



## Pancasila: Roadblock or Pathway to Economic Development?

Marcus Marktanner and Maureen Wilson  
Kennesaw State University  
[www.kennesaw.edu/icat](http://www.kennesaw.edu/icat)

## 1. WHAT IS PANCASILA ECONOMICS IN THEORY?

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When Sukarno (1901-1970) led Indonesia towards independence from the Dutch, he rallied his supporters behind the vision of Pancasila (five principles). And although Sukarno used different wordings on different occasions and ranked the five principles differently in different speeches, Pancasila entered Indonesia's constitution as follows: (1) Belief in one God, (2) Just and civilized humanity, (3) Indonesian unity, (4) Democracy under the wise guidance of representative consultations, (5) Social justice for all the peoples of Indonesia (Pancasila, 2013).

Pancasila is a normative value system. This requires that a Pancasila economic framework must be the means towards the realization of this normative end. McCawley (1982, p. 102) poses the question: "What, precisely, is meant by 'Pancasila Economics'?" and laments that "[a]s soon as we ask this question, there are difficulties because, as most contributors to the discussion admit, it is all rather vague." A discussion of the nature of Pancasila economics is therefore as relevant today as it was back then.

As far as the history of Pancasila economic thought is concerned, McCawley (1982, p. 103ff.) points at the importance of the writings of Mubyarto (1938-2005) and Boediono (1943-present). Both have stressed five major characteristics of Pancasila economics. These characteristics must be seen in the context of Indonesia as a geographically and socially diverse developing country after independence. They are discussed in the following five sub-sections.

### **State enterprises and cooperatives play an important role**

The importance of state enterprises has been a popular theme in early development economics, which was dominated by two camps. One camp advocated for a state to ignite a balanced growth strategy, the other for a state to start an unbalanced one. Both had in common that the state needs to

start the process of economic development with a big push strategy. The only difference in thinking was: How should this big push be implemented?

Balanced growth strategists, whose most famous representative was Nurske (1907-1959), argued that the state needs to develop an investment strategy that allows for all sectors of the economy to grow at the same rate (Nurske, 1961). This thinking reflected the concern that rural-urban migration in the course of economic development would lead to a negligence of food and agricultural production. Without a strong role for an imbalances-preventing state, economic development would become a zero-sum game in which the manufacturing sector grows only at the expense of a declining agricultural sector.

The most famous advocate for an unbalanced growth strategy was Hirschman (1915-2012). According to Hirschman (1958), unbalanced growth strategists believe that the state needs to deliberately invest into the so-called commanding heights of an economy: energy, steel, telecommunication, and transportation. This is necessary for three reasons. First, without the many forward and backward linkages with the rest of the economy of these industries, economic actors' entrepreneurial spirits would remain dormant. As these leading industries reconnect most sectors of the economy, they uncover economic opportunities in related industries, which otherwise would remain untapped. Secondly, financial markets are too underdeveloped for them to be able to finance the formation of energy, steel, telecommunication, and transportation sectors. Third, so-called commanding heights are often natural monopolies that require governmental control.

Both Mubyarto and Boediono were clearly influenced by this discussion. They acknowledge that both state enterprises and private entities must play an important role in development. Both also stress the important role of cooperatives, especially for agricultural development, which in turn suggests that these two prominent Pancasila thinkers shared the concerns of the balanced growth theorists.

Moreover, they advocate the need for all economic activity to contribute to social harmony, which identifies economic development as an important vehicle for national consolidation within Indonesia as one of the socially and geographically most diverse countries (compare McCawley, 1982).

### **Economic man is guided by religious and social values**

While this argument seems to be at odds with mainstream modern economics at first sight, a closer look reveals that it is not. Eventually, Adam Smith (1723-1790), the father of modern economics, saw himself as a moral philosopher. His moral philosophy was an attack on the medieval church's beliefs about individual responsibilities.

The medieval Catholic Church struggled with accepting private property as compatible with Christian values. The pursuit of self-interest was considered sinful. The church justified feudal land ownership, tax collections, and the restriction of individual citizens' economic opportunities with the church's alleged position as the earthly arm of divine law (Frost, 1, pp. 175-206). Others may argue that the medieval church abused this role.

Gutenberg's (1398-1468) invention of the printing press around 1440 marked the beginning of the decline of church power. The availability of the Bible to the common man terminated the Church's interpretive monopoly of God's words. As more people began to read the Bible, disagreement with the church's reading rose. Popular discontent eventually culminated in several peasants' uprisings across Europe. Europe's struggle for private land ownership had begun, but it was not before the 1789 French Revolution when it started to turn in peasants' favor.

As opposed to the church, Adam Smith explicitly accepted the idea that all individuals are driven by self-interest. But does that mean that a society which gives free reign to self-interest turns into a sin

city in which waste, gluttony, and immorality flourish? The answer is no, at least as long as a society's scarce resources are allocated through a competitive division of labor.

Modern economics motivated by Adam Smith's ideas has shown that market competition forces all economic actors to use scarce resources wisely. No economic actor can afford to waste them for the purpose of personal vanity. The market place will punish such behavior immediately. Under competition, the wasteful loses against the frugal and the vain against the humble. Vanity, immodesty, and waste will ultimately increase the cost of production and reduce investment capacities. Competition teaches individuals the same values that the church preached too. But people's right to pursue their own interest has led to a much greater supply of basic needs than what would have been ever possible under the rule of the medieval church. This was the moral philosophy of Adam Smith.

Already long before Adam Smith identified private property rights and competition as morally justifiable institutions, the famous Islamic scholar Ibn Khaldun (1332-1406) had made the same argument. As far as the importance of private property rights is concerned, Khaldun notes: "Men persist only with the help of property. The only way to property is through cultivation. The only way to cultivation is through justice. Justice is a balance set up among mankind" (Khaldun, n.d., Book One of the Kitab al-'Ibar). Khaldun argues moreover: "Civilization and its well-being as well as business prosperity depend on productivity and people's efforts in all directions in their own interest and profit. When people no longer do business in order to make a living, and when they cease all gainful activity, the business of civilization slumps, and everything decays" (Khaldun, n.d., Chapter III, 41. *Injustice brings about the ruin of civilization*).

A more detailed study of the social and religious values embedded in the history of Islamic and Christian economic thought shows more similarities than differences. While there may be slight differences in the practice of Islamic and modern Christian economics and finance, their value systems

are highly identical. They both rest on the belief that social prosperity starts with the economic empowerment of individuals, the division of labor, and competition.

The term competition often generates a negative connotation. This was particularly true in newly emerging countries after the end of colonial rule, where competition was frequently interpreted in a Darwinian sense of a survival of the fittest. However, neither Ibn Khaldun nor Adam Smith envisioned an economy in which, in the words of Proudhon (1947, p. 242), “competition kills competition.” The ideal for Adam Smith was perfect competition in which no economic actor would have any market power. And when Ibn Khaldun described the nature of the division of labor through specialization and market exchange, he talks about cooperation. Specifically, he notes that “the power of the individual human being is not sufficient for him to obtain the food he needs, and does not provide him with as much food as he requires to live. Even if we assume an absolute minimum of food - that is, food enough for one day, a little wheat, for instance - that amount of food could be obtained only after much preparation such as grinding, kneading, and baking. Each of these three operations requires utensils and tools that can be provided only with the help of several crafts, such as the crafts of the blacksmith, the carpenter, and the potter. [...] Through cooperation, the needs of a number of persons, many times greater than their own number, can be satisfied.” (Khaldun, n.d., *First Prefatory Discussion*).

Therefore, when Mubyaryto and Boediono emphasized the need for an economic system that is in line with religious and social values, they simply highlighted a long tradition in the history of economic thought. This tradition shows many similarities in both Islamic and Christian economic thought. This religious legacy has become increasingly forgotten. Unfortunately, economics has detached itself from its normative origin and turned into a cultureless social science.

## Economic development must be equitable social development

Modern economics has become overly negligent of concerns for equitable social development, even though that the trade-off between allocation efficiency and distributional justice is among the most controversial and unresolved debates in the history of comparative economics.

Socialists, for example, never disputed the idea that markets are efficient. In fact, Marx (1818-1883) argued that under the market “the production of too many useful things results in too many useless people” (Marx, 1844). Such a market scenario is plausible if, for example, the primary distribution of productive resources is highly unequal. Under an equal primary distribution of land and economic opportunities in combination with rigorous competition policy preventing market power, there is little reason to assume that factor labor would be marginalized. Obviously, under an equal primary distribution of land and economic opportunities, factor labor will have easier access to human and physical capital and finance than under a highly unequal economic system.

Not all economists would argue that economic development starting with high initial inequalities in terms of productive resources and opportunities will maintain social inequality. Laissez-faire economists, for example, would argue that market freedom will correct inequalities of the primary distribution of resources.

To illustrate this further, imagine a feudal society with a landed aristocracy and a landless peasantry. Assume the society decides to introduce laissez-faire capitalism without a land reform. A legitimate concern would then be to argue that a peasant’s child is unlikely to receive the same education and health care as the child from an aristocratic family. Peasants’ children would also be disadvantaged in access to financial services because they have no collateral.

A laissez-faire advocate would now argue that these concerns are theoretically not plausible. Why would a peasant’s child be disadvantaged in her access to education, health care, or finance? If the

child is smart enough, her parents will take her to the next commercial bank, which is assumed to have perfect information and to operate under perfect competition, in order to verify the child's future promise. Once this promise is established, the bank will be glad to finance the child's health care and educational needs. And if the peasant's child is smarter than the aristocrat's child, she will also secure for herself enough funding to be able to buy land from the aristocrats. Market freedom could therefore end feudalism peacefully. For laissez-faire economists the primary distribution of economic assets and opportunities does therefore not matter. All that matters is market freedom. And whatever the market result is, it must be good and efficient. So, at least, the laissez-faire theory goes.

There is very little disagreement that equitable social development is necessary for national unity and social peace. Already Aristotle (384 BC- 322 BC) noted that "for when there is no middle class, and the poor greatly exceed in number, troubles arise, and the state soon comes to an end." Similarly, Adam Smith finds that "[no] society can surely be flourishing and happy, of which the far greater part of the members are poor and miserable" (Aristotle, n.d.).

By emphasizing that economic development means equitable social development, Mubyarto and Boediono were pointing at an important discussion. They knew that the path to socially equitable development depends on many factors like economic geography, a country's social fabric, and historical factors and that there is no one-size-fits all political-economic philosophy, but only tailor-made designs. This is particularly true for a country as diverse as Indonesia.

### **Building a strong national economy**

McCawley (1982, p. 103) notes that a "Pancasila economic system would openly recognize the need for an appropriate degree for economic nationalism in a developing country such as Indonesia, both because domestic political considerations demand a display of national independence and because domestic entrepreneurs are unable to ever compete successfully with either domestic Chinese firms or

foreign competitors unless they are given support for a period of consolidation.” This argument is not necessarily an Indonesia-specific problem, but a general development-economic problem that addresses the so-called infant-industry argument.

The infant industry argument mirrors the thinking of many early development economists. It is a byproduct of dependency theory, which argues that formerly colonized countries are disadvantaged in international trade with developed countries. According to dependency theory, developing countries specialize on natural resources and factor labor intensive goods, while developed countries, which are often the former colonial ruler, specialize on capital intensive production. This international division of labor transfers much of the value added in global production to the industrialized countries. In order for developing countries to finance the imports of these high value-added products, developing countries would become ever more dependent on exports of their natural resources. Without protection of domestic industries, developing countries would never have a fair chance to catch up to developed countries.

The infant industry argument has a lot of support among development economists. Some even argue that all successfully industrializing countries after England temporarily protected their manufacturing industries. The interesting question is therefore not so much whether temporary protection is useful or not, but what the temporary protection should ideally look like. Shall protection be an import-substitution or export-led growth strategy? Shall government become an economic player like in the Japanese Keiratsu and Korean Chaebol models? Or, shall government leave the economic risk to the private sector exclusively?

Mubyarto and Boediono do not fit easily into a specific development model. Both were pragmatic economists who derived their policy recommendations from the careful analysis of the problems of a mostly agrarian economy at the beginning of development. They argued that building a

strong national economy requires strengthening rural communities through cooperatives. Building a strong national economy must be a bottom-up process. National economic strength must rest on strong communities, not an economically strong state.

## **Balancing centralization and decentralization**

The final characteristic that McCawley (1982) identifies as a distinct characteristic of Pancasila economics is the need for balancing centralized and decentralized decisions. This concern is again universal to all developing economies and echoes a fear from over-centralization.

The political organization principle that most effectively organizes the authorities of centralized and decentralized decisions is subsidiarity. Although the term subsidiarity does not appear as such, it was already addressed by the Federalist Papers. Alexander Hamilton (1755-1804), for example, wrote “that acts of the large society which are not pursuant to its constitutional powers, but which are invasions of the residuary authorities of the smaller societies” will not be part of the “supreme law of the land.” Later, Abraham Lincoln (1809-1865) wrote: “The legitimate object of government is to do for a community of people whatever they need to have done but cannot do at all, or cannot so well do for themselves in their separate and individual capacities. In all that people can do individually well for themselves, government ought not to interfere” (quoted in Nicolay and Hay, 1894, p. 180).

The principle of subsidiarity is also relevant to social solidarity. Solidarity in line with the principle of subsidiarity means that the larger solidarity community should extend its help to a smaller group of vulnerable individuals only after the smaller group has exhausted the means to help itself. The interaction of individual responsibility and social solidarity is also common to Christianity and Islam. The five pillars of Islam, eventually, specify four individual responsibilities (declaration of faith, prayer, fasting, and pilgrimage) and one social (alms giving). Similarly, the Christian belief stresses both individual and social responsibilities.

In summary, if one examines what Pancasila economics is supposed to accomplish, no individual concern is really specific to Indonesia, but the sum of all concerns is highly relevant for the formulation of a successful development strategy for Indonesia. Mubiyarto and Boediono need to be credited with initiating the important dialog on how to give Sukarno's national vision an economic identity. Both have sketched this identity by giving immense consideration to the details of Indonesia's social fabric and developmental needs at the time.

Unfortunately, Mubiyarto and Boediono's visions never became the face of Indonesia's economic system. For example, both Sukarno and Suharto shifted the balance of power between centralization and decentralization in their political favor. This has changed during the post-Suharto reform period, which has seen a greater movement towards decentralization. At the same time, new challenges emerged, most notably the fact that Indonesia is increasingly confronted with inequitable social development. National dialogue on Pancasila economics must therefore continue.

## **2. THE THREE POLITICAL STAGES OF PANCASILA**

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### **Sukarno**

Sukarno introduced Pancasila as the philosophical and ideological basis of the Indonesian state in 1945. During a speech to a preparatory committee for independence under the help of the Japanese (Badan Penyelidik Usaha Persiapan Kemerdekaan Indonesia, or BPUPKI) now known as the "Birth of Pancasila," Sukarno presented his vision for the soon to be independent Indonesian state. He envisioned Pancasila as a means to cope with the multicultural composition of Indonesia. Pancasila principles were inclusivist and universalist in nature and consisted of principles Sukarno thought were shared by all Indonesians, and meant to mitigate conflict between religious and political groups present in Indonesia, emphasizing plurality and religious tolerance. Sukarno laid out his basis for the Indonesian state in these five principles that were later included in the Indonesian constitution. These principles were not derived

from any one particular ethnic group, but rather were intended to create an Indonesian identity which was all encompassing. Pancasila was created to “replace other –isms” it is Indonesia’s “own ideology, which has grown within us and which wards off any other ideologies” according to former vice-president Adam Malik (1917-1984) (Jones, 1982). Discussions about Pancasila’s place in Indonesian politics and society were not without debate. There was a strong push from Muslims to specify Islamic obligations to Sharia. These stipulations however were later removed in an effort to consolidate national unity.

Initially, Pancasila was a well thought out response to the multicultural reality of Indonesia and a mechanism for unity within the state (Yuniarto, 2012). After independence, however the broad scope of Pancasila proved too challenging for a young democracy. Pancasila principles were laid out in a simple manner, yet have been conceptually challenging, especially for a newly democratizing state experiencing the growing pains of independence and regime change. Conceptually, the principles of Pancasila are lacking definition and thus are difficult to apply in a meaningful or effective sense to political, economic or social policy. Elkof (2003, p. 31) argues that Pancasila was designed “to be broad enough to be acceptable to all Indonesians, regardless of ethnicity, religion or political beliefs.” Sukarno saw the ambiguity of Pancasila as a strength. The general nature and conceptual vagueness of Pancasila, however, provided a vehicle for Sukarno to sustain his authority.

Upon independence, in an effort to play to the allied forces that had very recently caused the Japanese surrender, Sukarno established a parliamentary system of government in which he remained the president and appointed a prime minister to deal with day-to-day affairs. The establishment of a parliamentary system also satisfied the internal demands for political parties. The parliamentary system proved to be quite unstable. Three main competing groups all had different visions of what the newly independent Indonesian state should look like. Nationalist parties desired a secular state, Islamists moved towards an Islamic state and communist parties envisioned Indonesia as a socialist state. The

various political ideas have proven to be non-reconciliatory and drove Indonesia into political turmoil. Growing dissatisfaction with political instability caused Sukarno to take steps consolidating his power in an effort to unify Indonesia. After the 1955 legislative elections served to further reinforce antagonisms between the nationalists, Islamists, and communists, Sukarno called for a form of “guided democracy.” Guided democracy was an attempt to stabilize politics within Indonesia; it mocked community consensus and legitimate government through elections, which in practice had been pseudo-democratic reforms without any significant impact from the citizenry. In essence Sukarno’s Guided Democracy was a wolf in sheep’s clothing, serving as a platform to increase his own autocratic rule.

Throughout Sukarno’s rule, he increasingly neglected Indonesia’s economic system demonstrating that his regime under Pancasila was ineffective at creating and sustaining a viable economic system. At the same time, the Indonesian Communist Party (PKI) gained traction and influence within in the government which caused concern for both political Islamic parties and the Indonesian military. During this time period it was these three groups that provided the support for Sukarno to maintain his regime. The combination of growing economic unrest and increasing influence of the PKI would be the major factors in the fall of Sukarno’s regime.

## **Suharto**

Suharto came to power upon the resignation of Sukarno in 1967 after two years of political turmoil, economic and social unrest. Suharto’s time in power was known as the “New Order” as opposed to the “Old Order” of Sukarno. The New Order was promoted under the banner of Pancasila and Suharto envisioned his New Order as a society based on the Pancasila ideology. However, Suharto did not force the Pancasila principles immediately for fear of blowback from political Islam parties.

The successful stabilization of Indonesia’s economy in the late 1960’s helped gain support for the New Order and by 1978 Suharto was able to secure legislation mandating the application of

Pancasila across a variety of political and social institutions (Morfit, 1981). This resolution required that organizations within Indonesia abide by Pancasila principles. For political parties, this meant that exclusion on the basis of religion was banned. This was an unwelcome development for parties of political Islam. Pancasila training became mandatory for government workers, students, and civilians across the country. This training, known as P4, was top-down administered and served foremost the purpose of giving Suharto's political and economic program the legitimacy of the spirit of independence. Again, ambiguity of Pancasila worked to the autocratic leader's advantage. Pancasila remained vague enough that it allowed Suharto maintain his grip on authority by identifying threats to his power as violations of Pancasila: "[t]o this end, government officials thus evoked *Pancasila* to locate any political discussion, suggestion, organization or actor outside the permissible boundaries of the hegemonic political culture" (Eklof 2003, p. 293).

Towards the end of the New Order, Suharto had led Indonesia towards economic recovery from the defunct economic system left by his predecessor and attempted to propagate Pancasila as a means towards political and social cohesion. The political Pancasila rhetoric and economic reality became increasingly divergent. As time passed, his autocratic leadership also invited corruption, cronyism and nepotism. Popular opposition to his rule had begun to grow, although not in an overt manner. However, the Asian financial crisis of 1997-1998, failing health and growing discontent among the public over his autocratic rule contributed to his resignation of the presidency in 1998.

## Post-Suharto

After the resignation of Suharto in May 1998, his then deputy Habibie (1936-present) ascended to the Presidency. The focus on the role of Pancasila in public and political spheres proceeded to decrease dramatically as a result of the political misuse and manipulation of the Pancasila ideology under the Sukarno and Suharto regimes.

The result is that Pancasila has become a national memory best forgotten and a dirty word in the vocabulary of politicians. Since the fall of the New Order, many political elites were wary of the incorporation of Pancasila as a policy or rhetoric for fear of being associated with autocratic regimes. Pancasila rhetoric has always been cause for concern. Jones (1982) cites a political thinker who finds that “Indonesians talk ‘Pancasila, Pancasila, Pancasila’ and they end up talking about nothing at all.” This points to one of the critical concerns regarding Pancasila; that its lack of clarity and policy application allows political elites to hijack it for their own power.

In recent years however, there appears to be a growing call for a return to Pancasila principles in political, social and economic spheres of Indonesian life. Despite the tendency to “walk on eggshells” where Pancasila is concerned, every year the state commemorates Pancasila Sanctity Day. This day is intended to be a reminder to Indonesians of the principles of Pancasila as a guiding ideology of the state. What has happened since the end of the New Order regime however, is that while many may be familiar with the guiding principles of Pancasila, the true meaning and message requires further education and reinforcement, especially among the youth population (Jakarta Globe 2013).

The re-actualization of Pancasila in Indonesia will not be an easy task as the collective memory of authoritarianism remains fresh. However, Yuniarto (2012, p. 1254) provides a much needed reminder that “associating Pancasila with a certain regime is a fallacious reasoning. Pancasila is not a claim of the reign of the Old Order, not of the New Order or the today’s reform, but is the national identity of Indonesia as long as its sovereignty is firmly established [sic].” In order to bring Pancasila principles back into the main stream it is critical to pull away from associations to prior regimes and focus on the inclusivist and universalist nature of Pancasila as a state ideology.

### 3. THE POLITICAL ECONOMY OF PANCASILA – THE WAY AHEAD

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The original visions of Mubarto and Boediono provide the way ahead for the formulation of a Pancasila economic constitution. The normative intentions for a Pancasila economic system are as valid today as they were at independence, but a discussion on their economic implementation needs to start from scratch. A fresh discussion is necessary in order to learn from the political mistakes of the past and to revitalize the original spirit of Pancasila. An important question therefore is: What are new avenues for a discussion of the future role of the state, the incorporation of social and religious values, the initiation of equitable social development, building a strong national economy, and balancing centralization and decentralization?

#### Advancing the role of the state

The original idea that “state enterprises and cooperatives must play an important role” must be adjusted by the positive and negative experiences that different countries, including Indonesia, have made with the role of the state and cooperatives. Historically, state enterprises have played an important role in different development models. Different roles of the state can be categorized as: (1) classical socialist state economies, (2) capitalism-reformist socialist countries like China and Vietnam, (3) state-led capitalist-industrializing countries such as Japan (Keiratsu) and South Korea (Chaebol), and (4) natural-resources fueled state economies like the Gulf States in the Arab world.

From a historical perspective, Indonesia evolved from a socialist development model under Sukarno to a combination of a state-led capitalist-industrializing and natural-resources fueled economy since Suharto. All three models are problematic. Socialism has failed because it is not incentive-compatible. State-led capitalist-industrializing economies tend to generate too-big-too fail industries and lead to corruption and nepotism, despite the fact that they prove successful in initiating economic

development. Last but not least, the natural-resources fueled state economies need to deal with commodity price shocks, the Dutch disease, and lack of economic diversification.

That Indonesia's development model and those of other East Asian countries are subject to risks became clear during the 1997/1998 East Asian crisis. The crisis has shown that the role of the state must not only be seen in promoting growth, but shock resilience as well. An important lesson from the crisis with regards to the role of the state beyond growth is that economic development requires the state to evolve from an economic actor to an impartial economic regulator and referee. As far as the regulatory deficiencies were concerned, Radelet and Sachs (1998, p. 37) note, for example, that "there were many problems and weaknesses in the Indonesian economy before the crisis, including under-supervised banks, extensive crony capitalism, corruption, monopoly power, and growing short-term debt."

In order to advance the role of the state in a Pancasila economic system, the political process must find a way to address these shortcomings.

### **Advancing the idea that economic man is guided by social and religious values**

The World Value Survey asks the question "How important is God in your Life" and provides two observations for Indonesia, one for 2001, three years after the East Asian crisis, and one for 2006, two years after the Tsunami. The survey reports that while in 2001 still 96.9% of the respondents answered the question with "very important," only 85.2% considered God in their life "very important" in 2006. Despite this seeming downward trend in the importance of God, the level of religiosity in Indonesia is still very high compared to other countries.

A consensus on the influence of religiosity on the economic constitution is very important for a multi-religious society like Indonesia. For social peace, it is crucial that different religious concerns regarding economic affairs are granted not only coexisting rights; they also must experience mutual

tolerance, respect, and cooperation. Public inter-faith dialogue on economic affairs is very important for this purpose.

In comparative religious economics, there seems to be a trend to emphasize the differences between Islamic and Christian-style economics and finance more than their similarities. Moreover, the West has been guilty of ignoring for too long the rich heritage of Islamic economic thought that had existed long before mainstream economics declared Adam Smith as the father of modern economics.

Islamic and Christian economic values are very similar. Both emphasize the need for balancing the principle of individual freedom with social solidarity. Before Adam Smith, Ibn Khaldun already argued that the state must subordinate itself to the individual when at the same time medieval scholastics still advocated the exact opposite. The legacy of economic freedom in Islamic philosophy is highly underrated in the West.

Although economic liberalism as a philosophy spread rather late in the West, the West was luckier than the Islamic world in that the period of enlightenment was not only an intellectual movement, but a societal reality. The Golden Age of Islam, during which already similar liberal ideas were articulated, on the other hand, ended several centuries earlier under foreign invasions.

The idea that economic man is guided by social and religious values is relevant to the principles of Islamic finance, but even more so to the design of social safety nets. Both Islam and Christianity see man as a social animal with a need and desire for living within a solidarity community. Both religions emphasize that solidarity is mainly help to self-help. In the Bible, 2 Thessalonians 3:10, it says, for example, that “[t]he one who is unwilling to work shall not eat.” Similarly, the Holy Quran is very specific about who is entitled to alms (zakat), namely the poor and the needy (Holy Quran 9:60). Islamic laws derived from the Holy Quran also clarify that zakat is not meant to be given to persons who act irresponsibly, contradicting Islamic values.

The incorporation of social and religious values into a Pancasila economic system must not only be concerned with the differences between Islamic and Christian finance, but also with the design of targeted social safety nets. Religious groups, for example, could play an important role in conveying the need for moving away from universal subsidies to more effective targeted social assistance programs. Eventually, socialists propagate atheism because they know that their paternalistic top-down approach to solidarity contradicts most religions' bottom-up philosophy.

### **Advancing the idea that economic development must be equitable social development**

That economic development must be equitable social development is particularly relevant to Indonesia, which has faced rapidly rising inequality during the post-Suharto era. During the decade following the East Asian crisis, Indonesia's GDP almost doubled. Inequality as measured by the Gini coefficient, however, also increased by more than 30 percent, from a low Gini value of 29 to a score above 38 (World Bank, 2013).

Generally, it is not uncommon that after a major structural break, income inequality increases. It has been a particularly drastic experience after the collapse of socialism in Central and Eastern Europe.

But what is the source of rising inequality in Indonesia? Although a definite answer is not possible, economic theory and available data suggests that changes in Indonesia's economic profile matter. This profile is a hybrid of a natural resources-extracting rentier state and a productive manufacturing and services generating power house. Natural resources driven economies are more conducive to income inequality than economies employing human and physical capital. Generally, the greater is the demand for productive human and social capital within a society, the more opportunities for spreading a country's income equally exist.

Indonesia's development during the 1970s and 1980s was largely driven by an expansion of manufacturing and services exports. Prior to the East Asian crisis, the value added of manufacturing and services exports to GDP increased steadily while the share of natural resources exports continuously fell. The share of manufacturing and services exports of GDP was less than one percent in 1980 and increased to 12.4 percent in 1993, from where it slightly fell until the outbreak of the crisis. And while the majority of the economic debris of the crisis was removed by 2005 when real GDP per capita reached again pre-crisis levels and the value added of manufactures and services exports to GDP climbed to almost 20%, this valued added fell again to below ten percent in 2011. Since the decline in manufacturing and services exports was not compensated by more exports in natural resources, economic growth was largely driven by investment, whose share increased from 25% in 2005 to 35% in 2011. This investment, however, did not trigger economic activity that would have helped prevent the increase in income inequality. Since an expansion of investment activity typically increases the incomes of only a few and a widening of manufacturing and services export activity the incomes of many, the rise of investment activity and decline of manufacturing and services exports may explain the increase in inequality.

That economic development must be equitable social development is often attributed to insufficient redistribution. This has been a particular popular assumption among socialist thinkers, and it has likely influenced Sukarno, too. Suharto's New Order was characterized by the notion that equitable social development would inevitably result from economic reforms and economic growth. And in fact, inequality did not substantially increase under Suharto. However, as the Suharto era ended with a major economic disaster, whose aftermath was characterized by fast rising inequality, the seed of more inequality must have been sowed under Suharto, but began to blossom only after the crisis. Economic conglomeration under the New Order may have been this seed.

It is important to note that equitable social development is not so much a question of redistribution and the availability of social safety nets, but the creation of a competitive division of labor built upon equal opportunities. Competition policy and public investments in social mobility like education, public health, and public infrastructure, which are typically goods and services that markets fail to provide, are necessary to initiate equitable social development. A renewed discussion on a Pancasila economic framework should therefore take stock of how the supply side of the economy contributes to inequality, not only how policies of income redistribution could ameliorate it.

### **Advancing the idea of building a strong national economy**

What constitutes a strong national economy has undergone different interpretations. In post-colonial Indonesia under Sukarno and many other countries after independence, economic strength was equated with self-sufficiency. Under Suharto, economic strength was linked to export led growth and the attraction of foreign direct investment. However, the East Asian crisis has revealed that these two factors can become a dangerous cocktail, especially when the economic performance no longer anymore lives up to the profit expectations of international investors.

Economic strength means in particular economic resilience to economic shocks in a globalized and interdependent world economy. Adherence to sound principles of economic policy will be necessary to build this resilience. Such principles are, among many others: The separation of government from special interest groups, an effective competition policy, a monetary policy strictly following the objective of price stability, public investments into social mobility, and effective targeted social safety nets.

### **Advancing the idea of balancing centralization and decentralization**

Early development theories emphasized the importance of a strong economic planner state and many developing countries gladly responded to this idea with a politically highly centralized

government. Unfortunately, this has often led to the over-centralization of government and the under-performance of economic development.

Largely as a result of the loss of credibility of centralized power following the East Asian crisis, the post-Suharto era has seen a move towards greater political decentralization. Economic bankruptcy has always been the most effective facilitator of economic change. But economic bankruptcy is not necessarily the best mediator for balancing centralization and decentralization. Decentralization as a result of economic collapse is typically motivated by strategies to avoid burden-sharing of the short-term costs of cleaning up the economic mess. Ideally, however, decentralization should be motivated by the long term benefits of organizing a nation state in line with the subsidiarity principle.

For a Pancasila economic constitution to advance the division of labor between centralization and decentralization, the existing constitutional arrangements should be reviewed and reassessed. Such a political process, however, requires strong public support for cooperation and compromise, which, in turn, depends on a strong democratic culture. These prerequisites have never been as favorable as today.

## 4. CONCLUSIONS

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While initially conceived by Sukarno, Pancasila was eventually to be the vehicle through which both Sukarno and Suharto consolidated their own power in the Indonesian state. Since then, there has been a very real stigmatism attached to the Pancasila ideology, resulting in the overall neglect of it in the post-Suharto era. As Pancasila is primarily a normative mission or vision statement for the Indonesian state, the real development in Indonesia is the increasing deviation from this mission statement and a lack of credibility for the Indonesian state. This deviation began under Sukarno who neglected the economic aspects of Pancasila to such an extent that not only was the economy left in

shambles, but the state lost economic credibility. Under Suharto, who co-opted Pancasila for political traction, the state lost political credibility. The real danger then becomes if these issues go unaddressed, the state risks losing all credibility. While Sukarno used Pancasila as a means to defend socialism, Suharto manipulated Pancasila as a means to keep political Islam at a distance. The overall ambiguity of Pancasila has allowed for political leaders to use and abuse it to consolidate their own power. Partisan appropriations of Pancasila ideology has been a mechanism for autocracy in Indonesia in the 20<sup>th</sup> century.

Still under Sukarno though, the high ideals of Pancasila were abused to defend greater centralization. Suharto sold the New Order also in line with the Pancasila value system. For more than five decades, Pancasila had therefore not been subject to bottom-up political dialogue, but top-down political interpretation. Pancasila became politically stained and a political phantom whose normative value system the majority of Indonesians praises, but politicians are now afraid to discuss with respect to its incorporation in public policy.

This is a dangerous development. First, if all agree on the value system of Pancasila but there is no political leadership on what it means in political practice, politics loses its credibility, which in turn paves the way for alternative ideologies. These alternatives could range from political Islam to greater regional break-away dynamics. Second, not having a democratic discussion on specifying Pancasila economics and economic policy more precisely is a missed opportunity to legitimize an overhaul of existing political processes, which, despite Indonesia's huge success, also suffers from governance imperfections. Third, politicians may be blinded by Indonesia's impressive economic growth record and therefore overlook the fact that while the economy looks strong, its economic wealth is increasingly unequally distributed. A discussion about Pancasila could therefore save Indonesia from a socio-

economically explosive cocktail. Eventually, most uprisings occur not when all citizens are equally poor off, but under fast, inequitable growth.

While both the Old and New Orders attempted to incorporate Pancasila into their regimes, they both effectively crushed its potential. Pancasila as a normative mission statement in the Indonesian state has tremendous potential to increase economic and social development. However, the fact of the matter remains that Pancasila has not achieved its objective; there has been no delivery on promises made. From a political perspective, Pancasila principles are not unique concerns that have not been or would not be raised by other multicultural states. However, Pancasila could be made unique to the Indonesian case by coming to a consensus on what the principles of Pancasila truly mean for Indonesia. Since its inception, Pancasila has remained a normative vision statement with no handbook, no blueprint on how to achieve the objectives it sets forth for the state. Indonesia is now at a unique point where reevaluating and promoting discourse on Pancasila could serve to facilitate its re-actualization in a truly democratic Indonesia.

A practical policy recommendation to re-launch the discussion of Pancasila in public and political life could be to form an expert commission consisting of representatives from religious groups, political parties, academics, civil society, and the arts. This commission will be tasked with formulating the including groups' various expectations towards a Pancasila economic constitution. The commission is expected to develop policy recommendations independent of past Pancasila-related intra-societal conflict. Additionally, it should be made clear that any resulting policy recommendations are by default non-binding, but should guide political and public discourse towards the formulation of a potential Pancasila economic constitution. This constitution should consist of general rules. Such general rules could be: The Pancasila Economic Constitution (1) recognizes the rightful coexistence of Islamic and Non-Islamic Finance; (2) prescribes subsidiarity as the guiding principle for the assignment of centralized

and decentralized political authorities; (3) safeguards a competitive division of labor through markets; (4) protects consumers from the abuse of market power; and (5) shields the government from special interest groups. These are, of course, just examples, which seem to be plausibly in line with Mubarto and Boediono's original intentions. More important than any specific recommendations, however, is the fact that a bottom-up discussion is initiated. The general spirit is that renewed public discourse will remove the roadblock catapulted from the past, effectively paving the way for economic development guided by Pancasila.

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