Macroeconomic Developments, Policies and Issues in Indonesia, 1950-2005: a Review#

Akhtar HOSSAIN*
The University of Newcastle, Australia

Abstract: This paper reviews the major macroeconomic developments, policies and issues in Indonesia within a political economy perspective since it gained recognition of independence from the Dutch in December 1949. It reveals that the impressive economic and social progress in this country over the past five and a half decades was not a smooth process. Indonesia, under both the Japanese occupation (1942-1945) and the nationalist-revolutionary leadership of President Sukarno (1945-1966), suffered from economic and political instability resulting in an economic and political crises in 1965. This led many observers to term the country an economic 'basket case'. The establishment of the military government under Lieutenant General Soeharto in 1966 provided the much needed economic and political stability over the next three decades (1967-1996). This turned out to be the 'golden era' of Indonesia's modern economic history when the traditional agricultural, albeit natural resource-rich, economy underwent impressive transformation into a balanced, outward-oriented industrialising economy. Then the 1997-98 currency-cum-financial crises came that lasted much longer than in other countries in the region and exposed the dark side of this country's economic miracle, which took the form of 'corruption, collusion and nepotism or crony-capitalism in short.' Indonesia has slowly recovered and by 2004 moved to a higher growth path with improved economic, social and political institutions.

Keywords: Macroeconomic policies, inflation, capital flows, financial crisis, Indonesia
JEL classification: E31, E52, N15

1. Introduction

Since gaining recognition of its sovereignty[1] from the Dutch on 27 December 1949 after about eight years of Japanese occupation and the revolutionary war against the Dutch

*School of Economics, Politics and Tourism, Faculty of Business and Law, The University of Newcastle, NSW 2308, Australia.
Email: *Akhtar.Hossain@newcastle.edu.au*

The author would like to thank an anonymous referee, the Managing Editor of this Journal and Professor Howard Dick of the University of Melbourne for their comments and suggestions for improvement on this paper. Without implicating them, he bears the responsibility of any remaining deficiencies.

[1] Sukarno, with Mohammad Hatta at his side, read the Proclamation of Indonesian Independence in front of his house at Pegangsaan Timur 56, on 17 August 1945. He was selected as the New Republic's President. The next four years were Indonesia's Revolutionary War against the Dutch, which re-claimed sovereignty over Indonesia once the Japanese occupying forces surrendered to the Allied forces after World War II. After protracted negotiations in 1949, the Netherlands government recognised Indonesia's sovereignty on 27 December 1949. For a detailed discussion on Sukarno's declaration of independence and the revolutionary war and their implications on the Indonesian economy, society and politics during the next two decades, see Penders (1974). For the Preamble and Constitution of the Republic of Indonesia of 1945 that created a unitary State and provided 'unlimited executive power' to President Sukarno, see Tan (1967:169-74).

(Booth 1998; Higgins 1957), Indonesia has made an impressive economic and social progress over the past five and a half decades. This was, however, not a smooth process. Indonesia, under both the Japanese occupation (1942-1945) and the nationalist-revolutionary leadership of President Sukarno (1945-1966) suffered from economic and political instability that stifled economic growth and social development (Booth 1998) resulting in an economic and political crises in 1965. This led many observers to term the country a 'chronic dropout'[2] or a 'basket case' (Hill 2000; Booth 1998) despite the fact that Indonesia has been 'blessed' with both natural and human resources that has drawn the attention of many prominent economists[3] since the early years of its independence. Unlike other newly independent countries of Asia during that time such as India, Myanmar, Pakistan and Sri Lanka, Indonesia, however, encountered economic, social and political challenges. Its viability as a unified nation was even doubtful for many years.[4]

Having inherited from the Dutch colonial administration a vast archipelago with a large number of ethnic groups based on more than 300 languages and dialects (Taylor 2003), stretching from the Southwest of Thailand to the North of Australia and consisting of arguably '13,677 islands of which 6,000 are habitable' that the Dutch called 'a garland of emeralds that winds itself around the equator' (Selo Soemardjan 1988:1), the nationalist leadership, overwhelmed with the task of nation building, remained in an unenviable position at least for the first two decades to make any swift changes in the lives and fortunes of the impoverished people who lived so long under European colonialism and endured extreme exploitation even in terms of colonial standards.[5] President Sukarno therefore considered

[2] Hill (2000:1) has attributed the phrase 'chronic dropout' to Higgins (1968:678).

[3] Two early studies on the Indonesian economy are Higgins (1957) and Higgins and Higgins (1963). Although Higgins (1957:53) acknowledged the presence of a wide variety of resources ('rich in natural resources') in Indonesia, he considered them inadequate 'to produce a per capita income for 80 million people comparable to that of the more advanced European countries, at least with present levels of managerial and technical skills'. Gunnar Myrdal (Myrdal 1968:489) in his classic work *Asian Drama* also did not see much 'prospects of rapid economic growth in Indonesia.'

[4] For a list of socio-cultural and anthropological studies on the peoples of different Indonesian islands that developed somewhat separately and moulded their cultures, see McKay (1976). In addition to the inherent ethnic-cultural diversity of its people, the new Republic encountered the risk of disintegration from the way the Dutch left the country. In order to make it difficult for the nationalists to maintain a unitary form of the state, the Dutch created a group of regional states that formed the Federal Republic of Indonesia, which was designed to give some freedom to various ethnic groups to develop politically so that they may secede later. The nationalists were aware of this risk. As Selo Soemardjan (1988:54) comments: "Having left this time bomb, the Dutch expected the new Indonesian state to explode within a short time, and in that way to open the gate again for their return."

[5] Arguably the Dutch were at the top, the British were at the bottom and the French were somewhere in between in terms of their colonial exploitation and political oppression in Asia and Africa. On the debate of the extent of colonial resource transfer from Indonesia to the Netherlands and related issues, see Booth (1990), Lindblad (2002), Maddison (1989,1990) and van der Eng (1993). In his 1989 study, Maddison (1989:15) reports the following findings:

"The principal findings are that Dutch income in and from Indonesia probably amounted to about 1.4 per cent of Indonesian domestic product in 1700 and rose to about 17 per cent in 1921-38… Until 1870, about 90 per cent of this Dutch income in Indonesia was remitted out of the country…

the early years of independence a period of survival when the government had to deal with economic and financial strain and recurrent political crises, while it was apparent to the leadership that …`neither economic nor political stability can be assured unless Indonesia succeeds in raising output faster than her population grows' (Higgins 1957:xxi). In the end, although he (arguably) 'failed to deliver the fruits of revolution: better food, better education, better homes and employment' (Lee 1999:3), he was able to make a significant progress in terms of integrating ethnically diverse people, unevenly distributed across the archipelago, into a nation under a unitary political system and making them feel proud to be Indonesians.[6]

The abortive but 'mysterious' military *coup d'état*, under the banner of *Thirtieth of September Movement*, that took place on 30 September 1965 effectively ended the rule of President Sukarno and led the establishment of the military government under Lieutenant General Soeharto (Nguyen and Rochter 2003:3). Sukarno's apparent foreknowledge, if not his complicity, of the *coup* sealed his political fate but not his life.[7] This was the beginning of what was termed the New Order government vis-à-vis Sukarno's Old Order government that provided the country the much needed economic and political stability. While politics dominated economic affairs during the Sukarno era, the political legitimacy of the Soeharto government was derived from almost uninterrupted rapid economic growth and development over the next three decades (1967-1996). This turned out to be the 'golden era' of Indonesia's modern economic history when the traditional agricultural, albeit natural resource-rich, economy underwent impressive transformation into a balanced, outward-oriented industrialising economy. The scale of this transformation was reflected in the associated improvement in the standards of living of the people, whose per capita income increased from roughly about USD100 in the early 1960s to about USD1278 in 1996 while the size of

---

In India, where the literature on the colonial drain is much more voluminous, the flow to the colonial power was relatively much smaller and the economy much less involved in international trade. At its peak in the inter-war period, 1921-38, British income in India was about 5 per cent of Indian domestic product, and the remitted part was about 1.7 per cent."

6 In an historical context, there is emerging consensus that Sukarno's major contribution to Indonesia was in terms of nation building in a political sense while his credentials on economic management were limited. Accordingly, Penders (1974:197-98, 201-02) has assessed Sukarno's contribution as follows:

"… the credit for the creation of a unitary Indonesian state and for preventing the country from disintegrating into various separate units must in a large part go to Sukarno. He became the father of the fatherland, the symbol of Indonesia, the Moses who led his people out of captivity… Sukarno was a man in a hurry, who because freedom had come fairly late in life wanted to jump over mountains to achieve within his own lifetime what he fervently hoped for and dreamt about for so long: the creation of an Indonesia which was powerful, feared and respected by the nations of the world."

7 Although he retained the title President until 1968, Sukarno signed a document of transfer of some of his presidential authority to General Soeharto on 11 March 1966 to "maintain peace and order and the stable course of the revolution." Later, he was compelled to transfer all his powers to Soeharto on 12 March 1967 once 'concrete evidence' of his involvement in the *coup* became available. On this date, Soeharto was sworn in as Acting President. This was effectively the end of Sukarno's political career. Since then he remained virtually under house arrest. He died on 20 July 1970 (Penders 1974; Zainu'ddin 1976).

population increased from 114 million to 197 million.[8] In fact by the early 1990s, Indonesia gained the status of a second generation 'miracle economy' in Southeast Asia (World Bank 1993). This justified the growing leadership clout of Indonesia in the region in general and in the ASEAN in particular (Hill 2000; Thee 2002). With the rise in Soeharto's stature in the region, he was referred to as Indonesia's Father of Development (*Bapak Pembangugan*). Whilst his economic development strategy remained market-friendly and outward-oriented, his priority was economic development over any democratic political development (Wanandi 2003) much in the same way as General Park Chung Hee pursued economic development in South Korea.[9]

Then the 1997-98 currency-cum-financial crises came, which were unexpected in Indonesia given its perceived strong economic fundamentals. The Indonesian crises lasted much longer than in other countries in the region and exposed the dark side of its economic miracle, which took the form of 'corruption, collusion and nepotism or crony-capitalism in short' (Hughes 1999; Thee 2003; McLeod 2005). After struggling for about five years Indonesia recovered and has moved to a higher growth path in 2004 with improved economic, social and political institutions. In particular, since the crisis there has been a political transition from authoritarianism to liberal democracy, which has been eventful but 'surprisingly' less dramatic than many 'pundits' had predicted earlier (Nguyen and Richter 2003). The challenge for the infant democratic polity is, "how to steer the economy along a high growth path." As to how this is achieved could be critical for this country's social and political stability over the next few decades' (Usman 2003).

The rest of this paper is organised as follows. Section 2 reports the key indicators of economic and social development in Indonesia in an historical context, especially since the early 1960s to the onset of the currency crisis. Section 3 reviews the major macroeconomic developments, policies and issues in Indonesia during the Sukarno era (1950-1965). Section 4 reviews the major macroeconomic developments, policies and issues during the pre-crisis period of the Soeharto era (1966-1996). Section 5 reviews the currency-cum-financial crises and the problems associated with the recovery process. Section 6 draws the conclusion.

2. Economic Transformation and Social Development in Indonesia: 1900-1996

2.1. Economic Growth and Structural Change: 1900-1965

At the time of independence the Indonesian economy was in bad shape. This was partly due to the Japanese occupation during 1942-1945 and the revolutionary war against the Dutch during 1945-1949 that caused the destruction of physical infrastructure and the dislocation of productive resources (Booth 1998; Thee 2003). This happened at a time when

[8] The population figures are drawn from the *International Financial Statistics Yearboo*k of the International Monetary Fund while the per-capita income for 1996 is drawn from the *ICSEAD: East Asian Economic Perspective 2006*.

[9] For a review of South Korea's economic development under General Park Chung Hee, see Cho and Kim (1991).

the colonial economy, which was dualistic and/or subsistence in nature, was yet to transform into an integrated national economy.[10] The country needed a comprehensive economic plan for reconstruction and rejuvenation that would re-link the domestic economy to the world economy and create an impetus for rapid economic growth.[11]

However the political leadership under Sukarno[12] was apparently less effective in mobilising resources for economic reconstruction and rehabilitation. To begin with, he did not inherit disciplined macroeconomic policies and mechanisms, which would have steered the war-ravaged economy that saw its per capita income nosedive to the level that had existed at the end of the nineteenth century (van der Eng 1992; Booth 1998). The fact that Sukarno had little understanding of the workings of a modern economy or even showed little interest in economic affairs made the matter worse.[13] Therefore, as in many Latin American countries, Indonesia started with the policy of monetisation of budget deficits that fueled the inflationary pressure already generated during the revolutionary war.[14] This created serious balance-of-payments difficulties, although a short-lived respite came from the Korean War during 1950-1953 that sharply increased Indonesia's export earnings. Once the Korean War was over, the economic condition deteriorated. Nevertheless, the political leadership formulated development strategies and plans in broadly 'socialist' terms (that is, state controls, planning and the notion of equality) without disrupting "the thoroughly 'capitalist' economic structure inherited from the colonial regime" given the prevailing nationalist and revolutionary mood of the people.[15] After several years of preparatory study, the National Planning Bureau drafted a five-year plan in 1955 for implementation during 1955-1960.[16]

---

[10] Paauw (1963:157) has described this phenomenon as follows: "The geographical fragmentation of Indonesia into a large number of islands is basic to an understanding of the nation's economy. Integration of separate island economies into a national whole was not a major objective of colonial policy, and progress toward regional specialisation and trade developed slowly."

[11] Dick (2002:173-174) has described these problems as follows: "In 1950 the immediate problems were political, but the crisis of the new nation was also an economic one. For almost a decade, the economy had languished outside the mainstream of the world economy. These problems were most apparent in Java, where prolonged neglect and guerilla sabotage had done great damage to physical infrastructure, not only transport and communications but also irrigation and power supplies. In the Outer Islands, roads had become impassable, forcing traffic back to waterways. Less visible and more difficult to assess was the human dislocation."

[12] To be fair to Sukarno, he was practically a figurehead president until 1957. Economic policies and programmes were formulated and implemented by governments headed by prime ministers. Besides the fact that there was no consensus on key economic policy matters, the political situation in the country remained complex and volatile. For detailed discussion on political developments in Indonesia during 1945-1965, see Feith (1962) and Feith and Castles (1970).

[13] For a discussion on Sukarno's 'unorthodox' views on economic matters and impatience with the 'Western-trained bald-headed professors', see Tan (1967).

[14] Sjafruddin Prawiranegara (2003:82) points out that Sumitro Djojohadikusomo, who held key economic portfolios in the post-independence era, followed the Keynesian approach to monetary policy, implying 'pump priming and deficit spending' that 'inevitably entailed inflation'.

[15] According to Mackie (1971:44), "the pressures and limitations of practical politics have generally had greater influence than abstract theories in determining Indonesia's economic policies."

[16] For an outline of the Plan and its preparation, see Higgins (1957:40-53).

The main rationale of this plan was to build up within the public sector, the essential industries, utilities and services for sustaining and stimulating investment in the private sector. Even this *ad hoc* and small-scale plan did not last beyond 1957 when the country was in political turmoil and had experienced rising inflation (Mackie 1971). By this time the lingering political instability[17] and the lacklustre economic performance induced Sukarno to introduce 'Guided Democracy and Guided Economy' with the aim of bringing political stability for planned and balanced economic growth. The outcome was quite different from what had been expected. There was neither economic nor political stability during the next seven to eight years. A new Eight Year Overall Development Plan was launched in 1960, which, in the words of Mackie (1971:53), was "more interesting as a revelation of Indonesian political processes than an exercise of the economist's craft." The economic and political crises that had started to build up from the late 1950s reached their peak in 1965 in the middle of a hyperinflationary situation when an abortive military *coup d'etat* in September 1965 ended the rule of Sukarno and brought a military government into power under General Soeharto.

On the basis of historical data since the early twentieth century, it is possible to make a general assessment of economic growth and structural change in Indonesia during the 1950s and early 1960s. Booth (1998) suggests that the economic history of Indonesia since 1800 was essentially a study of missed opportunities. van der Eng (2002) has estimated annual data for real GDP since 1880, which suggests that there was a rise in per capita output from Rp 1744 in 1880 to Rp 2881 in 1941. Since then, there was a sharp decline in per capita output, which did not recover to the pre-war level until 1973. Although there was sustained rise in per capita income at the rate of 1.5 per cent per annum over the period 1900-1929, economic growth was volatile from then until the 1970s. As a result, there was no significant structural change in the economy, which remained predominantly agricultural, contributing about 40 per cent to GDP in the 1960s. But as population growth rate, which was about 1.2 per cent per annum during 1900-1950, increased to about 2.0 per cent per annum in the 1960s, the per capita income did not increase much (Table 1).

Table 1: Per capita real GDP and population growth rates (1900-1969)
(unweighted annual average, per cent)

Period	Population growth rate	Per capita real GDP growth rate	Period	Population growth rate	Per capita real GDP growth rate
1900-1904	1.3	0.2	1935-1939	1.5	1.7
1905-1909	1.0	1.5	1940-1944	1.2	-10.1
1910-1914	1.0	2.7	1945-1949	1.1	6.0
1915-1919	0.8	1.6	1950-1954	1.9	4.6
1920-1924	1.3	0.9	1955-1959	1.9	0.3
1925-1929	1.4	2.6	1960-1964	1.9	-0.3
1930-1934	1.4	-3.6	1965-1969	2.0	-0.5

Source: Author's computation based on van der Eng (1992).

[17] Higgins (1957:107) suggested the following interpretation of political instability in Indonesia during the early years of independence: "Between the declaration of independence in 1945 and the establishment of the Republic of Indonesia in December 1949, there were nine governments. Since

2.2. Economic Growth and Structural Change: 1966-1996

As indicated above, the economic and political crises that built up since the late 1950s ended with the loss of political power by Sukarno's nationalist-revolutionary leadership in March 1966. The military, which (originating from the revolutionary war) considered itself the vanguard of Indonesia's independence and stability, emerged as the saviour of the nation from economic chaos and political confusion. A sustained economic growth and development took place after this political change. The economic growth record for the next three decades was impressive. This is reflected in the sharp rise in per capita real income, which increased from about USD298 in 1970 to USD1113 in 1996 at 1995 prices (Table 2). The economic growth rate during 1966-1996 was about 7 per cent per annum, which was one of the highest in the region. Another remarkable feature was that there was no rise in income inequality during this period of rapid economic growth. For example, from 1970-1993 the Gini coefficient remained steady (except for the year 1978) within the range 0.34-0.32. In fact there has been a slight trend of declining income inequality in the rural areas since the mid-1980s (Hill 2000:197). This indicates that the benefits of economic growth were widely shared and this led to improvements in all major social indicators. Significantly, behind the sharp rise in per capita real income, there was a successful family planning programme that lowered the population growth rate from about 2.5 per cent per annum during 1965-1980 to just 1.4 per cent in 2000 (Table 5).

Table 2: Per capita real GDP (USD) and the rates of saving and investment (1970-1996)

Year/ Period	Per capita GDP (USD, 1995 prices)	Gross domestic saving (Per cent of GDP)	Gross capital formation (GCF) (Per cent of GDP)	Foreign direct investment: Net Inflows	
				Per cent of GDP	Per cent of GCF
1970	297.6	14.3	15.8	0.9	5.4
1971-75	348.7	23.8	20.8	0.9	4.3
1976-80	449.0	0.8	24.1	0.5	2.1
1981-85	563.8	30.3	28.0	0.2	0.9
1986-90	690.6	31.7	29.9	0.6	2.0
1991-95	932.9	32.4	30.9	1.4	4.5
1996	1113.2	30.1	29.6	2.7	8.9

Source: Author's compilation based on World Bank: *World Development Indicators* (various years).

then there have been eight more. It is this sequence of seventeen governments in twelve years that has given some outsiders a strong impression of 'instability'. However, there has been more continuity of policy than of governments. Indonesia has been developing its own species of political 'stability', somewhat along French lines; the civil service is more stable than the cabinets. Top-ranking officials tend to carry over the same policy lines from one cabinet to another. Indeed, the very weakness of most of the Indonesian cabinets has made the top officials strong."

Table 3: Sectoral distribution of output (1900-1996)
(Unweighted annual average, per cent)

Period	Share of GDP (per cent)			Period	Share of GDP (per cent)		
	Agriculture	Manufacturing	Services		Agriculture	Manufacturing	Services
1900-04	49.0	9.8	41.2	1950-54	40.9	15.3	43.8
1905-09	47.5	9.8	42.7	1955-59	37.9	16.5	45.5
1910-14	46.8	9.4	43.9	1960-64	36.6	16.4	47.0
1915-19	46.4	10.1	43.5	1965-69	38.2	15.7	46.1
1920-24	42.7	10.4	46.9	1970-74	36.5	13.0	50.4
1925-29	41.6	10.2	48.1	1975-79	32.5	13.9	53.7
1930-34	41.1	11.8	47.1	1979-84	29.2	14.8	56.0
1935-39	42.2	12.1	45.7	1984-89	26.1	19.7	54.3
1940-44	44.9	12.7	42.4	1991-95	16.5	20.6	46.2
1945-49	47.6	14.0	38.5	1996	16.7	25.6	39.9

Source: Author's computation based on van der Eng (1992) (1900-1989). The figures for 1991-1995 and 1996 are from the *World Development Indicators* of the World Bank.

Higgins (1957) suggested that Indonesia's economic growth and transformation would require large accumulation of capital and technological progress.[18] It is remarkable that the domestic saving rate in Indonesia increased from about 8 per cent of GDP in the early 1960s to 30 per cent of GDP in 1996 and that domestic savings funded most of its investment, which again was about 30 per cent of GDP in 1996. As Table 2 reveals, foreign investment in Indonesia was relatively small. This was different from Malaysia, Singapore and Thailand where foreign investment played a larger role. There was, however, one criticism of Indonesia's growth process that during the peak of its investment boom in the early 1990s, there was inefficiency in the utilisation of capital. Indonesia was therefore perceived to be a high-cost economy (Thee 2002;2003).

The sustained economic growth brought a significant structural change in the Indonesian economy during 1970-1996. The share of agriculture in output was about 40 per cent in the 1950s, which declined slowly until the late 1960s. Since then there has been a transformation of the economy with the share of agriculture in output declining from about 37 per cent in 1970 to 17 per cent in 1996. At the same time, the share of manufacturing in output increased from about 15 per cent to 26 per cent (Table 3). In fact by 1991, the share of manufacturing in output for the first time exceeded that of agriculture. This realised Indonesia's national aspiration for a balanced economy (Thee 2002).

As the modern growth theory suggests (Syrquin 1988), the rapid structural change in output was associated with the transformation of occupational structure of the labour force in Indonesia (Manning 1998). The share of agriculture in employment was about 75 per cent in 1960. This fell, albeit slowly, to 44 per cent in 1996 (Table 4). The difference between the rapid decline in agriculture's relative share of GDP and the slower decline of its share of labour force was a characteristic feature of Indonesia's economic transformation. This was

[18] In emphasising this point, Higgins (1957:53) was critical of the view that Indonesia was rich in natural wealth and a mere transfer of ownership and control of these resources to Indonesians would be sufficient to achieve a higher standard of living for Indonesians.

Table 4: Sectoral distribution of output and employment (1953-1996)

Year / Period	Share of total employment (per cent)		
	Agriculture	Industry	Services
1960	75	8	17
1970	65.8	10.1	24.1
1976-80	55.9	13.2	30.2
1981-85	54.7	14.2	31.1
1986-90	55.6	10.4	32.8
1991-95	49.9	16.3	33.7
1996	44.0	18.1	37.9

Source: Author's compilation based on the *World Development Indicators* of the World Bank; Booth and McCawley (1981:5); Hill (2000:23).

reflected in the relative rise in labour productivity in the non-agricultural sector vis-à-vis agriculture. However, the employment growth in the industrial sector, including manufacturing, construction, mining and public utilities, was rapid (Thee 2002).

Manning (1998) has examined the structural change in the labour market in Indonesia during the rapid growth phase under the Soeharto regime. He has found that economic growth and associated policies benefited all workers in terms of improved welfare, security and equity. The key feature of labour market change was the broad spread of growth in jobs and wages across sections, rural-urban boundaries and regions. Accordingly, the wage differentials narrowed between agriculture and other sectors, the town and the countryside, and across provinces. Another development was the rise in female participation in the workforce in the 1990s. Since then they have played a more important role in the more skilled segments of the labour market. Improvements in their education relative to men contributed to narrowing of the gender gap in employment and wages, although women have remained poorly represented in high-level positions and significant gender-wage differentials persist. In short, although the labour market transformation in Indonesia was not a smooth process, the sustained economic growth significantly transformed the labour market and removed most signs of classic labour surplus that existed at the beginning of the Soeharto regime.

2.3. Social Development

Unlike the speedy economic transformation over a relatively short period of time, Indonesia's social progress has been less impressive (Table 5). The 1997-98 currency-cum-financial crises also eroded some of the social progress made earlier. The impetus to Indonesia's social development came in the early 1970s when the government was able to use some of its windfall from oil revenues for the expansion of educational and health facilities, especially rural primary schools and health clinics. Although the level of primary enrolment was low in the 1970s, the government's achievement of universal primary education was rapid during the next decade. It compared favourably vis-à-vis Indonesia's neighbours such as Malaysia, the Philippines and Thailand. This was feasible because of the successful family planning programme that slowed the growth of the primary school age population. The success of the family planning programme itself was remarkable in a predominantly traditional Muslim

Table 5: Social development (1960-2000)

Indicators	Between 1960 to 1980		Between 1990 to 2000	
School enrolment (1965 versus 1996)				
Primary	72		115	
Secondary	12		48	
Tertiary	1		11	
Adult literacy rate (per cent of adult population)				
Male (female)	47	(yr: 1960)	90 (78)	(yr: 1990)
Life expectancy at birth (1960 versus 1990)				
Male (female)	40	(yr: 1960)	63 (67)	(yr: 1990)
Per-capita daily calorie supply	2126	(yr: 1974)	2750	(yr: 1989)
Crude birth rate (per 1000)	43	(yr: 1965)	23	(yr: 1996)
Crude death rate (per 1000)	20	(yr: 1975)	8	(yr: 1996)
Population growth rate (per cent per annum)	2.5	(yr: 1970)	1.4	(yr: 2000)
Prevalence of child malnutrition:				
Per cent of children under age 5			40	(yr: 1990-96)
Under 5 morality rate (per 1,000 life births)	124	(yr: 1980)	60	(yr: 1996)
Under 12 month mortality rate (per 1,000 life births)	132	(yr: 1971)	69	(yr: 1990)
Access to sanitation in urban areas:				
Per cent of urban population			73	(yr: 1995)
Population below the poverty line (per cent national)	40.1	(yr:1976)	15.1	(yr: 1990)
Distribution of income (Gini coefficient)	0.35	(yr: 1964-65)	0.342	(yr: 1995)
Total fertility rate (births per woman)	4.3	(yr: 1980)	2.6	(yr: 1996)
Maternal mortality ratio (per 100,000 live births)	390	(yr: 1990-96)		

Source: Author's compilation based on Thee (2002); World Bank: *World Development Report 1999*; Booth (2000); Hill (2000).

society. The success of the universal primary education, however, necessitated the expansion of secondary schools and the vocational and tertiary institutions. The expansion of both the secondary and tertiary education was also necessary because of the growing demand for skilled labour in manufacturing, construction and services. Indonesia was, however, slow in expanding its tertiary educational facilities. The standards of tertiary education were arguably somewhat lower compared with those in the Philippines, Thailand and Singapore but remained similar to those in Malaysia.

Along with the universal primary education, the basic public health in Indonesia improved markedly since the late 1960s. With the rapid rise in per capita income and the government's efforts to achieve food self-sufficiency, the daily per capita calorie supply increased significantly from 2126 in 1974 to 2750 in 1989. This was comparable with most countries in the region, such as Malaysia, South Korea, Hong Kong, Taiwan and Singapore, but was better than that in the Philippines and Thailand. However, although the improved nutrition, environment and health care facilities (through the public health clinics) lowered the infant mortality rates, they remained higher than those in neighbouring countries. The decline in infant mortality rate reinforced the family planning programme and contributed to the reduction in the desired family size. The decline in infant morality rate also contributed to the decline in crude death rate (Thee 2002).

3. Macroeconomic Developments, Policies and Issues: 1950-1965

This section starts with reviewing the major political developments, followed by a brief assessment of economic policies and achievements during the Sukarno era.

3.1. Parliamentary Democracy and Controlled Economy

There were two phases in Indonesia's political and economic developments during the Sukarno era. In the political arena, a Parliamentary form of democracy existed from 1950-1957 despite the suggestion of Sukarno that such a political system was not appropriate for Indonesia given its consensual decision-making traditions. Without having the required democratic traditions and institutions, the Parliamentary form of democracy arguably turned out to be a premature experiment. This created political divisions and fragmentation at all levels and generated political instability, which was reflected in the fact that eight cabinets had served in those eight years. In the midst of political instability, there were only *ad hoc* economic policies and programmes, although most political leaders articulated views on economic development along socialist paths.[19]

The economy was rehabilitated only partially during this period. Indonesia also apparently made a mistake in its choice of development strategy that placed emphasis on import substituting industrialisation, which effectively neglected agriculture that contributed about 55 per cent of GDP and employed about 75 per cent of the labour force. It appears that the industrialisation programme was essentially a nationalistic attempt to diminish the country's dependence on foreign economic interests rather than a well thought out development strategy given its natural resources. The strategy of forced industrialisation[20]

---

[19] For a review of political programs and economic policies under these cabinets, see Glassburner (1971). Although there were some differences in economic policies and programmes under different political leaders depending on whether they came from the religious-conservative or socialist-nationalist side of politics, 'socialism [was] basic to the political ideology of virtually all shades of the Indonesian political spectrum '. Below is a widely cited quote from Glassburner (1971: 71); "… from the point of view of economic policy, the years 1950 to 1957 in Indonesia are best understood as years of a hopeless losing battle on the part of a very small group of pragmatically conservative political leaders against an increasingly powerful political opposition of generally radical orientation."

[20] As Higgins (1957:68) pointed out, the Dutch colonial administration was not interested in any balanced growth of the Indonesian economy but concentrated on the plantations industries and on extractive industries such as petroleum, tin and bauxite. An industrial development plan was launched in 1951 under Sumitro Djojohadikusomo as Minister of Trade and Industry. The plan included both small industries and large-scale industries, which were considered 'of vital importance because of their influence on other segments of the economy'. However, there were both domestic and external factors behind the limited success of this industrialisation programme. Nevertheless,commenting on Indonesia's development strategy, he argued for balanced growth, incorporating both agricultural and non-agricultural sectors (Higgins 1957:83): "Fortunately for

led to the introduction of both multiple exchange rates and the import licensing system, which imposed controls over foreign exchange allocation for 'non-essential' imports. Historically, as large businesses and commercial interests were in the hands of both the Dutch and the Chinese, the government, as part of developing indigenous enterprises, also introduced an indigenous business development programme, the *Benteng* programme during the period 1950-1957, using the leverage of import licences. The outcome was the creation of a class of 'briefcase importers', who established what was later known as the *Ali-Baba* relationships with the non-indigenous, that is, ethnic Chinese businessmen (Glassburner 1971).

3.2. Guided Democracy, Regional Rebellions and the West Irian Campaign: 1957-1962

On 21 February 1957, Sukarno presented his *konsepsi* for reconstruction, a concept which was later to be known as 'guided democracy' or as Sukarno described it "Democracy with leadership," with Sukarno and the army as leaders. He argued that "Western democracy does not fit the Indonesian Republic" because Western parliamentary democracy, with its concept of parliamentary opposition, was alien to the Indonesian way of settling issues by all-round consultations. He then argued for the inclusion of all parties in the parliament in government on the grounds that "With the participation of all parties in the cabinet, the opposition would be eliminated." Although this could have been viewed as a sensible strategy for achieving political stability, his proposal encountered fierce opposition. This arose from the fear that his remedy for political instability would lead to Communist or dictatorial control over both the polity and the economy. His suggestion that all parties should participate in the cabinet, according to their parliamentary strength, practically meant that the Communists would be included in the government. This was the significance of his cabinet at that time being termed a 'three-legged horse' because it included ministers affiliated with the Nationalists, the Conservatives and the liberal Islamic political parties. The communists who were the fourth major political faction were excluded from the cabinet (Higgins and Higgins 1963:116), although they were considered the major power base of Sukarno.

Meanwhile the West Irian (Dutch West New Guinea) issue re-emerged in the political scene and needed a resolution with urgency. Since 1953 Sukarno had been advocating for "completing the revolution," by which he meant "liberating West Irian" from the Dutch and ridding the country of continuing Dutch economic influence through nationalisation of Dutch firms, plantations and other business interests. Indonesia brought the West Irian issue to the United Nations in 1957, which however voted against resumption of negotiations with the Dutch. This was the fourth time that the United Nations had rejected Indonesia's application for the resumption of negotiations with the Dutch. To Sukarno and all nationalists, this final rebuff meant that the Western powers were going to support each other on colonial issues and that the Dutch were determined to continue with colonialism and create

---

Indonesia, it is not necessary to choose between increased production of foodstuffs and industrialisation, or between smallholders' agriculture and plantation agriculture, or between small industry and heavy industry, in preparing a plan to raise overall productivity. The diversity of Indonesian resources permits an attack on all fronts at once, and a well-constructed plan will include projects in all major sectors of the economy."

security problems for Indonesia and that Indonesia could not turn to the United Nations for help. One option for Indonesia was to take control of West Irian by force, if necessary.[21] In the meantime the domestic political situation in Indonesia deteriorated when the regional autonomy movements in the Outer Islands, especially in West and North Sumatra, Kalimantan, North and South Sulawesi and Maluku, turned into open rebellions and/or armed insurrections. As this needed immediate action, the West Irian issue was put aside at least for the time being. By this time Indonesia became involved in international cold-war politics. Alarmed by the improving relationship of Indonesia with China and its hosting of the non-aligned conference of developing countries at Bandung in 1955, the Eisenhower administration of America agreed to provide covert support to regional autonomy movements in September 1957, as an insurance against Java 'going communist'.[22]

Having gained the American support, the dissident leaders in Sumatra announced the formation of the Revolutionary Government of the Republic of Indonesia (or the *Pemerintah Revolusioner Republik Indonesia,* PRRI) with headquarters in West Sumatra in February 1958 to serve until the return to a constitutional government. In the PRRI, Sjaffruddin became the prime minister and Sumitro the minister of economic affairs. They proposed a return to the Federal Constitution and urged building on "growing points and leading sectors" in Outer Islands to launch an effective economic development programme and eliminating from the central government, abuse of party politics, corruption and incompetence (Higgins and Higgins 1963:119).

The formation of the PRRI turned out to be a political crisis for Sukarno's nationalist government. Fortunately for him, the armed forces acted "with dazzling speed and efficiency" (Higgins and Higgins 1963:103) against the rebel forces and forestalled any American intervention. In Sulawesi, the *Permesta* rebellion, which started in March 1957 as a political

---

[21] Higgins and Higgins (1963) and Iongh (1967) have discussed this issue in detail. They suggested that the West Irian issue was complex in both colonial and economic terms. The Dutch presence in West Irian was an historical legacy and was seen as a threat to Indonesia's integrity and security, especially when other Western powers (including Australia) began to get involved in this 'colonial enterprise'. The Dutch control of West Irian also nurtured Indonesian suspicion that the Dutch were interested in this area because of its abundant natural resources. The Indonesians therefore took the issue seriously and it became a symbol of their struggle against the Dutch colonial 'exploiters of Indonesia' and a matter of national pride. Although Indonesia was weak militarily, by this time it gained some international profile, especially following the successful hosting of the conference of developing countries of Asia and Africa in Bandung in 1955. As a show of solidarity, the Afro-Asian and the Communist block countries supported Indonesia's stance on West Irian. On the other hand, both the Netherlands and her NATO partners voted against the proposal for resumption of negotiations. The US abstained from voting.

[22] Although the United States denied this charge, its denial did not have credibility. Masters (2003:187) made these comments on this issue: "Even more serious was US covert support in 1957 to 1958 for revolts against the Sukarno government in Sumatra and Sulawesi. The US denied it was supporting the rebels, but its credibility was shattered in May 1958 when a US citizen piloting a B-26 bomber on a run over Ambon was shot down and captured. This damaged US credibility to the extent that Indonesians have, for many years, accepted charges of US misdeeds and view American denials with scepticism.

demand to renegotiate the balance of economic and political power and not secession, collapsed at the end of June 1958 when the government forces captured Menado. Although the fire of rebellions in the Republic was extinguished with speed, sporadic rebel activity continued in some places for a while. On the international front, the Americans had no alternative but to seek rapprochement with Sukarno.

The collapse of the PRRI-Permesta rebellion was not only a triumph for Indonesia's armed forces but also revealed the Anglo-American collusion against Indonesia in general and President Sukarno in particular, who survived narrowly an assassination attempt in Jakarta on 30 November 1958. It is suspected that the assassination attempt on Sukarno had the American backing (Kahin and Kahin 1995; cited in Dick 2002). The collapse of the regional rebellions and the growing military strength (with support from the former Soviet Union and some East European countries) were instrumental in Sukarno's decision to resolve two inter-related issues: Dutch control over the economy and West Irian sovereignty. Here follows a brief discussion on these issues in an historical context.

3.2.1. The Nationalisation of Dutch Properties and Related Issues

The Indonesian leaders were split into two groups on the role of foreign capital in economic development. Some relatively young and foreign-educated intellectuals, known as the 'developmentalist group', attached high priority to economic and social development. They argued that such development should follow the Western models and that Indonesia should cooperate with the West and seek Western technical and capital assistance. In contrast, the Communists and nationalists (including Sukarno) attached importance to eliminating the economic control and influence of foreigners from Indonesian national life. They favoured economic and social development but were keen to retain national culture, language and religion by abolishing all remnants of foreign influence. Such polarisation of opinions on economic strategies was also related to the wide and deep disappointments over limited economic achievements in Indonesia since its independence. As economic prosperity did not come quickly, the nationalist leaders, workers and peasants alike talked about completing the revolution. Their argument was that the reason why poverty had not been eliminated was because the revolution was not finished yet. The Dutch were still in Indonesia and owned and operated plantations, mines, oil fields, shipping, airlines and banks. The non-indigenous Chinese, 'the lackeys of the Dutch', were also present. Therefore it was suggested that only when these foreigners could be driven out, Indonesians would enjoy the expected prosperity from the revolution (Higgins and Higgins 1963:89).

Some further background information is given here to explain why and how decisions were made on the nationalisation of Dutch properties. Note that the negotiated settlement that Indonesia reached in 1949 with the Netherlands on its sovereignty did not satisfy most nationalists. They considered the terms of the transfer of sovereignty unfair and severe. There were four controversial issues. First, the Dutch transferred sovereignty not to the Indonesian Republic but to the United States of Indonesia (*Republic Indonesia Serikat*, RIS). This compromised the Indonesian Republic and the 15 puppet states (BFO, *Bijeenkomst Federaal Overleg*), which the Dutch created to weaken the nationalist appeal of the Indonesian Republic. The nationalists resented the Indonesian acceptance of this federal structure. The second was the question of sovereignty of West New Guinea, named West

Irian by the Nationalists. The nationalists considered themselves to be the rightful inheritors of the Netherlands Indies. The Dutch refused to hand over West Irian, arguing that its Papuan population were racially, culturally and linguistically not a part of the Indonesian nation.

On the economic side, there were two issues. The first was the pre-war debts of the Dutch administration that Indonesia had to take over : about 3 billion guilders of domestic debt and another 3.3 billion guilders of external debt. The second was the continued operations of Dutch businesses in Indonesia. The Dutch businesses suffered extensive damage during the Japanese occupation and the revolutionary war. These business interests exerted pressure on the Dutch government to safeguard their interests in independent Indonesia. The Dutch government was also keen to safeguard its revenues that were derived from Dutch business interests in Indonesia. These revenues were considered indispensable for the post-war reconstruction of the Netherlands. Therefore the negotiated settlement included unrestricted legal transfer of all profits and dividends of Dutch enterprises in Indonesia to the Netherlands. Although there was a provision of nationalisation in Dutch enterprises, it was allowed only if it was considered to be in Indonesia's national interests and if the affected enterprises would give consent. The amount of compensation to the owners was to be decided by a judge on the basis of the real value of enterprises. The 'Financial-Economic Agreement' also contained other provisions that favoured the Dutch interests, including the commitment by Indonesia that it would consult with the Netherlands, if its financial and monetary policy might affect Dutch economic interests in Indonesia.

The nationalists did not like the Financial-Economic Agreement and its provisions. It was seen as a complete sell out. In fact, no other colonial territories in Asia signed such an agreement to gain independence. Therefore in 1949 Indonesia achieved political but not economic independence. As Thee (2003:8) points out, "Not being able to exert any control on important segments of the Indonesian economy greatly restricted the freedom of manoeuvre of Indonesia's economic policy-makers."

This explains why one of the major policy initiatives of the Sukarno government in the 1950s was to gain economic sovereignty through Indonesianisation of the economy by developing state-owned enterprises so that they could compete with Dutch firms by remaining at the commanding heights of the economy (Dick 2002). However, to nationalists, the pace of Indonesianisation of businesses, industries and services was perceived to be slow. Therefore, when the Indonesian government failed to persuade the United Nations General Assembly in November 1957 to adopt a resolution calling on the Dutch Government to cede West Irian to Indonesia, militant workers took over the management of the Dutch inter-island shipping company (KPM). In the following two weeks, this action was (under military supervision) followed by similar takeovers of other Dutch enterprises. Although the Indonesian government had not initiated these takeovers, it did not stop a nation-wide movement against the Dutch. The movement took various forms including the boycott of Dutch enterprises and individuals, which might have been inspired by Sukarno's wish to "throw out the Dutch, honourably or dishonourably, from Indonesia's soil" (Iongh 1967:106). In February 1959 the formal takeover of Dutch enterprises was legalised and the nationalised companies were turned into state-owned enterprises (Thee 2003:13).

The expropriation of Dutch enterprises was politically popular. It effectively severed the link between Indonesia and its former colonialists who were yet to come to terms with the reality. As pointed out earlier, the Dutch rule in Indonesia was exploitative. Nevertheless, even after Indonesia's independence, the Dutch business houses maintained their colonialist, arrogant attitude and were not sympathetic towards the interests and aspirations of the Indonesian people. Importantly, the nationalisation of Dutch properties provided the army an opportunity to consolidate its economic power and an increasing role in both economic management and the administration of government departments. Given the shortage of skilled managers, the army officers were given the responsibility to manage nationalised plantations, banks, trading concerns and mines. Many army officers also served as 'observers' in strategic government offices, where they sat with civil servants to perform tasks of economic and political importance. In this fashion, and through powers conferred by the State of War and Siege, the armed forces exercised control over such diverse activities as exports and imports, customs, immigration, inter-island movements, movement of aliens, communications, airlines and shipping, domestic trade, press censorship, and public meetings. In the process, the army became a government within the government (Higgins and Higgins 1963:125-126). It was only a matter of time before the army became apprehensive of the growing power and popularity of the communists, who were apparently instrumental in the major economic and political decisions of Sukarno at that time.

With the nationalisation of Dutch properties, President Sukarno expedited the process of import substituting strategy of development. On 17 August 1959, he inaugurated what he called 'Guided Economy'. This was however not a comprehensive blueprint for the economy and its working mechanism. Basically this was a version of the prevailing socialist strategy of development that down-graded the roles of markets in economic decisions, limited the scope for foreign enterprises and foreign trade, and placed emphasis on the public sector for investment and growth. A similar model of development was popular in other developing countries, especially India. As part of this strategy, an Eight-Year Plan was drawn up in 1960, which emphasised self-sufficiency in food, clothing and other basic necessities within three years. The economy was supposed to take-off into a self-sustained growth path during the remaining five years (Glassburner 1971; Mackie 1971).

Having removed Dutch control over the economy and introduced the socialist model of development, Sukarno raised his political stake at both home and abroad. With continued deadlock in the Parliament, he decreed the return to the 1945 Constitution in July 1959. He became the Chief Executive, at once President and Prime Minister. By becoming Prime Minister, he gained control over the cabinet, which was the stronghold of his political rivals. In March 1960 he dissolved the elected Parliament and replaced it by one representing main political parties. This constitutional reform was in the direction of what he had earlier called 'democracy with leadership' (Higgins and Higgins 1963:120).

3.2.2. The West Irian Campaign and Confrontation against Malaysia

During the next few years, Indonesia became involved in a series of political campaigns and foreign policy initiatives that had wider economic and political implications. They included the West Irian campaign (1960-1962), confrontation against Malaysia (1963-1966), withdrawal from the United Nations (1965) and a campaign for self-reliance (1965) (Dick 2002). Despite a confrontational situation that was about to go out of control, the West Irian issue was resolved through negotiations under the auspices of the United Nations. Australia, the United States and other Western countries who became involved in this 'colonial enterprise'.

Neither the Netherlands nor its NATO partners, however, could afford another Asia-Pacific war in the height of cold-war politics (Iongh 1967). Indonesia got what it had bargained for. The campaign against Malaysia was protracted and there were complex reasons behind Sukarno's hostility towards the creation of Malaysia in 1963.[23] In his confrontation with Malaysia, Sukarno found not only a reason to sustain and celebrate his revolutionary credentials but was able to differentiate the routes through which Malaysia and Indonesia gained their independence. As Legge (1972:363) writes:

> "Sukarno had not forgotten his suspicions that Malaya had sympathised with the rebels of 1958. His feelings were buttressed by an awareness of other vital differences between Indonesia and Malaya. The latter, it seemed, had obtained her independence the easy way; she had not had to struggle for it and it was therefore an inferior commodity when compared with Indonesia's hard-won freedom. Moreover, this independence was, almost certainly, a cover for continued British economic, political and military influence."

3.3. The Sukarno Era: An Economic and Political Assessment

The Sukarno era in Indonesian political and economic history was eventful and complex. This was true for most other governments in newly independent countries of Asia and Africa. For Indonesia, any economic assessment of the Sukarno era is bound to be incomplete without looking into the objective condition of the country at that time with respect to both administration and politics. Indonesia started with a colonial administrative infrastructure that was not suitable for economic growth. Higgins and Higgins (1963:70) aptly pointed this out:

> "What the Indonesians took over from the Netherlands was not a tightly knit administration, maintaining law and order on a uniform basis throughout the archipelago, but an administrative system so diverse and so complex as to border on chaos. This system served well enough the primary Dutch aim of divide and rule, but it was completely inappropriate for a new state seeking national unity, with virtually no trained personnel above the lowest echelons of the civil service. In trying to build up a united nation, independent Indonesia started almost from scratch."

As Thee (2003) suggested, the interplay of economic, social and political problems, the ideas of policy makers and the contending interests of diverse groups in the society shaped Indonesia's economic policies during the 1950s and early 1960s. In the early years of independence, the policy makers faced the problem of reconciling the need for reconstruction of physical infrastructure and the rehabilitation of productive resources with the national aspiration to "convert the colonial economy into a national economy." This aspiration was

[23] Hatta (1972:581), the second most important nationalist leader of Indonesia, articulated the view that there should be three separate states of Malaya, Singapore and North Borneo out of British colonial territories but not one state comprising these three territories. According to him, "The creation of a 'Malaysia' is nothing but the creation of a second China using the mask of 'Malay', a new colony dominated by Chinese capitalists, oppressing the Malay nation."

realised politically by owning and controlling the country's productive assets, especially foreign-owned properties. Whether such political decision made economic sense was a different matter. Opinions on such sensitive issues are bound to differ, as they cross the boundaries of economics.

As in other newly independent countries of Asia and Africa, the Indonesian political leaders and policy makers were attracted to socialist ideals and rapid economic development through industrialisation. They remained averse to capitalism because it was associated with the colonial rule that was exploitative and repressive. However, except for some die-hard communists, most Indonesian nationalists interpreted socialism as Indonesianisation of the economy in the sense of both ownership and control. The idea was to break the monopoly control of foreign capital, mostly owned by the Dutch and the ethnic Chinese, over the trading and industrial sectors and plantation agriculture. Opinions differed whether socialism should be achieved through the nationalisation of foreign-owned properties or by promoting Indonesian business enterprises through state support (Thee 2003: 9). As Indonesia was resource rich, there was a perception that the transfer of ownership of resources from foreigners to the state would significantly raise the standards of living of the poor people. In the end, both the approaches to Indonesianisation cited above were adopted, as circumstances evolved with 'twists and turns' throughout the 1950s and early 1960s.

One controversial issue was whether the attempted 'forced industrialisation' was a sound strategy. The Indonesian leadership attributed the country's economic backwardness to the colonial government's lack of interest in developing manufacturing industries. Although the colonial administration set up resource processing facilities of export crops, such as sugar factories, and extractive industries, such as oil refineries, they were seen as the instruments of colonial exploitation. At the time of independence, Indonesia was therefore an agrarian economy and priority was accorded to import substituting industrialisation to establish a balanced economy. As this was a national aspiration, industrialisation efforts continued in one form or another until the goal was achieved in the early 1990s (Hill 1990 2000).

While Sumitro Djojohadikusomo was credited with the view of rapid industrialisation in Indonesia, he was neither alone nor did it proceed without some opposition. For example, Sjafruddin placed higher priority on developing agriculture first. He argued that manufacturing should be based on agriculture and on Indonesia's natural resources. He had a point when he suggested that building a manufacturing sector could be difficult when the agricultural sector was underdeveloped. He also pointed out that the Indonesians needed to be educated in management and technology first before rushing into industrialisation. As in other developing countries, the rapid industrialisation plan did not work for Indonesia in the way it was perceived. The major hurdles to industrial development included insufficient supplies of raw materials, problems with importing capital goods, problems of management and marketing and the lack of capital goods-producing facilities (Thee 2003:16).

3.3.1. Economic Policies and Macroeconomic Performance

Table 6 reports summary data for selected macroeconomic indicators for the period 1950-1966. The economic growth rate was relatively low and unstable during this period. Inflation

Table 6: Money, output and prices (1950-1966)

Period/Year	Real GDP growth (%)	CPI-inflation rate (%)	Narrow money growth rate (%)	Broad money growth rate (%)	Budget deficits (% of GDP)
1950		21.4	30.2		
1951-1955	5.1[a]	23.5	24.0		-2.3
1956-1960	2.2	20.9	32.4		-3.6
1961-1965	1.8	221.5	135.5	135.6	-5.3
1966	2.3	10.5	753.8	725.5	-5.2

Source: Author's compilation based on Arndt (1971); Thomson and Drysdale (1964); *International Financial Statistics Yearbook* (various years) of the IMF. *Note:* a = 1952-1953.

Table 7: Macroeconomic indicators: selected years (1951-1965)

Indicators	1951	1957	1960	1962	1964	1965
Real GDP (1938=100)	90	123	123	132	134	135
GDP per capita (Rp)	2126	2320	2441	2441	2364	2324
Official exchange rate (Rp/USD)	3.8	11.4	45	45	250	10000
Black market exchange rate (Rp/USD)	16.5	45.8	150	850	7200	36000
Foreign reserves (USDMillion)	511	224	337	135	35	26

Source: Dick (2002:192).

was relatively low in the 1950s but increased sharply since the early 1960s, exceeding more than 500 per cent in 1965. Both budget deficits and money supply growth rates had similar patterns.

As pointed out earlier, there was political instability in the 1950s and this slowed the economic recovery process. The economy also did not perform the way it was planned under 'guided democracy and guided economy'. The government's experiment with economic controls and regulations within a socialist model of development caused macroeconomic imbalances, resulting in slow economic growth, high inflation and a balance-of-payments crisis that led to a depletion of foreign exchange reserves to merely USD26 million in 1965 (Table 7). As the population growth rate remained high, the per capita income remained roughly constant. The major problem was accelerating inflation, which was apparently caused by excessive money growth. Given the rudimentary financial system and no other sources of deficit financing, the government resorted to money creation. The major cause of large budget deficits was Indonesia's West Irian campaign and confrontation against Malaysia during 1963-1966. By 1965 Indonesia became a 'basket case' and was on the verge of 'bankruptcy'. Arndt (1984:29) described this situation as follows:

> "A decade of ever-increasing economic mismanagement (in Indonesia) had brought a degree of economic breakdown with few parallels in modern history. The country was literally bankrupt, unable to meet payments due to foreign debt… Export earnings had fallen to a level where they were barely sufficient to finance half the country's minimum requirements, excluding debt service."

Mackie (1967) has reviewed the Sukarno government's fiscal policy from a political economy viewpoint and highlighted a number of factors behind budget deficits. First, there was the paradox that Sukarno's authoritarian and broadly based government was unable to apply such policies that could have hurt its supporters, unless suddenly and indiscriminately. Second, budget deficits acted as a 'safety valve' to avoid making difficult choices. Third, no influential group within the government had direct interests in economic stability *per se*. Therefore, redistributive policies took precedence over stability and growth and politics got priority over disciplined economic policies. The government was able to continue with 'macroeconomic populism' in the absence of institutional checks and balances.

While the Sukarno government's monetary and fiscal policies were responsible for high inflation and the balance-of-payments crisis, the underlying reasons for undisciplined macroeconomic policies and the resultant economic stagnation were not unique for Indonesia. As pointed out earlier, most newly independent countries introduced the then fashionable import-substituting strategy of development that effectively closed their economies and neglected agriculture, the dominant sector of the economy. This happened at a time when the population growth rates in developing countries were within the range of 2 to 2.5 per cent per annum. The consequent result was economic stagnation and a sharp rise in the incidence of poverty. Nevertheless, as Dick (2002:191) points out, there were not many growth-promoting factors working for Indonesia and that under the difficult circumstances, it probably did quite well:

> "Despite the economic chaos of the mid-1960s, things were still much better than in 1944-45 at the end of the Japanese occupation, when there was mass starvation. Indonesia did not implode into civil war like Burma or Cambodia…. Even if there had been a more stable macroeconomic climate in the 1950s and no attacks on foreign capital, economic growth would not necessarily have been rapid... After the short-lived Korean War boom there were no more big opportunities for primary producing nations until the dramatic oil price rise of 1973. Little foreign investment flowed into Southeast Asia, which was still the risky frontline of the 'War against Communism'. The 'Green Revolution' awaited the technological breakthroughs of the mid-1960s."

President Sukarno presided over Indonesia at a time when he, like most nationalist leaders in Asia and Africa, was overwhelmed with economic and political problems and failed to articulate a development strategy that could have put the Indonesian economy on a sustained growth path by maintaining economic and political links with the West and making the economy outward oriented. Political rhetoric, as part of nation building through forging and managing political coalitions, received priority over economic development. Sukarno's "romantic vision of ongoing revolution" (Dick 2002:191) turned out to be a costly rhetoric in an economic sense, especially when this newly independent country needed foreign investment and technology for utilisation of its natural resources. Boediono (2005:313) has summed up Sukarno's act of balancing between politics and economics that in the end proved untenable:

> "… during [the guided democracy] period economic policy making in Indonesia was at its lowest ebb in its history. Politics was everything: economic problems were to be solved politically. Energy was spent more on creating images than on alleviating

> real-life problems. The doctrine of guided economy, which exalted the state and distrusted the private sector, and which preferred regulations to incentives, had aggravated rather than relieved the scarcity problem. Macro imbalances were left to grow untamed, first out of neglect, but later out of despair. People were losing their faith in the rupiah, and hyperinflation set in while the economy first stalled and then regressed. At some point the situation became so untenable that the only way out was regime change. Sadly, this was a violent process involving an enormous cost in human lives. The theme of the 1950s recurred: a political order that led to economic failure eventually collapsed."

Indonesian politics took a nasty turn when on 30 September 1965 a small group of army officers kidnapped and murdered six senior generals and another officer in an attempt to remove the top military leadership. The *coup* leader Colonel Untung had links with the *Partai Komunis Indonesia* (PKI); later, the military implicated President Sukarno with this unsuccessful *coup d'etat* and forced him to surrender political power to General Soeharto on 11 March 1966 (Legge 1972). Emil Salim (2003:214) and Sumitro Djojohadikusomo (1986:27) have summed up Sukarno's political legacy as follows:

> "During the Sukarno period it was difficult, if not impossible, to have economic development as the country was not united; we were still split into many ethnic groups. We needed a Sukarno to hold the country together. Sukarno's great contribution was that, with his magic and charisma, he built Indonesia into one nation. Later we needed a low-profile president like Soeharto to initiate economic development."

> "No one can accuse me of being a Sukarno henchman seeing that he put a price on my head at a certain stage of my life, but I hold him in high regard despite my severe criticism of his policies. I still think he was a great political leader. He made Indonesian the national language; it was to his everlasting credit that he chose for the national language a language that was not used by the majority. By sheer political intuition, he chose the *lingua franca* rather than Javanese."

4. Macroeconomic Developments, Policies and Issues: 1966-1996

4.1. 1966-1973: Stabilisation, Rehabilitation and Partial Liberalisation

Following the military takeover of power in March 1966, the New Order government of General Soeharto gave top priority to economic stabilisation and recovery through dismantling economic controls and opening up the economy. As Selo Soemardjan (1988:97) remarks, under 'the Old Order Regime, Indonesia had an economy of control, rather than a controlled economy.' For political stabilisation, Soeharto dismantled the architecture of 'guided democracy', banned the Indonesian Communist Party and its affiliated organisations and, because of alleged China's involvement in the *coup d'etat* of 30 September 1965, dissolved the Jakarta-Beijing alliance forged during the early 1960s. To re-establish international links, Indonesia rejoined the United Nations and its affiliated organisations such as the IMF and the World Bank and terminated armed confrontation against Malaysia that started in 1963. The high priority that was given by the new leaders to end confrontation against Malaysia was interpreted as a gesture to the world of Indonesia's intention to concentrate her efforts on the country's economic problems.[24] This was also an attempt to draw sympathy from foreign creditors and potential lenders.

To encourage foreign aid and investment and to re-establish trade links with Western countries, the Soeharto government replaced the Sukarno government's socialist, inward-oriented development strategy by a market-based, outward-oriented development strategy. Strategically, the switch from the socialist to a market-based development strategy was dubbed pragmatic and non-ideological and the task of policy-making was entrusted to economic technocrats. In September 1966, a team of experts in the field of economics and finance was appointed from the Faculty of Economics at the University of Indonesia, comprising Widjojo Nitisastro, Ali Wardhana, Mohammad Sadli, Emil Salim, and Subroto.[25]

Most of them were Western educated and over the years they grew into a 'cohesive group under the leadership of Widjojo Nitisastro' (Sadli 1993). With the full support of General Soeharto, the economic technocrats prepared a multi-year *Programme for Stabilisation and Rehabilitation*, which was then incorporated in Decree No.23 of the Provisional People's Consultative Assembly. On the basis of this Decree, the guidelines for Indonesia's economic recovery were set out, especially in incorporating policies on a balanced budget, the balance of payments, the rehabilitation of physical infrastructure, food production and agricultural development. The main policy instrument was the balanced budget, which was adopted on the principle that the government should not resort to finance budget deficits by printing money. To make this policy realistic, foreign aid and loans were however added to domestic revenues to match the government outlays (Hill 2000; Thee 2002).

The *Programme for Stabilisation and Rehabilitation* had three phases: stabilisation, rehabilitation and development. The two-year stabilisation component of the Programme contained at least four short-term objectives (Arndt 1984):

1. Halting 'hyperinflation'
2. De-control of the economy
3. Re-scheduling of foreign debts and obtaining new loans
4. A new, open door policy toward foreign direct investment

4.1.1. Price Stabilisation

Facing high or hyperinflation and the balance-of-payments crisis, the New Order government's main task was to give top priority to restoring macroeconomic stability. The

[24] For details of various economic problems, such as high inflation, re-scheduling of foreign debt and the balance-of-payments difficulties, see Panglaykim and Arndt (1966) and Arndt (1967).

[25] Subroto (2003:230) points out the unique relationship that existed between this group of economists and the army, which allowed them to work in unison for stabilising the economy and the polity: "There was something special in the relationship between us economists and the army, because all of us had participated in the war of independence. After independence was achieved, some of us continued to 'wear a green shirt', while others 'wore a white shirt'. But since we had all experienced the same struggle for independence and had more or less the same ideals and enthusiasm, this military-civilian relationship in 1966 was unique."

diagnosis and remedies of these problems were orthodox, in the sense that both inflation and the balance-of-payments problems were assumed to have originated from excess demand, caused by expansionary fiscal and monetary policies.[26]

Therefore the government introduced tight fiscal and monetary policies to reduce the demand pressure. On the fiscal front, the government enacted the Balanced Budget Law in 1967 and brought fiscal discipline. This Law prohibited domestic financing of budget deficits in the form of domestic debt or through money creation (Bhattacharya and Pangestu 1993). The overall strategy was that any shortfall in government revenues must be supplemented by foreign aid and loans. Therefore the government treated *Official Development Assistance* as government revenues. As Sumitro Djojohadikusomo (2003:63) points out, the balanced budget actually acted as an internal disciplinary instrument and was a constraint on the behaviour of political leaders. As domestic financing of budget deficits was not allowed (that is, the government was not allowed to borrow from the central bank or the domestic bond market), the policy effectively restrained monetary growth and inflation (Asher and Booth 1992). Above all, there was a consensus that there should not be a 'recurrence of the financial excesses of the early 1960s' (Hill 2000:60). As Table 7 shows, the stringent fiscal and monetary discipline that the government imposed was therefore credible and it brought the inflation rate down from a hyperinflationary situation to a single digit level by 1971 (Grenville 1981; Hill 2000; Thee 2002).

4.1.2. Decontrol of the Economy

The Indonesian economy was historically open until the 1930s (Dick 2002). It was heavily regulated and controlled by the time the Sukarno government lost power. The myriad of regulations and controls distorted the relative prices and interfered with market incentives (Arndt 1984; Thee 2002) that affected resource mobilisation and utilisation. On the external front the government's decontrol measures aimed at dismantling the complex system of foreign trade and exchange controls. In particular, the import controls were relaxed or removed, the exchange rates were adjusted and the multiple exchange rates were merged into a unified exchange rate system (James and Stephenson 1993). The government also liberalised the capital account transactions in 1971 that allowed capital to move freely into and out of the country. On the domestic front, except for the prices of basic goods and services such as petroleum products, electricity, drinking water and urban transport, the price control measures were removed on most goods and services (Hollinger 1996). The introduction of such decontrol measures restored market mechanisms and raised the efficiency of resource allocation and utilisation. Although there was general acceptance of freeing the markets,

---

[26] Sadli (1970:400) stated this view in his inaugural lecture as Professor of Economics at the University of Indonesia on 31 August 1963: "Managing the national economy with little discipline and self-discipline in handling government budgets, so as to give rise to those large deficits which are the main cause of strong inflation is not an example of the most effective implementation of the 'Guided Economy.' The large deficits in the budget can be likened to a kite with a broken thread. Given such deficits, all the government's efforts to rescue the economy are like chasing a drifting kite. To make 'Guided Economy' effective, a start must be made with settling the affairs of the nation in a more orderly way, based on careful planning and fiscal and monetary discipline."

the task was not that popular. There was suspicion of the workings of a free market economy and the bureaucrats in particular resisted price deregulations.

4.1.3. Debt Rescheduling

The third component of the stabilisation programme was the rescheduling of foreign debt service payments and the securing of foreign aid and loans. As Indonesia's large foreign debt obligations (about USD4.5 billion), incurred by the Sukarno government, caused a heavy burden on the balance of payments, the rescheduling of debt service payments, along with securing new aid and loans, was critical for stabilising the external sector of the economy (Prawiro 1998). Politically, the technocrats realised that foreign aid and investment were necessary for the survival of the new government and that they should not indulge in nationalist rhetoric (Mackie and MacIntyre 1994; Thee 2002).

Fortunately the above task was proved less difficult for economic technocrats. Since the overthrow of the Sukarno regime, the Western countries and Japan were sympathetic towards any requests from the 'anti-communist' Soeharto government for rescheduling of debt service payments and other economic support for its survival (Chalmers 1997). In September 1966 Indonesia attended a preliminary meeting with the Paris Club countries (comprising Western countries and Japan) to which it was indebted. In a follow-up meeting in Paris in December 1966, the representatives of the Indonesian government, Western countries and Japan reached an agreement on a moratorium of debt service payments (Bresnan 1993).

During the Sukarno government, Indonesia also incurred large debts with the communist countries, especially the former Soviet Union and some Eastern European countries. They were invited to attend a Western donor meeting in Tokyo. They did not attend this meeting but held a separate one with Indonesia at a later date (Prawiro 1998). The negotiations on debt service payments with the communist countries (particularly the Soviet Union) were protracted. Nevertheless, an agreement was reached in 1971 with the Soviet Union on rescheduling of debt service payments on terms and conditions that were similar to those of the Paris Club countries (Prawiro 1998; Thee 2002).

4.1.4. Foreign Aid and Loans

Once the difficulties in rescheduling of foreign debt were overcome, Indonesia started to receive an increasing level of new aid and loans. This was done through the establishment of an aid consortium (Inter-Governmental Group on Indonesia IGGI) in 1967 by Western countries, Japan and the multilateral organisations, including the World Bank, the IMF and the Asian Development Bank. By 1970, Indonesia became the second-largest aid-recipient (after India) among developing countries. Having settled itself on the anti-communist platform during the heightened cold-war politics, Indonesia continued to receive large amounts of foreign aid and loans. By 1990, Indonesia became the largest aid-recipient country, followed by China and India. Such continued aid inflows were crucial for Indonesia's macroeconomic stability and management, given that the implementation of the Balanced Budget Law left it no scope for domestic financing of large budget deficits (Hill 2000).

4.1.5. Foreign Investment

As a long-term strategy of Indonesia's industrialisation, the economic technocrats realised the importance of foreign direct investment. This was considered critical for the exploration and development of Indonesia's natural resources, especially the oil and gas fields and the timber industries. Therefore, to encourage foreign direct investment, the government enacted an Investment Law in January 1967 that reversed the Sukarno government's hostile foreign investment policy. This Law provided guarantees to foreign investment against arbitrary nationalisation and also contained other attractive incentives such as tax concession and guarantee for the transfer of profits and dividends.[27] Whilst this Law opened Indonesia's door wide to foreign direct investment, there was general resentment that, only a few years after the nationalisation of Dutch enterprises, the new foreign investors (along with non-indigenous entrepreneurs: Sino-Indonesians) would once again dominate the Indonesian economy. The policy makers also shared such concerns[28] (Sadli 1993). Since the economy was in a bad shape, there was, however, no viable alternative for the government but to encourage foreign investment in order to put the economy on a higher growth path.

4.1.6. Domestic Investment

In 1968 the government overturned policies hostile towards domestic private enterprises by enacting a Domestic Investment Law, which offered domestic entrepreneurs similar incentives and guarantees to those given to foreign investors. In some respects, domestic investors received better incentives than foreign investors. For example, domestic investors had access to credit provided by the state banks whereas foreign investors did not have such access. Furthermore, in order to encourage domestic investment, the authorities adopted

---

[27] Sadli (1993:43) emphasised the comparatively better incentives in Indonesia *vis-à-vis* other Southeast Asian countries and explained how foreign investors reacted to those incentives. "During the late 1960s I often travelled overseas for investment promotion purposes. It was not a difficult time to attract foreign investment, because Indonesia did not face much competition from other countries… 100 per cent foreign equity ownership, absence of capital controls, tax holidays, and the opportunity of exploiting Indonesia's abundant natural resources were all factors recommending Indonesia as a suitable place for foreign investment. Japanese investors were at first particularly interested in resource-oriented investment, and later in the import substitution industries. Once a foreign investor entered a certain industry, others followed suit. This was very much in accordance with the theory of foreign investment in oligopolistic industries, that once a firm enters a certain industry, its rivals cannot afford not to do so likewise."

[28] Despite the liberal provisions of the Foreign Investment Law, the Indonesian government was aware of the continuing appeal of economic nationalism. Recognising this appeal, the Law contained several restrictive provisions. For instance, foreign-controlled companies were not accorded national treatment. Accordingly, they were not permitted to establish subsidiaries to market their products but had to sell their products through local distributors. Foreign companies were also not allowed to borrow Rupiah denominated loans from the state banks. Over time, the provisions on foreign investment became more restrictive, particularly the oil boom of the 1970s led the government to believe that foreign investment was not as important as it might have been in the late 1960s (Thee 2003).

a ‘whitewash policy’ to encourage the Sino-Indonesians to repatriate their capital from overseas. This capital might have been transferred or smuggled overseas during the political turmoil in the 1950s and early 1960s. This policy was somewhat risky given the undercurrent anti-Chinese feeling, especially after the *coup d’etat* in 1965. The whitewash policy proved effective in stimulating domestic investment (Thee 2002, 2003).

4.2. 1967-1973: Economic Recovery

The pragmatic, market-oriented economic policies, introduced by the government, contributed to impressive economic recovery. The economic growth rate was about 8.9 per cent per annum during the 1967-1972 period (Table 8). Importantly, by early 1970s, underlying strong economic fundamentals were in place. For example, the gross investment rate rose from about 11 per cent of GDP in 1967 to about 20 per cent in 1972. Private domestic savings financed two-thirds of such investment and foreign savings (that is, foreign aid) financed the rest (Gillis 1984). The sharp increase in the share of private savings in gross investment from 1967-1972 was partly due to the repatriation of capital by Sino-Indonesians. As pointed out earlier, such capital flight took place in the 1950s and early 1960s and they started to return to Indonesia after political stability was restored in 1966. Government savings, which were negligible in the mid-1960s, also rose steadily following the imposition of controls over expenditures and the greater efforts to collect tax revenues (Gillis 1984). Given the turn-around of the economy, foreign direct investment jumped from a cumulative USD83 million during the 1967-1969 period to about USD271 million in 1972 (James and Stephenson 1993).

4.3. 1974-1981: Oil Boom, Rapid Economic Growth and Government Intervention

Indonesia experienced an economic boom over the period 1974 to 1981 when the economy grew at a rate of about 8 per cent per annum. This was impressive given the poor economic performance in the 1950s and 1960s. This impressive performance was attributed to an improvement in the country’s external terms of trade, which originated from the oil price shocks of the 1970s. The first oil price shock occurred during 1973-1974 when OPEC[29], of which Indonesia is a member, was able to quadruple the export price of oil by cutting back the supply. The second oil shock was in 1979. This occurred when the Islamic revolution against the Shah’s regime in Iran (the world’s second-largest oil producer and exporter) led to a temporary closure of the country’s oil industry. This created a short-term imbalance in world oil supply and demand and doubled the oil price to more than USD30 per barrel. For Indonesia, the oil price in the nominal term rose from USD1.67 per barrel in 1970 to USD35 in 1981 (Prawiro 1998; Subroto 2003).

The oil boom relieved two major constraints on the Indonesian economy. In the external sector, Indonesia’s export earnings rose steeply and generated current account surpluses. On the fiscal side the government’s revenues from oil taxes (paid by foreign oil companies in Indonesia) rose sharply. Thus the oil windfall relieved both the balance-of- payments and the budget constraints that had hampered Indonesia’s economic performance since the 1950s (Gillis 1984; Bresnan 1993). The Indonesian government for the first time was able to

---

[29] Organisation of Petroleum Exporting Countries.

Table 8: Indonesia: selected macroeconomic indicators (1961-1972)

Economic indicators	1961-1965[1]	1966	1967	1968	1969	1970	1971	1972
Real GDP Growth (%)	2.0	2.8	1.4	6.9	10.9	7.5	7.0	9.4
CPI-Inflation (%)	221.5	10.5	109.5	129.5	14.9	12.9	3.8	6.6
Narrow Money Growth (%)	69.5	174.7	149.9	81.9	63.5	39.2	28.0	32.0
Ratio of Government Revenue to Income (%)	6.3	4.1	7.1	7.6	8.7	9.6	10.3	10.1
Ratio of Government Expenditure to Income (%)	11.6	9.3	10.3	8.9	10.1	13.0	13.9	14.7
Budget Deficits (% of GDP)	-5.3	-5.2	-3.2	-1.3	-1.4	-3.4	-3.6	-4.6
Gross Domestic Saving (% of GDP) [2]	12.6	15.5	10.7	13.8	14.4	17.3	18.6	20.3
Gross Domestic Capital Formation (% of GDP)	10.3	10.9	8.8	11.5	11.7	14.4	15.6	17.0
External Terms of Trade (1961-65=100)	100.0	50.3	57.9	75.4	64.7	86.2	92.1	93.5
Ratio of Exports to GDP at constant prices (%)	14.1	13.9	13.7	14.1	15.1	15.7	16.1	18.5
Ratio of Imports to GDP at constant prices (%)	12.0	9.3	11.8	11.7	12.4	12.9	13.2	15.2
Bilateral Real Exchange Rate (1961-65=100) [3]	100.0	93.3	29.9	26.5	26.5	27.6	30.0	30.7
Trade Balance (Millions of US D)	-39.2	118.0	-34.0	41.0	0	57.0	81.0	347.0

Sources: Author's compilation based on Arndt (1971), Aghevli and Khan (1977), Booth and McCawley (1981), Sundrum (1986) and IMF, IFS Yearbook 1979.

Notes: 1. Unweighted annual average of five years.
2. Saving is defined as GDP minus the sum of private and government consumption expenditure in billions of Rupiah at 1973 prices.
3. The bilateral real exchange rate is defined as the nominal exchange rate of Rupiah against per unit of USD times the ratio of the US-CPI to Indonesia-CPI.

raise public investment and expand and improve the efficiency of public administration, for instance, by raising the salaries of public servants. On the production side, the availability of increased foreign exchange earnings made it possible for the government to import raw materials, intermediate inputs and capital goods for expanding the manufacturing sector. The increased investment (and associated imported capital goods) meant the introduction of sophisticated production techniques that raised production efficiency (Sundrum 1986).

The oil boom had a negative impact on both foreign and domestic investment in Indonesia. By mid-1970s the government's policy became interventionist, which affected both foreign and domestic investment. Two factors accounted for this policy shift. Since the early 1970s, there was the emergence of economic nationalism in response to the perceived 'sell out' of the economy to foreign capital and the preferential treatment, such as huge loans by the state-owned banks, accorded to non-indigenous (that is, Sino-Indonesian) entrepreneurs. In particular, there was resentment for the perceived 'over presence' of Japanese investment in Indonesia.[30] This culminated in anti-Japanese riots in January 1974 during the state visit of the then Japanese Prime Minister Tanaka (Bresnan 1993).

The government responded to this incident by introducing some restrictive measures on foreign investment and the preferential policies that favoured indigenous businessmen. For instance, from 1974 new foreign direct investment was allowed to enter into Indonesia only in the form of joint ventures with local businessmen or companies in which *pribumi* (indigenous Indonesian) businessmen had majority ownership or majority control or were to obtain this in the near future. The second factor that led to the government's intervention was the vastly increased government revenues from the oil company taxes, which removed the budget constraint on the government's development plans. Having overcome economic difficulties left by the Sukarno government, the Soeharto government felt able and confident to revise its recently introduced liberal, free-market policies in favour of interventionist policies (Mackie and MacIntyre 1994). The government launched several ambitious development programmes, including large projects that aimed at promoting regional and social development, expanding physical infrastructure and establishing chemical, manufacturing and resource-processing industries.

4.3.1. The 1975 Pertamina Crisis

One major development in Indonesia during the oil boom was the rapid increase in activities of Pertamina (a state-owned oil company). Given its access to large oil revenues, expanded activities and limited accountability only to President Soeharto, Pertamina was referred to as Indonesia's other development agency alongside the Bappenas (National Planning Board) and an agent of development. As only a small portion of its revenues was surrendered to the government, Pertamina was able to finance a number of ambitious projects, including state-owned steel plants. To both its admirers and critics, Pertamina became a state within the state. A government commission was established in 1970 to investigate corruption and bureaucratic mismanagement. The Commission was critical of Pertamina but continued to operate with immunity from any form of external audit (Robison 1986; Booth 1998).

The Pertamina crisis started in February 1975 when it was unable to roll over a short-term loan of USD40 million from a small American bank. It was only after this default that the

[30] For a discussion on the key features of Japanese investment in Indonesia, see Thee (1984).

actual extent of its financial problems became known. It turned out that Pertamina had in fact accumulated a staggering foreign debt of USD10.5 billion, of which approximately USD1.5 billion were short-term debts. Hill (2000:104) has given some background information on the creation of this debt problem:

> "The origins of the problem lay in a government requirement, introduced in 1972, that all state enterprises were to obtain official approval for overseas borrowings of between one and 15 years' maturity. To circumvent this, Pertamina's President Director, Dr Ibnu Sutowo, embarked on an ambitious programme of short-term external borrowing. Initially international banks were eager to lend to Pertamina. But as world economic growth began to slow in 1974, problems arose, and in March 1975 the company was unable to meet its debt commitments. The Indonesian government assumed responsibility for Pertamina's external obligations, which initially appeared to be quite modest in total. However, in the President's budget speech of January 1976, it was revealed that the problem was far more serious… Pertamina's external debts exceeded USD10 billion, equivalent to almost 30 per cent of Indonesia's GDP at that time."

The Pertamina crisis imposed huge costs to the treasury, but it did not lead to much improvement in the public sector's overall performance. However the economic technocrats, who handled the crisis with competence, gained the respect of the President. This helped them to maintain macroeconomic stability, especially during the early 1980s when oil prices fell sharply and there was a need for structural adjustment of the economy (Thee 2002, 2003).

4.4. 1982-1986: The Fall in Oil Prices and Economic Adjustment

With the fall in oil prices in 1982, there was a rising trend in external indebtedness. The sharp decline in economic growth in 1982 also signalled the end of a decade of oil-financed growth and abundance.[31] On the fiscal side, the end of the oil-boom dried up government revenues. By then foreign aid flows also started to decrease. As the external debt incurred over the past 15 years or so was maturing, a debt crisis was in the offing. For the period 1982-1986, the economy grew at an average rate of about 5.2 per cent per annum (Table 9). In response, the government introduced various adjustment measures, including the reduction of public expenditure, cancellation of large projects and the devaluation of the Rupiah in April 1983. Some taxation and banking reform measures were also introduced. However, some measures that were introduced in the early 1980s when oil prices nose-dived to promote industrial deepening (such as non-tariff barriers) continued until 1986 (Thee 2002).

---

[31] Following the Keynesian tradition, Sundrum (1988) has explained the sharp decline in the rate of economic growth in Indonesia since 1981 in terms of the reduction in aggregate demand. He has argued that, to solve the balance-of-payments problems arising from the sharp decline in oil prices, Indonesia adopted orthodox IMF policy measures, such as contractionary monetary and fiscal policies including currency devaluation, that lowered aggregate demand (via lower investment, budget deficits and imports) and output growth.

Table 9: Indonesia: selected economic indicators (1970-1996)
(Unweighted annual average, inclusive)

Economic indicators	Economic recovery 1970-1973	OPEC oil boom (cont'd) 1974-1977	OPEC oil boom 1978-1981	Economic recession and recovery 1982-1986	Economic liberalisation 1987-1991	Large Foreign capital inflows 1992-1996
Per-Capita GDP (Current USD)	98.5	272.5	474.6	551.9	582.2	948.3
Per-Capita GDP (Constant 1995 USD)	321.6	393.5	489.8	582.4	731.7	989.3
Real GDP Growth Rate (%)	8.2	7.3	8.3	5.2	7.7	7.6
Gross Domestic Saving (% of GDP)	19.5	27.9	32.4	29.6	32.7	31.7
Gross Capital Formation (% of GDP)	19.2	22.7	24.9	28.3	30.5	30.7
Population Growth Rate (%)	2.4	2.3	2.0	1.8	1.7	1.4
CPI-Inflation (%)	13.6	22.7	13.7	8.5	8.1	8.6
Narrow Money (M1) Growth Rate (%)	39.1	31.7	34.3	12.5	18.7	15.6
Broad Money (M2) Growth Rate (%)	44.0	33.8	33.1	23.4	29.6	23.1
Money and Quasi Money (M2) (% of GDP)	10.3	13.1	13.9	19.1	29.6	42.2
Deposit Rate of Interest (%)	17.3	11.3	6.0	12.3	18.8	16.1
Tax Revenue (% of GDP)	12.4	16.1	19.1	17.1	15.4	15.4
Government Expenditure (% of GDP)	15.2	18.7	22.0	21.1	18.5	16.1
Financing from Abroad (% of GDP)	2.3	3.0	2.4	1.4	1.1	-0.1
Official Development Assistance and Official Aid (Current USD million)	543.5	634.8	818.3	723.6	1665.4	1652.5
Exports of Goods and Services (% o GDP)	16.8	25.8	29.2	24.0	24.6	26.7
Imports of Goods and Services (% of GDP)	16.4	20.6	21.6	22.7	22.4	25.6
External Balance on Goods and Services (% of GDP)	0.3	5.2	7.6	1.4	2.2	1.0
External Debt (total, USD, billion)	5.7	12.8	20.1	33.4	63.1	107.7
External Debt (% of GDP)	47.6	34.7	29.6	38.1	61.9	59.8
External Short-Term Debt (% of total debt)	9.2	10.3	12.2	15.6	14.4	20.9
External Terms of Trade (2000=100)	29.9	59.3	73.6	77.6	80.2	87.9
Exchange Rate (Rp/USD)	396.2	415.0	581.0	998.0	1778.5	2173.7
Real Effective Exchange Rate (REER) (2000:100) (12-month average)[1]	220.1	268.7	241.2	243.0	145.3	142.9

Source: Author's compilation based on World Bank: World Development Indicators (except for REER which is drawn from JP Morgan website).
Note: [1] The declining index means that the Rupiah depreciates.

4.5. 1987-1996: Economic Liberalisation and the Recovery

The fiscal austerity, flexible exchange rate management and deregulatory measures that were introduced in 1982, and continued thereafter, brought strong economic recovery in 1987. The annual economic growth rate for the period 1987-1991 averaged about 7.7 per cent (Table 9). This was close to the rate achieved during the oil boom of the 1970s. This time the rapid economic growth was achieved without having windfall oil revenues. By this time, Indonesia, for the first time, became a major manufacturing exporter and joined the club of newly industrialising economies. This was achieved through the growing commercial strength and independence of the private sector. By then, the share of state enterprises in the economy also started to shrink and the state regulation, protection and subsidies became less significant in firms' business decisions. Politically, the Soeharto regime enhanced its reputation by demonstrating its capacity to maintain a high growth in adverse circumstances (Thee 2002). By early 1990s Indonesia effectively weathered the impending debt crisis that was predicted in the early 1980s. After investigating the evolution of foreign debt in Indonesia and its debt-servicing capacity, Radelet (1995:67) was therefore able to draw this conclusion against any debt crisis in the near future:

> "Indonesia does not appear to be headed toward a debt crisis, either now or in the immediate future. If the trends in exports and GDP growth recorded since 1989 continue, the debt problem should ease gradually. Even if they do not, Indonesia should be able to withstand a fairly *substantial balance of payments shock*. Exports are far more diversified than they were a decade ago, so trade flows are much less vulnerable to commodity price swings. Moreover, the government's foreign exchange reserve position is strong, providing a comfortable cushion in the event that shocks occur."

Despite such an assessment of the foreign debt scenario, the negative side of foreign capital-led economic boom in Indonesia was exposed during the 1997-98 currency-cum-financial crises. This issue is taken up next.

5. The Currency-cum-Financial Crises and the Recovery: 1997-2005

By 1996, Indonesia had become an economic success story and General Soeharto's uninterrupted 30-year rule became a symbol of stability and growth. Around this time the level of per capita income exceeded USD1100. For an archipelago, having unevenly distributed population across islands with heavy concentration in Java, this was by all means a remarkable achievement. As Indonesia joined a small group of East Asian newly industrialising economies, Soeharto was seen as an elder statesman in the Asia-Pacific region. Most global and regional analysts also recognised Indonesia as an emerging major market economy.

Despite all these plaudits, there were however structural and institutional weaknesses in the Indonesian economy that remained in the background until the cold-war politics was over. In particular, the Indonesian legal system was weak and there was no effective means to enforce legal contracts, collect debts and to sue for bankruptcy. The banking practices were also unsophisticated. For example, most loans were granted on collaterals and there were widespread violations of prudential regulations, including limits on connected lendings. Although some real and financial sector reforms were undertaken after the collapse of oil prices in the early 1980s, there remained widespread economic distortions, caused by non-tariff barriers, export restrictions, the presence of state-owned monopolies, and massive subsidies on basic goods and services.

The alarm bell started to ring by 1994 when Krugman (1994:78) made a comparison of economic trends between East Asia and the former Soviet Union and argued that the pace of 'extensive-nature'[32] economic growth in East Asia could not be sustained for long:

> "It is likely that growth in Asia will continue to outpace growth in the West for the next decade and beyond. But it will not do so at the pace of recent years. From the perspective of the year 2010, current projections of Asian supremacy extrapolated from recent trends may well look almost as silly as 1960-vintage forecasts of Soviet industrial supremacy did from the perspective of the Brezhnev years."

Krugman, however, did not foresee the immediate onslaught on East Asian economies in the form of a currency crisis. It appears that the stage was set after the Mexican currency crisis during 1994-95 that was sudden and vicious (IMF 1995a; 1995b).

The currency crisis hit Indonesia in mid-August 1997. It started in Thailand in July 1997. The large-scale capital outflows from Thailand and consequently the collapse of the pegged exchange rate of the Thai Baht in July 1997 shattered foreign investor confidence in the region. This section reviews the macroeconomic developments that led to the currency crisis in Indonesia.[33] The factors that slowed the recovery process in Indonesia are also reviewed.

5.1. Factors behind the Currency Crisis

There is no general agreement on the factors that triggered the currency crisis in Indonesia. Since the early 1990s, Indonesia experienced rapid growth, with per capita income almost doubling from 1990 to 1997. By this time the economy had been sufficiently diversified to be able to lower its dependence on oil and gas to a broad export basket that included primary products, textiles and light manufactures. A stable macroeconomic environment, reflected in the balanced budget and moderately high but stable inflation, supported rapid economic growth. One area of concern was the relatively large current account deficits during 1992-93, which decreased sharply by 1994 with the depreciation of the real exchange rate (Table 10).

With the benefit of hindsight, one can however pitch together the diverse trends that triggered the crisis in Thailand, which later spread across the region. In a booming economic environment during the early 1990s, foreign investors invested heavily in Southeast Asia. The investment risk was minimum while its return was attractive. This was reflected in

---

[32] In the context of East Asia, two types of growth process have been identified: intensive and extensive. Intensive growth means that the economy grows because it uses new technology and becomes more efficient, creating more and more output per unit of units, while extensive growth means that the economy grows because it uses more resources as inputs, such as factories, buildings and machines, and has higher participation in the labour force (Sarel 1997).

[33] The early studies on the East Asian crisis include Jomo (1998), Lane *et al*. (1999); McLeod and Garnaut (1998), Montes (1998); Radelet and Sachs (1998); World Bank (1998); Arndt and Hill (1999).

Table 10: Indonesia: selected economic indicators (1990-1996)

Economic indicators	1990	1991	1992	1993	1994	1995	1996
Per-Capita GDP (Current USD)	642.0	706.9	754.7	843.9	930.8	1048.7	1163.3
Per-Capita GDP (Constant 1995 USD)	776.7	831.6	877.1	926.1	981.2	1048.7	1113.2
Real GDP Growth Rate (%)	9.0	8.9	7.2	7.3	7.5	8.4	7.6
Gross Domestic Saving (% of GDP)	32.3	33.2	33.4	32.5	32.2	30.6	30.1
Gross Capital Formation (% of GDP)	30.7	31.6	30.5	29.5	31.1	31.9	30.7
Population Growth Rate (%)	1.7	1.6	1.6	1.5	1.4	1.4	1.4
CPI-Inflation (%)	7.4	9.3	7.6	9.6	8.6	9.4	8.0
Narrow Money (M1) Growth Rate (%)	15.9	12.1	6.5	21.9	23.7	15.6	10.0
Broad Money (M2) Growth Rate (%)	44.6	17.5	20.7	20.1	20.2	27.5	27.1
Money and Quasi Money (M2) (% of GDP)	33.9	36.8	38.8	40.0	41.5	43.3	47.1
Deposit Rate of Interest (%)	17.5	23.3	19.6	14.6	12.5	16.7	17.3
Tax Revenue (% of GDP)	17.8	15.6	15.8	14.4	16.3	16.0	14.7
Government Expenditure (% of GDP)	18.4	16.5	18.5	16.7	16.2	14.7	14.6
Financing from Abroad (% of GDP)	0.7	0.7	0.4	-0.1	-0.1	-0.4	-0.5
Official Development Assistance and Official Aid (Current USDmillion)	1743.1	1876.3	2085.4	2021.2	1641.8	1391.1	1123.1
Exports of Goods and Services (% of GDP)	25.3	25.8	27.9	26.8	26.5	26.3	25.8
Imports of Goods and Services (% of GDP)	23.7	24.1	25.0	23.8	25.4	27.6	26.4
External Balance on Goods and Services (% of GDP)	1.6	1.7	2.9	3.0	1.1	-1.3	-0.6
External Debt (total, USDbillion)	69.9	79.5	88.0	89.2	107.8	124.4	128.9
External Debt (% of GDP)	61.1	62.1	63.3	56.4	61.0	61.5	56.7
External Short-Term Debt (% of Total Debt)	15.9	18.0	20.5	20.2	18.0	20.9	25.0
Share of Government Debt to Total Debt(%)	71.8	69.6	66.5	65.1	60.7	55.3	50.2
Share of Private Debt to Total Debt (%)	28.2	30.4	33.5	34.9	39.3	44.7	49.8
External Terms of Trade (2000=100)	77.1	76.2	76.8	80.3	89.5	98.0	94.8
Exchange Rate (Rp/USD)	1842.8	1950.3	2029.9	2087.1	2160.8	2248.6	2342.3
Real Effective Exchange Rate (2000:100) (12-month average) [1]	142.9	143.7	141.7	144.5	142.7	140.5	145.1

Source: Author's compilation based on World Bank: World Development Indicators (except for REER, which is drawn from JP Morgan website, and the share of government debt to total debt, which is drawn from Nasution (2000)).
Note: [1.] The declining index means that the Rupiah depreciates.

positive assessments of the World Bank, the IMF and credit-rating agencies on a regular basis. Facing low real returns of investment in Europe and North America, institutional investors, international banks and other financial institutions made large funds available for investment in both tradable and non-tradable sectors, especially in real estate, in Southeast Asia. They ignored the weaknesses of the financial systems and the distortions and inefficiencies hidden in these booming economies (IMF 1997a; 1997b).

The Indonesian problem started with the management of large capital inflows. Indonesia had maintained open capital accounts since the early 1970s and had minimum restrictions on capital flows. Until the early 1990s, capital inflows played only a minor role and there was no problem with the management of capital flows. The situation changed in the early 1990s when there was a borrowing spree by the private sector given the stable macroeconomic environment. The combination of open capital accounts and the lending rate interest of about 21 per cent during 1995-96 encouraged foreign borrowing (Hill 1999). This caused a sharp increase in external debt (public and private) from about USD70 billion in 1990 to USD140 billion in mid-1997. About half of this debt was private and much of it was short term, with an average maturity of only 1.5 years, and unhedged. Apparently the private sector's external debt was implicitly guaranteed by the government because a part of foreign loans was used to finance large-scale infrastructure projects undertaken by both the state-owned enterprises and politically connected private investors (Vichynond 1998).

Although Indonesia did not peg the Rupiah exchange rate to the USD, it effectively maintained (through managed floating) a quasi-fixed exchange rate with the USD. As a result, the borrowers ignored the exchange rate risk and left their foreign loans unhedged (Hill 1999). In 1996, the inflation differentials between the Southeast Asian countries (including Indonesia) and the USA widened and this required a depreciation of the Rupiah to maintain export competitiveness. This was especially the case when the Japanese yen began to depreciate *vis-à-vis* the USD, which appreciated the real effective exchange rate of the Rupiah (Komine 1998).

Thus an environment was created for a speculative attack on the currency. The Indonesian authorities ignored some other early warning signals (Table 11) because they did not have adequate information on the size of capital inflows, especially the short-term capital inflows. In the absence of well-regulated capital markets, it was difficult to keep track of capital movements under open capital accounts. Still, as Bank Indonesia imposed some restrictions on external borrowings, the well-connected conglomerates were able to hide their total borrowings (Radelet 1995). Above all, there was some indulgence on the part of the authorities given the euphoric condition in a booming economy that had brought prosperity for all.

5.2. Chronology of the Crisis

Table 12 provides a brief chronology of the currency crisis in Indonesia. As pointed out earlier, the Indonesian crisis was triggered by contagion in Thailand, especially after the Thai Baht was floated on 2 July 1997 (McLeod 2004). The contagion occurred despite the fact that Indonesia had stronger macroeconomic fundamentals than Thailand.[34] Although

---

[34] Nasution (2000:148-149) has argued that Indonesia 's strong economic fundamentals were actually

Table 11: Indonesia: selected indicators of vulnerability (period ended December 1996)

Macro Indicators	Yes/No
Inflation >5 %	Yes
Fiscal deficits >2 % of GDP	No
Public debt >50 % of GDP	No
Current account deficits>5 % of GDP	No
Short-term capital flows >50 % of current account deficit[1]	Yes
Capital Inflows 5 % of GDP	No
Ratio of short-term debt to international reserves >1[2]	Yes
Financial indicators	
Recent financial sector liberalisation	Yes
Recent capital account liberalisation	No
Credit to the private sector >100 % of GDP	No
Credit to the private sector, real growth >20 %	No
Emphasis on collateral when making loans	Yes
Estimated share of bank lending to the real estate sector >20 %[3]	Yes
Stock of non-performing loans >10 % of total loans	No
Stock market capitalisation (% of GDP)	40

Source: Lindgren and Associates (1999).
Notes: 1. Defined as the sum of net portfolio and other investments in the financial accounts.
2. As of June 1997.
3. At the end of 1997, includes indirect exposure through collateral.

the real exchange rate appreciated and export competitiveness was lost, the current account deficits were not that high. There were also no structural fiscal imbalances.

Facing the possibility of massive capital outflows, Indonesia initially widened the Rupiah's band on 11 July 1997 and floated the Rupiah exchange rate on 14 August 1997. The exchange rate depreciated sharply and immediately but recovered temporarily in response to tightening of liquidity. Some fiscal measures were also introduced to avoid creating fiscal imbalances given that economic activity had started to slow down. However, the exchange rate pressure heightened again in September and October due to easing of the monetary condition in view of increasing strain on the banking sector. Once the investors perceived that a serious problem was emerging, their herd-and-panic behaviour led to a stampede of the Rupiah. By then the Rupiah had fallen by more than 30 per cent since July. This was the fastest depreciation of a currency value in any of the crisis countries in the region (IMF 1999; Lane *et al.* 1999).

---

artificial: "The strong economic fundamentals (low inflation rate, high economic growth and respectable growth of non-oil exports) that the authorities were so fond of boasting about before the crises were actually artificial. The low inflation rate was brought about by large subsidies to state-vended products. The high rate of economic growth (over 6 per cent per annum) was mainly generated in non-traded sectors of the economy (such as land-based industry, physical infrastructure, and financial system). Most of the growth of non-oil exports during the 1990s came from sectors that relied least on domestic inputs and were associated with foreign firms. In contrast, exports from sectors that were domestically owned and which relied on domestic inputs, fared poorly."

Table 12: A chronology of the currency crisis in Indonesia (July 1977-July 1999)

Date, year	Event
1997	
Early July	Pressure on the Rupiah developed.
11 July	The Rupiah's band was widened.
14 August	The authorities abolished band for Rupiah, which plunged immediately.
31 October	Bank resolution package was announced. 16 commercial banks were closed. Limited deposit insurance for depositors in other banks was introduced. Other bank closures followed.
5 November	The IMF approved a three-year stand-by arrangement.
Mid-December	There were deposit runs on banks that accounted for half of banking system assets.
1998	
15 January	The second IMF-supported programme was announced.
26 January	The Indonesian Bank Restructuring Agency (IBRA) was established and a blanket guarantee on bank deposits was announced.
15 February	President Soeharto was re-elected as President. Doubts about the future financial sector programme grew stronger amid political uncertainty. The Rupiah depreciated further and the possibility of a currency board was debated.
4 April	IBRA closed seven banks and took over seven others.
Mid-May	There were widespread riots. The Rupiah depreciated, deposit runs intensified and Bank Indonesia provided liquidity support to distressed banks.
21 May	President Soeharto stepped down.
29 May	A major private bank was taken over by IBRA.
5 June	The international lenders and Indonesian companies agreed on corporate debt rescheduling.
Mid-July	The authorities allowed market-determined interest rates on Bank Indonesia securities.
23 September	Indonesia's bilateral external debt to official creditors refinanced.
30 September	Bank Mandiri was created through merger of four largest state-owned banks. Plans were announced for joint government-private sector recapitalisation of private banks.
6 October	An amended Banking Law was passed, which included strengthening of IBRA.
1999	
13 March	Government closed 38 banks and IBRA took over seven others. Eligibility of new banks for joint recapitalisation with government was announced.
21 April	One joint-venture bank was closed.
April	Government announced a plan to recapitalise three other state banks (all insolvent)
30 June	Eight private banks were recapitalised jointly through public and private banks.
5 July	Government announced a plan for resolution of IBRA banks.
31 July	Legal merger of component banks of Bank Mandiri.

Source: Author's adaptation based on Lindgren and Associates (1999).

The sharp depreciation of the currency affected the Indonesian banking sector, which had been experiencing various problems for some time. Most Indonesian banks were undercapitalised and poorly managed and had high ratios of non-performing loans (Lane *et al.* 1999). Once the currency depreciated sharply, many banks suffered from sudden jumps in their foreign currency liabilities in terms of domestic currency. In addition, as many conglomerates and even medium-sized firms became insolvent, they defaulted on their liabilities to banks. This heightened the banking crisis by increasing the ratios of non-performing loans. By then the full-blown currency-cum-financial crises engulfed the country. The result was falling output, income and a sharp rise in unemployment and the incidence of poverty (Chart 1).

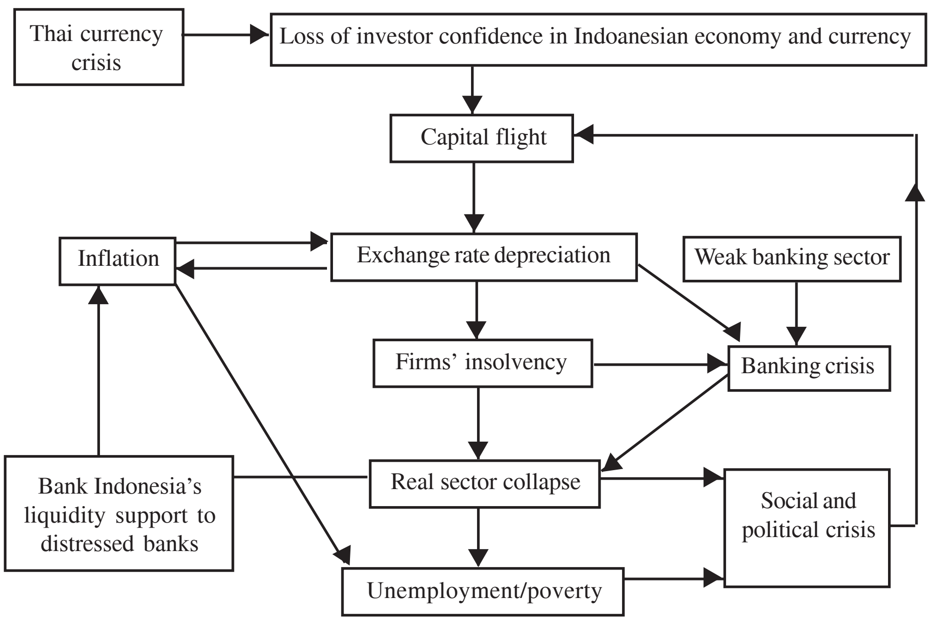

Figure 1: *Mechanics of currency-cum-financial crisis in Indonesia*
Source: Author's adaptation based on Suryahadi (1999)

On 5 November 1997 the IMF approved a three-year stand-by loan arrangement with Indonesia. This was equivalent to about USD10 billion. Other international financial institutions and interested countries committed extra funding and contingent credit lines, amounting to about USD18 billion as a second line of defense. The objectives of the underlying structural adjustment programme were to restore market confidence, bring about an orderly adjustment in the current account, limit the unavoidable decline in output growth and contain the inflationary impact of exchange rate depreciation. The policy package included tight monetary policy (combined, if necessary, with exchange market intervention to stabilise the Rupiah), measures to strengthen the underlying fiscal position to facilitate current account adjustment, a plan to strengthen the financial sector, including closure of non-viable financial institutions, and an initial set of structural reforms to enhance efficiency and transparency in the corporate sector.

The market response to the IMF programme was initially positive but it did not last. The exchange rate fell sharply in December 1997. While the current account improved, capital outflows increased and reserves fell sharply. The factors that contributed to the exchange rate depreciation included a stop-and-go monetary policy, vacillating between support for the exchange rate and strong liquidity expansion in the face of financial strain and runs on deposits, uneven implementation of important structural measures, signalling lack of commitment to the programme and political uncertainty in the light of concerns about the President's health and the forthcoming presidential election (IMF 1999; Lane *et al.* 1999). The liquidity support of Bank Indonesia was apparently excessive and misused by private banks. As Azis (2006:115) writes:

"By the end of 1997 the injected amount (liquidity funds to private banks) swelled to reach 7 per cent of GDP. This policy caused the currency value to weaken further. What made it worse was that most of the funds were not properly used by recipient banks; some were gambled away in the foreign exchange or securities markets, others were used to expand bank operations, staff, branches, and services. A considerable amount was also transferred to bank owners' accounts abroad or lent recklessly to businesses within the banks' own group (potentially non-performing)."

In January 1998 a strengthened IMF programme was announced. The programme included a commitment to reverse the depreciation of the Rupiah. The market reaction was, however, sceptical. The economic downturn deepened and inflation accelerated. The programme included a commitment to tight monetary policy, a comprehensive package of structural reforms prepared in cooperation with the World Bank and a comprehensive bank-restructuring plan. Implementation of the structural agenda was, however, slow. The macroeconomic programme quickly ran off track. The base money grew rapidly because of Bank Indonesia's liquidity support to financial institutions. The Program implementation was also sidetracked by discussion about the introduction of a currency board and the preparation for the March Presidential election.

Following the formation of a new government after the re-election of the President, the IMF review was completed on 4 May 1998 on the basis of a modified programme. With the economy on the verge of a vicious circle of currency depreciation and hyperinflation, the main objectives of the revised programme were to stabilise the exchange rate of the Rupiah at a realistic level and to reduce inflation. In addition, the programme sought to limit the decline in output, eventually restore growth, and protect the poor from the effects of the crisis. The policy package included the tightening of monetary policy (with sharply higher interest rates and strict control over Bank Indonesia's net domestic assets), an adjusted fiscal framework that took into account the less favourable outlook for growth and allowed for the cost of bank restructuring as well as expenditures to cushion the impact of the crisis on the poor, a strengthened plan for the restructuring of the banking system, and an expanded set of far reaching structural reforms (including the privatisation and dismantling of monopolies and price controls) to improve efficiency, transparency and governance in the corporate sector. In addition, talks were underway on agreements with private creditors regarding the restructuring of corporate sector obligations and the roll-over of short-term bank loans (IMF 1999; Lane *et al.* 1999).

However the revised programme was cast off track by severe civil unrest, apparently caused by tightening of the budget and the sharp rise in interest rates. In the middle of political violence and riots, President Soeharto resigned on 21 May 1998 and Habibie became the President. The macroeconomic programme was modified and a limited degree of macroeconomic stability was restored. Although the exchange rate of the Rupiah fell as low as 16,650 against the USD in June, by the end of August 1998 the exchange rate recovered to 11,075 Rupiah and stabilised at about 8000 Rupiah per USD in late 1998. Since then various financial sector reforms have been introduced through mergers and recapitalisation of banks.

5.3. Factors Behind the Slow Recovery

Unlike Thailand and South Korea, Indonesia's recovery was slow, although the problems of the financial sector in all these countries were similar. The differences were in the relative size of their respective external debts and short-term corporate external debts. Indonesia was the most vulnerable in terms of the ratio of total debt to GDP, of total debt to exports or of short-term external debt to international reserves. In addition, it embarked on the resolution of corporate debt much later than South Korea and Thailand. The financial restructuring programmes in these countries were not identical. For example, Cole and Slade (1999) pointed out substantial differences between the closing of sixteen banks in Indonesia and the suspension of fifty-eight finance companies in Thailand and fourteen merchant banks in South Korea. The sixteen banks in Indonesia were part of the national payments system and their closure raised public concern that other bank closures would follow and therefore had substantial impact on the financial sector. In addition, the bank closures were permanent and settlement was immediate while the suspension of finance companies and merchant banks in Thailand and South Korea was not permanent and the settlement was carried out without immediately affecting the payments system (Hill 2000).

Business investment in Indonesia was slow to recover for a number of reasons. First, businesses were concerned about the scope for expanding their markets, as confidence in the prospects of economic recovery diminished and the purchase orders from abroad fell. Second, the sharp depreciation of the Rupiah raised interest rates and the inflationary pressure, which decreased profit margins and raised doubts about the government's ability to stabilise the economy. Third, the increased pressure on the budget and the political uncertainty led to concerns about the quality of public services, the lack of clarity in the procedures for fulfilling bureaucratic requirements, the delays in crucial decisions, the emergence of new costs and the potential for deterioration of services provided by public utilities. Fourth, several bomb blasts heightened concern about basic law and order and security. Finally, businesses were increasingly pessimistic about their ability to have contracts properly enforced so as to ensure a fair business environment (Pangestu and Goeltom 2001).

Indonesia's social and political problems also played a role in the recovery process. About 30 to 40 thousand wealthy Chinese left the country since the economy plunged into chaos in January 1998. They took with them vast (but incalculable) sums of money. It is generally believed that both small and large business enterprises, headed by ethnic Chinese, were the main engine of growth in Indonesia. They were responsible for providing the capital, the enterprise, the commercial connections, the technological knowledge or innovations and the managerial skills (Mackie 1999). Their exodus slowed the recovery process.

One question remains whether Indonesia suffered from poor quality decision-making during the crisis and/or became heavily dependent on the IMF for policy advice. There are two sides of this story. To most critics, the IMF policy programmes were too comprehensive

Table 13: Indonesia: selected economic indicators (1996-2005)

Economic Indicators	1996[a]	1997	1998	1999	2000	2001	2002	2003	2004	2005
Per-Capita GDP (Current USD)	1278	1196	522	756	800	785	945	1111	1184	1292
Real GDP Growth Rate (%)	7.8	4.7	-13.1	0.8	4.9	3.8	4.4	4.9	5.1	5.3
Gross Domestic Saving (% of GDP)	30.1	31.0	26.5	19.5	25.6	26.0	21.1	24.9[b]	25.3[b]	22.9[c]
Gross Domestic Investment (% of GDP)[b]	30.7	31.3	16.8	12.2	17.9	17.8	15.7	16.0	15.9	15.9
Open Unemployment Rate (% of Labour Force)	4.9	4.7	5.5	6.4	6.1	8.1	9.1	9.5	9.9	10.3[b]
CPI-Inflation Rate (%)	8.0	6.7	57.6	20.3	9.4	12.6	10.0	6.8	6.0	10.49[b]
Narrow Money (M1) Growth Rate (%)	10.0	32.8	25.3	28.8	37.7	8.8	7.4	17.3	13.9	15.9
Broad Money (M2) Growth Rate (%)	27.1	25.3	62.8	12.2	16.6	12.8	4.5	8.1	8.3	17.0
Overall Fiscal Balance (% of GDP)	0.7	-1.1	-1.6	-2.8	-1.6	-2.8	-1.5	-2.0	-1.3	-0.8
Current Account Balance (% of GDP)	-3.1	-2.1	3.9	3.8	4.8	4.2	3.9	3.5	1.2	1.1[b]
External Debt (USD, billion)	128.9	136.2	151.2	151.2	144.4	134.0	131.8	134.4	136.0	134.7
External Debt (% of GDP)	51.6	57.5	144.0	98.2	87.5	81.7	65.9	56.2	52.7	47.3
Short-Term External Debt (% of GDP)	12.9	13.9	19.2	13.0	13.7	13.3	11.4	9.6		
International Reserves (ratio of average monthly imports, %)	3.3	2.8	5.0	5.9	5.1	5.5	6.1	6.5	4.7	4.2c
International Reserves (ratio of cumulative inward portfolio investment, %)	1.2	1.3	2.1	3.0	4.1	4.0	3.9	3.4	2.6	
Net Capital Flows (USD, billion)	13.4	-2.9	-7.4	-3.7	-3.8	-6.7	-1.9	-4.7	-2.8	
Net Capital Flows (% of GDP)	5.3	-1.2	-7.1	-2.4	-2.3	-4.1	-0.9	-2.0	-1.1	
Inward Capital Flows (USD, billion)	11.4	-0.4	-9.6	-5.9	-7.7	-7.5	-0.6	-0.9	3.0	
Inward Capital Flows (% of GDP)	4.6	-0.2	-9.1	-3.8	-4.7	-4.6	-0.3	-0.4	1.2	
Exchange Rate of Rupiah per USD (period average)	2342	2909	10014	7855	8422	10261	9311	8577	8939	9706
Real Effective Exchange Rate (REER) (2000=100) (12-month average)[d]	145.1	135	68	104	100	96	116	123	116	112.3[e]
External Terms of Trade (2000=100)	94.8	101.8	125.1	103.0	100.0	107.9	104.6	102.7	100.8	
Yearend Stock Price Index (2000=100)	153.1	96.5	95.6	162.6	100.0	94.2	102.1	166.2	240.3	279.3
Lending Rate of Interest (%)	19.2	21.8	32.2	27.7	18.5	18.6	19.0	16.9	14.1	13.5
Real Lending Rate of Interest (%)	11.3	15.1	-25.5	7.3	9.1	6.0	8.9	10.2	8.1	3.0

Sources and Notes: Author's compilation based on *ICSEAD: East Asian Economic Perspectives 2006* and IMF publications (country information) on http//:www.imf.org (except for REER, which is drawn from JP Morgan website).

a. Some figures for 1996 may differ from those in Table 9 as the data sources of these tables are different.

b. These figures are drawn from *Asian Development Bank, Asian Development Outlook* (various years).

c. IMF estimate

d. The declining index means that the Rupiah depreciates.

e. IMF http://www.imf.org/country information/Indonesia, Jan 2006 and heavy-handed and they created problems for implementation due to non-ownership of the programmes at the highest level. Boediono (2002:386-387) has aptly pointed this out:

> "The implementation of the programme during the Soeharto era was thus characterised by rapidly weakening ownership. This process was triggered by the president's disenchantment with the programme's early performance. His disaffection deepened as he increasingly felt pressured to accept conditionality, which was repugnant to him. We can only speculate with respect to counter-factual scenarios. But it is quite possible that things might have turned out differently had the conditionality (particularly in the first two LOIs) been confined to issues that were really critical to handling the emerging crisis (which certainly would have included comprehensive banking reform). Other issues that were not critical (such as the dismantling of the clove monopoly, IPTN and the national car project) could have been postponed until our heads were above water."

There were also problems with decision-making and leadership in Indonesia during the crises. As political power was heavily concentrated in the president himself and public discussion was limited, it was difficult for policy makers and/or economic technocrats to articulate views and policies that did not have the chance of being approved by the president. This might have acted as self-censorship on the part of policy makers and/or economic technocrats. In addition, although during the early years of the Soeharto regime, economic technocrats were effective in designing and implementing economic policies and in tackling economic crises, they became less effective in later years with the ascendancy and interventions of the president's family members and 'controversial business partners' in the conduct of state affairs. Nasution (2000:155) has put this rather bluntly:

> "The six months before President Soeharto's fall from power in May 1998 was a wasted period because the government could not decide amongst the alternative solutions to the economic crisis. The quality of decision-making had declined because of the erosion of the quality of technical competence and integrity of President Soeharto's cabinet ministers as he relied increasingly on his family members and cronies for advice."

Some studies have suggested that the characteristics of the Indonesian authoritarian political system played a role in the duration and depth of the recession (Husain and Wihlborg 1999; Pomelearno 1998; Classens 1999). The long and deep recession that Indonesia experienced was expected because of its high index of corruption[35], the high concentration of asset ownership, the low rule-of-law score and the weak creditor-oriented insolvency procedures. Some prominent Indonesians, including Sumitro Djojohadikusomo, earlier suggested that Indonesia's problems were due to 'institutional diseases'. Since then McLeod (2005:367) has developed the theme that the Indonesian slow recovery has been due to lack of effective governance:

> "With Soeharto's demise, Indonesia gained democracy but lost effective government. A return to sustained, rapid economic growth will require an overhaul of Indonesia's bureaucracy and judiciary which, along with legislatures, the military and the state-owned enterprises, had been co-opted by the former president into his economy-wide 'franchise' a system of government designed to redistribute income and wealth

> from the weak to the strong while maintaining rapid growth. This franchise has disintegrated, its various component parts now working at cross-purposes rather than in mutually reinforcing fashion. The result has been a significant decline in the security of property rights and in turn the continued postponement of a sustained economic rebound.

While it is acknowledged by all concerned that both social and political factors played a role in the slow recovery of Indonesia's economy, the question remains whether it was an exaggeration to suggest that 'corruption, collusion and nepotism' are all what actually matters insofar as Indonesia's recovery is concerned. van der Eng (2004) has showed that not everyone in Indonesia agrees with the view that corruption is a serious obstacle to the economy in general and to doing business in particular. According to him, corruption instead acted as grease in the wheel of economic growth in Indonesia. This does not mean that one should condone corruption, collusion and nepotism as a necessary part of economic growth. Corruption imposes costs to the economy and creates uncertainty that may retard economic growth. Political stability under the Soeharto regime lowered both economic and political uncertainty (McLeod 2000) and this might have lowered the adverse effect of corruption on economic growth. The type of political stability that exists in an authoritarian state is unlikely to be found in a nascent democracy, such as Indonesia. Nevertheless, it is too strong a statement to suggest that the Indonesian economic recovery and its future macroeconomic performance are conditional on elimination of corruption, nepotism and other vices that have gone hand-to-hand in this country for so long. This is an unrealistic proposition. The experiences of other rapidly growing economies in Asia and Europe, such as China, India, Russia and Vietnam, suggest that even under changed circumstances after the financial crises in many parts of the world, corruption, nepotism and economic growth can indeed co-exist.

The Indonesian economy has slowly recovered and moved to a higher growth path since 2004. Although in December 2004, a tsunami struck Aceh and caused massive economic, social and human losses, rather ironically the disaster may have contributed positively to Indonesia's economic growth because of large inflows of foreign humanitarian assistance for the reconstruction of Aceh (Ananta and Riyanto 2006). What remains important for Indonesia's long-term economic growth and stability is the development of economic, social and political institutions. Indonesia has already undertaken various institutional reforms (economic, social and political) under the IMF-World Bank supported structural adjustment programmes. Still, there remain many challenges.

Importantly, the objective condition of the country is significantly different from what had existed in the early 1960s. In the mean time, the Indonesian society has seen a marked significant demographic change from high population growth to low population growth,

---

[35]There is a view that corruption in Indonesia during the Soeharto era was concentrated to, and controlled by, Soeharto's family and the military leadership in partnership with Sino-Indonesian conglomerates (Bardhan 1997). Businesses were able to predict costs associated with corruption and bureaucratic harassment and calculated them as transaction costs. This is one explanation why corruption was compatible with high economic growth in Indonesia during the Soeharto regime (Kuncoro 2006).

which has increased the old dependency ratio (Ananta and Riyanto 2006). The traditional family system, which remains the backbone of old-age security and support, is bound to change with the evolution of the modern economy and the society. In recognition of this reality, the Megawati government introduced an ambitious National Social Security System in 2004, which, however, does not seem to be economically sustainable in the long run without major changes in its scope and coverage (Arifianto 2006). This indicates that the government's economic policies are now dictated by both social and political factors that could have been ignored earlier. At the same time, the Indonesian economy has moved from a net oil exporter to an oil importer (Azis 2006), and the old days of massive fuel and food subsidies appear to be over.

Under changed circumstances, economic policy making in Indonesia has already undergone significant change. In particular, since the crisis, the policy makers have worked under at least three democratically elected governments and learned the lesson that institutional development, which is a time-consuming process, remains critical for tackling future economic, social and political problems. Indonesia is moving to that direction, slowly but surely. Boediono (2005:313-314) has put this issue in an historical context:

> "The (authoritarian) nature of the (Soeharto) regime had denied the country an adequate mechanism for checking the cumulative growth of corruption, nepotism and other narrow interests that had come to complicate, and increasingly to impair, the quality of economic policy in later years. The demise of the New Order highlighted a new lesson — the importance of the quality of institutions in the development process. The cause of the regime's downfall was not its inability to bring about economic progress or to maintain political stability, but rather the inability of existing institutions to self-correct and respond coherently to the unexpected stresses and strains that have become more common in the globalised world. But a more balanced assessment of the New Order probably has to wait until we gain a better perspective of the recent far-reaching changes in the political economy of the country."

6. Summary and Conclusion

This paper has reviewed the major macroeconomic developments, policies and issues in Indonesia within a political economy perspective since 1949. It has revealed that the impressive economic and social progress in this country over the past five and a half decades was not a smooth process. Until 1966, Indonesia, under the nationalist-revolutionary leadership of President Sukarno, suffered from post-colonial economic and political instability that resulted in an economic and political crises in 1965, which led many observers to term this country an economic 'basket case'. The establishment of a military government under Lieutenant General Soeharto in 1966, however, provided much needed economic and political stability over the next three decades. This turned out to be the golden era of Indonesia's modern economic history when a traditional agricultural, albeit natural resource-rich, economy underwent impressive transformation into a balanced, outward-oriented industrialising economy. Then the 1997 currency-cum-financial crises came, unexpected in this country with strong economic fundamentals.

The Indonesian currency crisis evolved over a considerable period of time. There were symptoms that could have been picked up by the authorities as signs of danger developed. The speculative attacks on the Baht in early July spread to Indonesia in mid-August. There were three broad causes of the currency crisis in Indonesia. First, large capital inflows created an overheated economy. This was manifested in external deficits and property and stock market bubbles that were not dampened quickly. Second, the quasi-pegged exchange rate regime and implicit or explicit government guarantees encouraged private overborrowing and caused excessive exposure to foreign exchange risk in both financial and corporate sectors. Third, the absence of prudential banking regulations and supervision deteriorated the quality of bank loan portfolios. As the crisis unfolded, political uncertainties and doubts about the authorities' commitment and ability to implement the IMF adjustment and reform programmes exacerbated pressure on the Rupiah and the stock market (Boediono 2002).

With the benefit of hindsight, it is possible to suggest that Indonesia maintained an impressive growth performance over three decades in the midst of weak economic, social and political institutions. However, they were not unique to Indonesia or in a dire condition that would have signalled an immediate attack on the currency. Some of these weaknesses were also post hoc rationalisation of an event that for many came as a surprise. Unlike other affected countries in the region, the Indonesian crisis lasted much longer and exposed the dark side of its economic miracle, which took the form of 'corruption, collusion and nepotism or crony-capitalism in short'. Indonesia has slowly recovered and moved to a higher growth path since 2004 with improved economic, social and political institutions. In particular, since the crisis, there has been a political transition from authoritarianism to liberal democracy, which has been eventful but 'surprisingly' less dramatic than many 'pundits' had predicted. The challenge for the infant democratic polity remains how to steer the economy along a high growth path, which could be critical for this country's social and political stability over the next few decades. As Booth (1998:336) aptly points out, both external threats and internal insurrections have indeed been instrumental in uniting the elite in Indonesia for rapid economic growth:

> "The main reason why economic growth has been broadly supported as a policy goal since 1966 is that all sections of the policy-making elite in Indonesia realise that rapid economic growth is occurring throughout the region and that if Indonesia falls behind, it will become more vulnerable to external threats and to internal insurrections. Economic growth is thus desired not as an end in itself, but as the means of achieving the pre-eminent policy objective of preserving the territorial integrity of the nation."

References

Aghevli, Bijan B. and Mohsin S. Khan. 1977. Inflationary Finance and the dynamics of inflation: Indonesia 1951-72. *American Economic Review* **67(3)**:390-403

Ananta, Aris and Yohanes Eko Riyanto. 2006. Riding along a bumpy road. *ASEAN Economic Bulletin* **23(1)**: 1-10.

Arifianto, Alex. 2006. The new Indonesian social security law: a blessing or curse for Indonesians? *ASEAN Economic Bulletin* **23(1)**:57-74.

Arndt, Heinz W. 1967. Economic disorder and the task ahead. In *Sukarno's Guided Indonesia,* ed. Tan, Tjin-kie, pp.129-140. Melbourne: Jacaranda Press.

Arndt, Heinz W. 1971. Banking in hyperinflation and stabilization. In *The Economy of Indonesia: Selected Readings,* ed. Bruce Glassburner, pp. 359-395. Ithaca and London: Cornell University Press.

Arndt, Heinz W. 1984. *The Indonesian Economy: Collected Papers*. Singapore: Chopmen.

Arndt, Heinz W. and Hal Hill (eds). 1999. *Southeast Asia's Economic Crisis: Origins, Lessons and the Way Forward.* Singapore: Institute of Southeast Asian Studies.

Asian Development Bank. Various Years. *Asian Development Outlook.* Manila: ADB.

Asher, Mukul G. and Anne Booth. 1992. Fiscal policy. In *The Indonesian Economy During the Soeharto Era,* ed. Anne Booth, pp.41-76. Kuala Lumpur: Oxford University Press.

Azis, Iwan J. 2006. A drastic reduction of fuel subsidies confuses ends and means. *ASEAN Economic Bulletin* **23(1)**:114-136.

Bardhan, Pranab. 1997. Corruption and development: review of issues. *Journal of Economic Literature* **35(3)**: 1320-1346.

Bhattacharya, A. and M. Pangestu. 1993. *The Lessons of East Asia: Development Transformation and Public Policy*. Washington, D.C.: World Bank.

Boediono. 2002. The IMF support program in Indonesia: comparing its implementation under three presidents. *Bulletin of Indonesian Economic Studie*s **38(3)**:385-391.

Boediono. 2005. Managing the Indonesian economy: some lessons from the past. *Bulletin of Indonesian Economic Studies* **41(3)**:309-324.

Booth, Anne. 1990. Foreign trade and domestic development in the colonial economy. In *Indonesian Economic History in the Dutch Colonial Era,* ed. Anne Booth, W.J. O'Malley and A. Weidemann, pp. 267-295. New Haven, CT: Yale University Press.

Booth, Anne 1998. *The Indonesian Economy in the Nineteenth and Twentieth Centuries: A History of Missed Opportunities*. London: Macmillan.

Booth, Anne. 2000. Poverty and inequality in the soeharto era: an assessment. *Bulletin of Indonesian Economic Studies* **36(1)**: 73-104.

Booth, Anne and Peter McCawley. 1981. The Indonesian economy since the mid-1960s. In *The Indonesian Economy During the Soeharto Era*, ed. Anne Booth and Peter McCawley, pp.1-22. Kuala Lumpur: Oxford University Press.

Bresnan, J. 1993. *Managing Indonesia: The Modern Political Economy.* New York: Columbia University Press.

Chalmers, I. 1997. Introduction. In *The Politics of Economic Development in Indonesia,* ed. I. Chalmers and V.R. Hadiz, pp.1-35. London: Routledge.

Cho, Lee-Jay and Yoon Hyung Kim. 1991. Major economic policies of the Park administration. In *Economic Development in the Republic of Korea: A Policy Perspective,* ed. Lee-Jay Cho and Yoon Hyung Kim, pp.15-40. Honolulu: East-West Center.

Claessen, Stijn *et al.* 1999. Financial Restructuring in East Asia: Halfway There? Financial Sector Discussion Paper No.3. Washington DC.: World Bank.

Cole, David C. and Betty F. Slade 1999. Comments on the IMF Report on IMF-Supported Programs in Indonesia, Thailand and Korea: A Preliminary Assessment (mimeo), 2 February.

Dick, Howard. 2002. Formation of the nation-state, 1930s-1966. In *The Emergence of a National Economy*, ed. Howard Dick, Vincent J.H. Houben, J.Thomas Lindblad and Thee Kian Wie, pp.153-193. Sydney: Allen and Unwin.

Emil Salim. 2003. Recollections of my career. In *Recollections: The Indonesian Economy, 1950s-1990s,* ed. Thee Kian Wie, pp.187-219. Singapore: Institute of Southeast Asian Studies.

van der Eng, Pierre. 1992. The real domestic product of Indonesia, 1880-1989. *Explorations in Economic History* 29:343-373.

van der Eng, Pierre. 2001. Indonesia's growth performance in the 20th century. In *The Asian Economies in the Twentieth Century*. London: Edward Elgar.

van der Eng, Pierre. 1993. *The Colonial 'Drain' from Indonesia, 1823-1900*. Research School of Pacific Studies. Canberra: Australian National University.

van der Eng, Pierre. 2004. Business in Indonesia: old problems and new challenges. In *Business in Indonesia: New Challenges, Old Problems,* ed. M. Chatib Basri and Pierre van der Eng. Singapore: Institute of Southeast Asian Studies.

Feith, Herbert 1962. *The Decline of Constitutional Democracy in Indonesia.* Ithaca, N.Y: Cornell University Press.

Feith, Herbert and Lance Castles (eds.). 1970. *Indonesian Political Thinking, 1945-1965*. Ithaca, New York: Cornell University Press.

Gillis, M. 1984. Episodes in Indonesian economic growth. In *World Economic Growth,* ed. Arnold C. Harberger. San Francisco: Institute for Contemporary Studies.

Glassburner, Bruce. 1971. Economic policy-making in Indonesia, 1950-1957. In *The Economy of Indonesia: Selected Readings*, ed. Bruce Glassburner, pp.70-98. Ithaca: Cornell University Press.

Grenville, Stephen. 1981. Monetary policy and the formal financial sector. In *The Indonesian Economy During the Soeharto Era*, ed. Anne Booth and Peter McCawley, pp.102-125. Kuala Lumpur: Oxford University Press.

Hatta, Mohammad. 1972. One Indonesian view of the Malaysia issue. In *Portrait of a Patriot: Selected Writings by Mohammad Hatta,* pp. 576-581. The Hague: Mouton Publishers.

Higgins, Benjamin. 1957. *Indonesia's Economic Stabilization and Development.* New York: Institute of Pacific Relations.

Higgins, Benjamin. 1968. *Economic Development.* 2nd edn. New York: W.W. Norton.

Higgins, Benjamin and Jean Higgins. 1963. *Indonesia: The Crisis of the Millstones.* Princeton, New Jersy: D. Van Nostrand Company.

Hill, Hal. 1990. Indonesia's industrial transformation: Parts I and II. *Bulletin of Indonesian Economic Studies* **26(2)**:79-120 and 26(3):75-110.

Hill, Hal. 1999. An overview of the issues. In *Southeast Asia's Economic Crisis: Origins, Lessons and the Way Forward,* ed. Heinz W. Arndt and Hal Hill, pp.1-15. Singapore: Institute of Southeast Asian Studies.

Hill, Hal. 2000. *The Indonesian Economy.* 2nd edn. Cambridge, London: Cambridge University Press.

Hollinger, W.C. 1996. *Economic Policy Under President Soeharto: Indonesia's Twenty-Five Years Record.* Washington: US Indonesia Society.

Hughes, Helen. 1999. Corporatist (Crony) Capitalism and the East Asian Crisis. Unpublished Paper. Canberra: Australian National University.

Hunter, Alex. 1971. Notes on Indonesian population. In *The Economy of Indonesia: Selected Readings,* ed. Bruce Glassburner, pp.183-195. Ithaca and London: Cornell University Press.

Hussain, Qaizer and Clas Wihlborg. 1999. Corporate Insolvency Procedures and Bank Behavior: A Study of Selected Asian Countries. IMF Working Paper. Washington, D.C.: IMF

International Centre for the Study of East Asian Development (ICSEAD). *East Asian Economic Perspectives*, Various Years. Kitakyushu, Japan.

International Monetary Fund. *International Financial Statistics Yearbook*. Various Years. Washington, D.C.: IMF.

International Monetary Fund (IMF). 1995a. *World Economic and Financial Surveys: World Economic Outlook* (May*).* Washington, D.C.: IMF.

International Monetary Fund (IMF). 1995b. *International Capital Markets: Developments, Prospects, and Policy Issues* (August). Washington, D.C.: IMF.

International Monetary Fund (IMF). 1997a. *World Economic and Financial Surveys: World Economic Outlook* (October). Washington, D.C.: IMF.

International Monetary Fund 1997b. *World Economic and Financial Surveys: International Capital Markets; Developments, Prospects and Policy Issues* (November). Washington, D.C.: IMF.

International Monetary Fund. 1999. IMF-Supported Programs in Indonesia, Korea, and Thailand: A Preliminary Assessment. Occasional Paper No.178, Washington D.C.: IMF.

International Monetary Fund. I*nternational Financial Statistics Yearboo*k. Various Years. Washington, D.C.: IMF.

International Monetary Fund. *http://www.imf.org/country information/Indonesia.*

Iongh, R.C. de. 1967. West Irian confrontation. In *Sukarno's Guided Indonesia,* ed. Tjin-ke Tan, pp.102-114. Melbourne: Jacaranda Press.

James, W.E. and S.M. Stephenson. 1993. Indonesia's Experience with Economic Policy Reform: Reversing the Conventional Wisdom about Sequencing. Discussion Paper. Jakarta.

Jomo, K.S. (ed.). 1998. *Tigers in Trouble: Financial Crises, Liberalisation and Crises in East Asia.* London: Zed Books.

Kahin, A.R. and G.M. Kahin. 1995. *Subversion as Foreign Policy: The Secret Eisenhower and Dulles Debacle in Indonesia.* New York: New York.

Komine, T. 1998. Currency Crisis and Financial Turmoil in Asia and the Potential for Future Growth. Paper presented at the International Symposium on Foreign Direct Investment in East Asia, Tokyo.

Krugman, Paul. 1994. The myth of Asia's miracle. *Foreign Affairs* 73(Nov/Dec):62-78.

Kuncoro, Ari. 2006. Corruption and business uncertainty in Indonesia. *ASEAN Economic Bulletin* **23(1)**:11-30.

Lane, T. *et al.* 1999. IMF-Supported Programs in Indonesia, Korea, and Thailand. Occasional Paper 178, Washington, DC: IMF.

Lee Khoon Choy. 1999. *A Fragile Nation: The Indonesian Crisis*. Singapore: World Scientific Publishing.

Legge, J.D. 1972. Sukarno: *A Political Biography*. New York: Praeger.

Lindblad, J. Thomas. 2002. The late colonial state and economic expansion, 1900-1930s. In *The Emergence of a National Economy*, ed. Howard Dick, Vincent J.H. Houben, J.Thomas Lindblad and Thee Kian Wie, pp.111-152. Sydney: Allen and Unwin.

Lindgren, C.J. and Associates 1999. Financial Sector Crisis and Restructuring Lessons from Asia. Occasional Paper 188. Washington, D.C.: IMF.

Mackie, Jamie 1971. The Indonesian economy, 1950-1963. In *The Economy of Indonesia: Selected Readings,* ed. Bruce Glassburner, pp.16-69. Ithaca and London: Cornell University Press.

Mackie, Jamie. 1999. Tackling the Chinese problem. In *Post-Soeharto Indonesia: Renewal or Crisis?* Ed. Geoff Forrester, pp.187-197. Singapore: Institute of Southeast Asian Studies.

Mackie, J.A.C. and A. MacIntyre 1994. Politics. In *Indonesia's New Order: The Dynamics of Socio-Economic Transformation*, ed. Hal Hill, pp.1-53. Sydney: Allen and Unwin.

Maddison, Angus. 1989. Dutch income in and from Indonesia, 1700-1938. In *Economic Growth in Indonesia, 1820-1940,* ed. Angus Maddison and Gé Prince, pp.15-41. Dordrecht-Holland: Foris Publications Holland.

Maddison, Angus 1990. Dutch colonialism in Indonesia: a comparative perspective. In *Indonesian Economic History in the Dutch Colonial Era,* ed. Anne Booth, W.J. O'Malley and A. Weidemann, pp. 322-335, New Haven, CT: Yale University Press.

Manning, Chris. 1998. *Indonesian Labour in Transition: An East Asian Success Story*? London and Melbourne: Cambridge University Press.

Masters, Edward. 2003. The ups and downs of US-Indonesia relations. In *Indonesia Matters: Diversity, Unity, and Stability in Fragile Times,* ed. Thang D Nguyen and Frank-Jürgen Richter, pp.185-197. Singapore: Times Editions.

McKay, Elaine (ed.). 1976. *Studies in Indonesian History*. Carlton, Victoria: Pitman Publishing Pty Ltd.

McLeod, Ross H. 2000. Soeharto's Indonesia: a better class of corruption. *Agenda* 7(2):92-112.

McLeod, Ross. H. 1998. Indonesia. In *East Asia in Crisis: From Being a Miracle in Needing One?,* ed. Ross H. McLeod and R. Garnaut, pp.31-48. London: Routledge.

McLeod, Ross. H and R. Garnaut (eds.). 1998. *East Asia in Crisis: From Being a Miracle in Needing One?* London: Routledge.

McLeod, Ross H. 2004. Dealing with bank system failure: Indonesia, 1997-2003. *Bulletin of Indonesian Economic Studies* **40(1)**:95-116.

McLeod, Ross H. 2005. The struggle to regain effective government under democracy in Indonesia. *Bulletin of Indonesian Economic Studies* **41(3)**: 367-86.

Montes, M.F. 1998. *The Currency Crisis in Southeast Asia*. Singapore: Institute of Southeast Asian Studies.

Myrdal, Gunnar. 1968. *Asian Drama -An Inquiry into the Poverty of Nations*. Harmondsworth: Penguin.

Nasution, Anwar. 2000. The meltdown of the Indonesian economy: causes, responses and lessons. *ASEAN Economic Bulletin* **17(2)**:148-162.

Nguyen, Thang D. and Frank-Jürgen Richter (eds.). 2003. *Indonesia Matters: Diversity, Unity, and Stability in Fragile Times*. Singapore: Times Editions.

Paauw, Douglas S. 1960. *Financing Economic Development: The Indonesian Case*. Glencoe: Free Press.

Paauw, Douglas S. (1963). From colonial to guided economy. In *Indonesia*, ed. Ruth T. McVey, pp.155-247. New Haven: HRAF Press for the Southeast Asia Studies at Yale University.

Panglaykim, J. and Heinz W. Arndt. 1966. Survey of recent developments. *Bulletin of Indonesian Economic Studies* 4(June):1-35.

Pangestu, M. and Miranda Swaray Goeltom. 2001. Survey of recent developments. *Bulletin of Indonesian Economic Studies* **37(2)**:141-171.

Penders, C.L.M. 1974. *The Life and Times of Sukarno*. Rutherford: Fairleigh Dickinson University Press.

Pomelearno, M. 1998. The East Asian Crisis and Corporate Finances: The Untold Story. World Bank Working Paper WPS 1900. Washington D.C.: World Bank

Prawiro, R. 1998. *Indonesia's Struggle for Economic Development: Pragmatism in Action*. Kuala Lumpur: Oxford University Press.

Radelet, Steven. 1995. Indonesian foreign debt: headed for a crisis or financing sustainable growth? *Bulletin of Indonesian Economic Studies* **31(3)**: 39-72.

Radelet, Steven and Jeffrey Sachs. 1998. The East Asian Financial Crisis: Diagnosis, Remedies, Prospects. Brookings Papers on Economic Activity 1-90.

Robison, Richard. 1986. *Indonesia: The Rise of Capital*. Sydney: Allen and Unwin.

Sadli, Mohammad. 1970. Inflation, the drifting kite. In *Indonesian Political Thinking,* ed. Herbert Feith and Lance Castles, pp. 396-400. Ithaca, New York: Cornell University Press.

Sadli, Mohammad. 1993. Recollections of my career. *Bulletin of Indonesian Economic Studies* **29(1)**:35-51.

Sarel, M. 1997. Growth and Productivity in ASEAN Economies. IMF Working Paper WP/97/97. Washington, D.C.: IMF.

Selo Soemardjan. 1988. I*ndonesia: A Socio-Economic Profile*. New Delhi: Sterling Publishers.

Sjafruddin Prawiranegara. 2003. Recollections of my career. In *Recollections: The Indonesian Economy, 1950s-1990s*, ed. Thee Kian Wie, pp.77-86. Singapore: Institute of Southeast Asian Studies.

Subroto. 2003. Recollections of my career. In *Recollections: The Indonesian Economy, 1950s-1990s*, ed. Thee Kian Wie, pp.223-250. Singapore: Institute of Southeast Asian Studies.

Sumitro Djojohadikusomo. 1986. Recollections of my career. *Bulletin of Indonesian Economic Studies* **22(3)**: 27-39.

Sumitro Djojohadikusomo. 2003. Recollections of my career. In *Recollections: The Indonesian Economy, 1950s-1990s,* ed. Thee Kian Wie, pp.49-65. Singapore: Institute of Southeast Asian Studies.

Sundrum, R.M. 1986. Indonesia's rapid economic growth: 1968-1981. *Bulletin of Indonesian Economic Studies* **23(3)**: 40-69.

Sundrum, R.M. 1988. Indonesia's slow economic growth: 1981-86. *Bulletin of Indonesian Economic Studies* **24(1)**:37-72.

Suryahadi, Asef. 1999. The economic crisis: effects and policy framework. In *Post-Soeharto Indonesia: Renewal or Chaos?,* ed. Geoff Forrester, pp.153-160. Singapore: Institute of Southeast Asian Studies.

Syrquin, M. 1988. Patterns of structural change. In *Handbook of Development Economics* (Vol.I), ed. H. Chenery and T.N. Srinivasan. Amsterdam: North-Holland.

Tan, Tjin-kie. 1967. Sukarnian economics. In *Sukarno's Guided Indonesia*, ed. Tjin-kie Tan, pp.29-45. Melbourne: Jacaranda Press.

Tan, Tjin-kie (ed.). 1967. *Sukarno's Guided Indonesia*. Melbourne: Jacaranda Press.

Taylor, Jean G. 2003. *Indonesia: Peoples and Histories.* New Haven and London: Yale University Press.

Thee Kian Wie. 1984. Japanese direct investment in Indonesian manufacturing. *Bulletin of Indonesian Economic Studies* **20(2)**:90-106.

Thee Kian Wie 2002. The Soeharto era and after: stability, development and crisis, 1966-2000. In *The Emergence of a National Economy*, ed. Howard Dick, Vincent J.H. Houben, J.Thomas Lindblad and Thee Kian Wie, pp.194-243. Sydney: Allen and Unwin.

Thee Kian Wie. 2003. Introduction. In *Recollections: The Indonesian Economy, 1950s-1990s*, ed. Thee Kian Wie, pp.1-43. Singapore: Institute of Southeast Asian Studies.

Thomas, K.D. and P. Drysdale. 1964. Indonesian inflation 1951-60. *Economic Record* Dec.: 535-553.

Usman, Marzuki. 2003. A vision of Indonesia's political future by 2020. In *Indonesia Matters: Diversity, Unity, and Stability in Fragile Times,* ed. Thang D. Nguyen and Frank-Jürgen Richter, pp.223-227. Singapore: Times Editions.

Vichynond, P. 1998. Management of financial flows in Southeast Asia. Paper presented at the UNU-AERC Conference on 'Asia and Africa in the Global Economy', Tokyo.

Wanandi, Jusuf. 2003. The Suharto regime 1967-1998: what went wrong? In *Indonesia Matters: Diversity, Unity, and Stability in Fragile Times,* ed. Thang D. Nguyen and Frank-Jurgen Richter, pp.17-27. Singapore: Times Editions.

World Bank. 1993. *The East Asian Miracle: Economic Growth and Public Polic*y. New York: Oxford University Press.

World Bank. 1998. *East Asia: The Road to Recovery.* Washington, D.C.: World Bank.

World Bank, *World Development Indicators*. Various years.

World Bank, *World Development Report.* Various years.

Zainu'ddin. 1976. the role of the military in Indonesian society. In *Studies in Indonesian History,* ed. Elaine McKay, pp. 202-236. Carlton, Victoria: Pitman (Australia) Publishing.