per cent per year over the past decade. A recent IMF report on the medium-term outlook estimates the national economy to grow modestly by about the same level. Pessimists would point out that anything above this norm would reflect an overheating economy, which is not a sustainable basis for growth.

Encouragingly, Indonesian leaders seem to understand that expecting high growth rates in the long term requires a comprehensive structural reform strategy that increases productivity, bolsters production factors, tackles institutional weaknesses, and continues strengthening global trade and financial integration. Indonesia's aspiration for high-income status and especially membership of the Organization for Economic Cooperation and Development (OECD), which involves a length accession process, can only be achieved through pressing economic restructuring — most importantly, improving tax revenue administration.

The Tacitus Trap

Drawing on the work of an ancient Roman historian, this political theory describes a situation where a disillusioned population regards whatever an incumbent government says or does as a lie or a bad deed. The latest public surveys suggest that Indonesia has yet to come to this stage. A large majority of Indonesians approve of President Prabowo's first few months in office, mainly owing to his populist programmes — particularly free nutritious meals for schoolchildren and affordable public housing for low-income individuals.

However, worrying trends that can lead to a Tacitus trap have begun to emerge. The anticipated weakening of the Rupiah in the coming months will put price pressures on imported commodities, such as food staples and petroleum. Although the unexpected decision to delay the value-added tax hike on non-luxury goods could partially shield lower-income households from currency depreciation effects, it undermines the government's ability to meet this year's state revenue target. Moreover, the administration's expansionary fiscal policies may push inflation towards the higher end of the target range of 1.5–3.5 per cent set by Bank Indonesia, the country's central bank.

Given the current climate of high interest rates, several economists have warned that incurring additional debt to fund populist programmes could hurt Indonesia's hard-won reputation for fiscal prudence. Instead, the incumbent government made massive budget cuts that could potentially backfire and lead to slower economic growth. Despite a decline in the national unemployment rate to 4.91 per cent in August 2024, youth unemployment remains alarmingly high at 22.48 per cent for those aged 20–29. Inequality also persists, with the Gini ratio at 0.381 in September 2024, highlighting a stark divide between the privileged class and the struggling one.

To overcome the Tacitus trap, Indonesian leaders should enhance accountability and transparency, as well as preserve democratic norms for good governance. Yet, instead of promoting political reform in this direction, the pro-government party coalition has been mulling over unsettling initiatives such as allowing loose oversight over Indonesia's new sovereign wealth fund, rolling back direct regional head elections, and expanding the military's role outside the defence arena.

Achieving high-income status demands the preservation of both political stability and social cohesion at home. The recent waves of student protests in major cities should serve as a wake-up call for the Prabowo administration. The austerity measures have disproportionately affected government spending on education, such as lecturer allowances, various types of social assistance scholarships, and public services at universities. These cuts could result in increased tuition fees for students. Public criticisms have sparked concerns about misplaced priorities and policy missteps, further deepening frustration with economic stagnation. The president should not be complacent about inflated approval ratings because the reality on the ground could be far less reassuring.

The Thucydides Trap

This popular term refers to the warning by an ancient Greek historian that the prospect of war increases when a rising power becomes more confident and the status-quo power fears losing its competitive edge.

Geopolitical rivalry between China and the United States will become more intense as each of the two merges its foreign policy with commercial, industrial, and technology policy. With Donald Trump back in the White House, the US government has begun to adopt a unilateral and muscular approach to keep the country ahead in its competition with China, including through the use of sanctions and tariffs to pressure other nations. Meanwhile, Xi Jinping is doubling down on China's investment in cutting-edge technologies and courting emerging economies as it seeks to close the gap with the United States in areas such as artificial intelligence.

As the world watches the two superpowers stagger into conflict, Indonesia could be among the victims of the Thucydides trap. Despite pursuing a non-aligned foreign policy, the Prabowo administration will have to nimbly tread the difficult path ahead. Under his administration, Indonesia officially joined the BRICS intergovernmental bloc as a full member in early January 2025. The decision is more likely a pragmatic push by the country to foster Global South cooperation, rather than an overt pivot to China or to supporting anti-Western agendas. Prior to this decision, the Indonesian government made a bid for OECD membership, with accession not expected until 2026 at the earliest.

China is a major investor in Indonesia's infrastructure, manufacturing, and mining sectors. Jakarta's restraint in confronting Beijing directly over Chinese incursions into its exclusive economic zone has fostered closer economic ties between the two nations. However, increased bilateral cooperation is not likely to prevent Indonesia from imposing trade restrictions against its largest economic partner, either to facilitate localisation of supply chains or protect domestic industries.

The Indonesian government also seeks to reduce the country's dependence on China by pursuing free trade agreements (FTA) with other strategic partners. Upcoming FTA deals include those with Peru and the Eurasian Economic Union, which will be concluded by the first quarter of 2025. In September last year, Jakarta conveyed a formal request to join the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), although the accession process will be lengthy and fraught due to Indonesia's high trade barriers.

Sensitivity to economic and security relations with Western powers means that Indonesian policymakers will have to engage in a grand bargain over economic and strategic issues. Jakarta has long invited the United States and European Union to invest in the country's green industry as part of its transition towards renewable energy. While the new EU and Indonesian governments are keen to finalise a free trade pact by June this year, the key challenges remain the ongoing dispute over deforestation and nickel mining.

Separate talks over a limited FTA on critical minerals with the United States have also proven challenging due to heavy Chinese investment in Indonesia's nickel industry and concerns over Chinese firms allegedly exploiting the Indonesian "back door" into the US market. Securing a deal by offering policy concessions to the Trump administration will become the litmus test for President Prabowo's personal and relationship-led diplomacy to achieve Indonesia's high-income ambition.

The Kindleberger Trap

Deriving from the work of a leading architect of the US Marshall Plan, this concept posits that world peace can collapse when the ascendant power bests the status-quo power but fails to assume the latter's role in providing global public goods such as financial stability, freedom of navigation, and regional security.

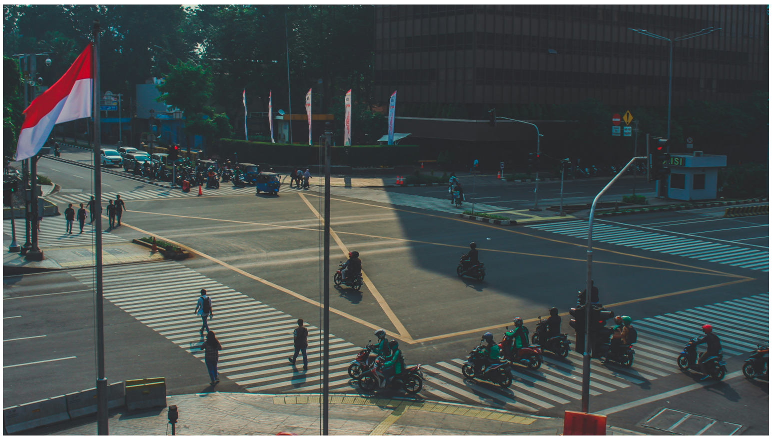
Trump's "America first" foreign policy prioritises US national interests and competition with China above stable relations with traditional allies in Asia and Europe. Its insular approach to policymaking is likely to undermine international cooperation on decarbonisation, technology, and trade issues. The fight against climate change will face significant headwinds due to strained funding and less political support from the world's preponderant power. Global institutions, including the World Trade Organization and the International Organization for Migration, are ill-prepared to manage looming trade conflicts and the ongoing influx of immigrants, respectively.

Any perceived weakening of US international commitments means that lesser powers — including Indonesia — have little incentive to uphold the existing rules-based global order. Frustrations over Group of Seven (G7) sanctions and the overwhelming influence of the US policy on international reserves have pushed developing countries to search for alternatives to the current US-dollar-dominated financial architecture. However, recent increases in the share of world trade settled in Renminbi should not be construed as a radical shift in global markets towards China's currency or payment system. Operating outside the US-dominated system will remain a riskier and costly option for countries and firms, with the exception of those that are already subjected to international sanctions.

Meanwhile, the international community is concerned about China's investment record. The country's financial institutions have lent approximately US$1.3 trillion to foreign governments for over two decades. Yet, these institutions have begun to pull back in recent years, owing partly to high indebtedness among borrowers. Repayment difficulties further proliferated during the COVID-19 pandemic, particularly among low-income countries. Efforts to reach debt-restructuring agreements were often marked by disagreements between Chinese creditors and other lenders, thereby slowing the disbursement of bailout funds and delaying economic recoveries.

Although Xi Jinping has reiterated that China harbours no ambition for global hegemony, a combination of the country's importance in global trade and its industrial prowess makes the People's Republic a prime competitor to the United States. China's foreign aid programme remains nascent, given its preference for providing commercial loans. According to one estimate, the country increased aid funds up to US$7.9 billion in 2022. The recent pause in US humanitarian aid disbursement has given Beijing the momentum to step up assistance to the developing world.

Nevertheless, China has been grappling with deflation, with prices falling for several consecutive quarters due to oversupply and weak demand in the market. Beijing's efforts to reflate the economy through increased public spending and monetary easing will have limited impact in terms of boosting household and business confidence. Hence, emerging economies like Indonesia would have to keep in mind the risk of, in the words of Joseph S. Nye, "a China that seems too weak rather than too strong" in the provision of global public goods.



Indonesia's goal of achieving high-income status by 2045 faces four major challenges.
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Conclusion

On a final note, the Middle-Income and Tacitus traps will determine Indonesia's domestic transformation, while the Thucydides and Kindleberger traps will have direct impact on its ties with the great powers. However, they are mutually inclusive in practice. The first two can undermine the Indonesian government's ability to increase its strategic engagements at global and regional levels. Meanwhile, the other two shape the international security architecture and global governance that provide encouragement or impediments for Jakarta to address the country's political and economic challenges. President Prabowo will have to ponder over these realpolitik predicaments in pursuing high-income status for Indonesia.

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