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LIBERALIZING NEW ORDER INDONESIA: IDEAS, EPISODE COMMUNITY, AND ECONOMIC POLICY CHANGE, 1986-1992

DISSERTATION

Presented in Partial Fulfillment of the Requirements for the Degree Doctor of Philosophy in the Graduate School of The Ohio State University

By

Rizal Mallarangeng, MA.

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Dissertation Committee:
Professor R. William Liddle, Adviser
Professor Kevin O'Brien
Professor John Champlin

Approved by
Adviser
Political Science Graduate Program
ABSTRACT

Major theories in social and political science have not taken seriously the role of ideas in explaining economic policy change. This study is different. The case of Indonesia from 1986 to 1992 demonstrates that ideas and the actors in the public arena who fought for their acceptance and implementation strongly influenced the movement of policy from dirigism to greater liberalism.

The relevant actors were economists, journalists, present and former government ministers, writers, and public speakers. Some of them, the technocrats, worked inside the government. But most worked outside, constituting an influential intellectual epistemic community. These actors did not belong to a formal organization. They did not appoint a leadership or authority to orchestrate their actions. Instead, what they had was a broad intellectual consensus, a shared belief in the best course the country could take to achieve a higher level of economic development.
When the opportunity came in the early 1980s following the fall of the world oil price, these actors attacked the dirigist status quo and offered their liberal solution. The technocrats worked from inside to convince the ruling elite of President Soeharto’s New Order regime that the time had come to begin policy reorientation. They revived the modernizing spirit that had characterized the early New Order in the mid and late 1960s, when it dismantled the anti-capitalist legacy of Indonesia’s first president, Sukarno. The intellectuals did their part from outside to discredit the dirigist status quo and to persuade the general public to support economic liberalization.

When their ideas won the day, the course of policy shifted substantially. This shift affected major economic sectors, particularly trade, investment, finance and banking. The period of 1986-1989 in Indonesia’s history is properly called the deregulation era. After 1989, newly powerful business interests and the inability of the liberals to produce persuasive new ideas combined to weaken the reform process.

The study concludes with the suggestion that taking the role of ideas seriously might also be useful in understanding broader processes of social, political and cultural change in other times and places.
Dedicated to Dewi and Dundun
This dissertation could not have been written without the help of many people.

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I dedicated this dissertation to them.
VITA

October 29, 1964

Born, Ujungpandang, Indonesia

1990

Drs., Political Science, Gadjah Mada University

1994

MA., Political Science, The Ohio State University

1994-2000

Graduate Teaching Assistance, The Ohio State University

PUBLICATION

Research Publication


FIELDS OF STUDY

Major Field: Political Science
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CHAPTER 1

INTRODUCTION:
IDEAS AND THE MAKING OF PUBLIC POLICY

In this study economic liberalization is understood as a process of policy shift, from a heavy dirigist or state-directed policy to a more market oriented one. Through this process of policy shift, the state gradually loses its direct control over important economic resources, and consequently state officials have fewer resources which can be used to mobilize political support or to buy loyalty. Hence the tempting problems: Why does a government shift its policy? How does the process unfold?

This study is focused upon the process of policy making in Suharto's Indonesia, from 1986 to 1992. Suharto's government started the early process of economic liberalization in 1983. The process peaked in 1989, with several ups and downs along the way. Sometimes the government surprised many skeptics by launching a policy packet which deregulated a highly protected area. At other times the pro-market economists, after one or two years expecting bolder moves, lost hope and declared that the govern-
ment was in a state of deregulation fatigue.

The questions this study wants to answer are: Why did Suharto's government shift its economic policy, from dirigism to greater liberalism? What were the most important variables behind the adoption of the new policy?

1.1 Theoretical Review

My explanation about policy change comes to rest upon the argument of the importance of ideas, both as programmatic knowledge and as public philosophy. I believe that our understanding of the politics of policy making and the process of policy change will be very limited if we do not understand the power of ideas and how they are carried by particular groups of significant actors (e.g., entrepreneurs, economists, bureaucrats) in certain institutional contexts.

Before I elaborate my position, I will review several arguments from various theories which so far have been commonly used to explain the politics of policy making. All of these theories (coalition politics and economic interest theory, state autonomy theory, and rational choice theory) do not accord a proper role to ideas. Despite their differences, these theories seem to agree on one critical point, that it is possible to understand how large scale economic changes unfold without under-
standing how economic ideas inspire the agents of change in their particular context. From one point of view, this refusal to take ideas seriously is ironic: scholars, whose chief job is to produce and disseminate ideas, do not believe that ideas matter.

1.1.1 Coalition Politics and Economic Interest Theory

For this theory policy change requires the support of a broad coalition of economic groups. Policy change creates winners and losers -- therefore, change is only possible if the potential winners are strong enough to force the policy makers to adopt a particular policy.

The emphasis of this theory is on the power of economic groups in influencing policy. Jeffrey Frieden (1991), for instance, defines this power in terms of asset specificity and concentration. For him, if a group of companies has specific and concentrated assets, its possibility to influence the direction of policy is greater. Others, like Gourevitch (1986), explain this power in broader terms, i.e., the company's position in relation to the international and domestic economy. Here, if a group of companies is on the cutting edge of international competition, and its capital is tightly linked to the international market, its power to influence policy is greater compared to
other companies whose operations are mainly domestic.

The merit of this theory lies in its underlying assumption that policy change is a reflection of a broader change in the society, i.e., change in the balance of power among social classes and among economic pressure groups. This assumption implies that to properly understand the process of economic liberalization we have to go beyond the narrow focus of studying only the interactions among the politicians and the policy makers.

The problem with this theory, however, is that it fails to consider the possibility that government officials, the economic specialists often called "technocrats", for instance, might play important roles in the process of policy making. True, the power of government officials is often exaggerated. Moreover, these officials are not a unitary force with a homogenous interest. Yet, to dismiss their role altogether and to regard them only as puppets directed by the interests of economic classes or pressure groups is simply mistaken. In the study of East Asian economies there is a growing consensus among scholars that government officials play a very important role in formulating industrial policy. The point of difference among these scholars is not whether such a role exists, but whether its role supports or inhibits economic growth (see Wade 1990; Johnson 1995; Lal 1986; Krugman 1989).
Another problem for this theory is that it is too simplistic in explaining the interests of economic groups. Gourevitch (1986:56), for instance, asserts that "what people want depends on where they sit," while Frieden (1991: 19) says that "purely economic characteristics of the actors ... determine whether they will seek government policies and what sort of policies they will seek." This kind of explanation can only be fully convincing if in economic reality every significant actor (e.g., business corporations) has only one and a well defined economic activity. However, in modern economic interactions, it is becoming rarer that every actor has only one "chair." A corporate giant, for instance, may have five businesses related to export industries, and five others related to import industries. Under this condition, the actor's interests are divided and contradictory.

Furthermore, the relationship between interest and policy is complex. Important policies often have multiple consequences, which are not always easy to know prior to their enactment. In other words, to borrow Judith Goldstein's formulation, between interest and policy there is a space of "uncertainty" (Goldstein 1993:10). Therefore, even if an actor knows his interest quite well, there is no guarantee that he also knows what kind of policy best advances this interest.
One of the reasons why this theory of coalition and economic interest fails to account for the complexity in the relation between interest and policy is its refusal to place ideas as an important variable in its explanation. In the face of uncertainty in regard to the impact of policy, an actor often relies on a particular economic idea to convince both himself and the members of his coalition that the policy might work. Here idea functions as a map to guide the actors in relating their interest and the means available to them. Therefore, by not regarding ideas as an important factor, this theory implies a mechanistic relation in which policy choice is regarded only as an appendix to economic interests.

1.1.2 State Autonomy Theory

This theory describes the state as neither an instrument of the ruling class nor a neutral cash register. The state is instead an organic body, an actor in its own right. Thus the state, as Stephen Krasner (1984:225) puts it, "cannot be understood as a reflection of societal characteristics or preferences." In the process of policy making, the state enacts a particular policy to pursue its own interests. This theory therefore sharply opposes the coalition and economic interest theory. For the latter, policy change is a direct consequence of pres-
sures from societal interests; for the former, it is a result of a state's effort to achieve its own objectives (Skocpol et al., 1985).

The concept of state autonomy can only be intelligible if it is related to a specific state's objective or interest. Autonomy is a relational concept. While crucial, this problem of interest, unfortunately, is explained by state theorists in both abstract and simplistic formulations. One group of scholars explains that the interest of the (capitalist) state lies in the enlargement of capital accumulation. Here the state develops capitalism from one stage to another. So under this interpretation, a policy shift from dirigist to liberal policies should be seen as a change in the state's orientation to deepen the process of capital accumulation. Another group of scholars maintains that the state is primarily a developmental institution, whose chief interest lies in the continuation of the development process. Here the state is given a very noble purpose: to bring the society from one stage of modernization to another, higher stage (Przeworski 1990).

For a highly macro analysis of social and political reality, such a formulation of interest might be attractive. Its simplicity enables researchers to reduce complex interactions of factors in understanding profound historical changes. However,
when we move from the abstract formulation of interest to understanding the reality of the policy making process, the state theory loses much of its attractiveness. There are always elements of elite competition under any regime, democratic or authoritarian; open competition in the case of the former, closed in the latter.

In Indonesia, for instance, protectionist officials are competing against pro-market technocrats in directing government economic policies. Partly because of this competition, government policies are often incoherent, even contradictory. Under this situation, how would we know what the state interest is: pursuing pro-market policies or undertaking protectionist measures? Should we say -- taking the risk of being accused of ignorance of economic reality -- that these two different policies are actually two different sides of the same coin?

This difficulty of state theory in understanding the reality of policy making, I believe, springs from its vision of the state as a unitary, coherent force. This kind of vision was partly influenced by Hegel, who sees the state as an organic body, a unified universal force, and partly by Weber, who thinks that rational-legal bureaucracy is the core of the modern state with a well-defined function. For this theory, therefore, inside the state there is no place for competition among actors to in-
fluence the direction of a state’s policy. The actors are uni­
ified; their actions are guided to achieve a homogenous purpose.
So, by implication, there is no “politics” of policy making.
What we see here instead is only a concerted effort by state of­
ficials to meet a given end.

Partly because of its simplicity in understanding the
problem of interest and the interactions among actors, state
theory has little regard for the role of ideas in the process of
policy making. Ideas provide the “content” of interest and as
Irving Kristol once said, “establish and define in men’s mind
the categories of the politically possible and the politically
impossible, the desirable and the undesirable, the tolerable and
the intolerable...” (Novak 1999:223). Moreover, by providing
such content ideas help differentiate one group of politicians
or policy makers from another.

Ideas are also important elements in the fighting over
policy: to win a particular policy, an element of persuasiveness
is needed to reduce the cost of bargaining. Without persuasive
ideas, social and political competition in the public arena will
be, to use the Hobbesian dictum, “nasty, brutish, and short.”

In short, as long as we understand that the concept of in­
terest and the interactions of actors are complex (an under­
standing the state autonomy theory fails to develop in its
analysis), a sufficient understanding of the role of ideas is required.

1.1.3 Rational Choice Theory

This theory starts from the assumption of utility maximization. The basis of the society is individuals, who always act rationally in pursuing their self-interests. In the market entrepreneurs act to maximize their profit, in politics politicians and bureaucrats play their role solely for the purpose of increasing their power. Using the conceptual apparatus borrowed from the field of microeconomy, the theorists in this tradition want to explain what they often call the micro-foundations of politics.

Policy outcomes, for this theory, are the result of political interactions among rational actors who want to maximize their gains. A particular policy to protect certain industries,

---

1 The root of this assumption of the individual as utility maximizer goes as far back as the founders of liberalism: Adam Smith and Jeremy Bentham. What distinguished the founders of liberalism from the thinkers of their time, and from those before them, was their idea that the individual existed prior to the society, and that it was part of human nature for the individual to act according to his or her self-interest. Even Hobbes, who preceded the birth of liberalism, thought that the sole reason behind the creation of government was precisely that men were always pursuing their self-interest. Here, the creation of government was considered a rational solution, a contract, in order to meet the problem of collective action arising from the nature of men as utility maximizers (see Hobbes's Leviathan, 1962). In the hands of rational choice theorists, this assumption of human behavior is treated more explicitly and, with the aid of formal logic, is made more analytically rigorous, aimed at creating counter-intuitive and universal scientific generalizations.
for instance, is considered a rational equilibrium which satisfies the interests of both government officials and rent-seeking entrepreneurs. Here, by implication, politics is considered an arena in which each party competes to extract resources from the public realm.

This theory has inspired many interesting works which give us some useful insights about how government's policies, motivated perhaps by the most noble of intentions, end up harming the people the policies are supposed to help. To appreciate its strength, perhaps we should bear in mind that post-World War II political economy, deeply influenced by Keynes, worked largely under the assumption of welfare maximization. In Keynesian equations there was no place for a consideration that the pursuit of power, by politicians or bureaucrats, or by professional economists working for the government, might influence the process of policy making. Here the realm of government was thought to be an arena in which good men, armed with correct ideas, would do good things. The last fifty years of the 20th Century has thought us

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2 A good example of research in the tradition of rational choice theory applied to the problem of developing economies is Robert Bates (1981).

3 Todd Bucholz (1990) provides two explanations as to why Keynes failed to consider that his theory rested upon unrealistic assumptions about government as a benevolent agency and government officials as interest-free planners. First, Keynes was influenced by a Weberian view of bureaucracy (for Weber, the chief characteristic of modern bureaucracy is its rationality). Second, more important than the first, Keynes -- a man deeply influenced by Victorian values, a respected member of the highest intellectual aristocracy of his time --
that this assumption was simply mistaken and, sometimes, quite dangerous.

I believe the chief attraction of rational choice theory lies in the fact that governments often make bad policies; and the welfare assumption is simply quite useless as a starting point from which we can begin to understand this important fact. From post-War political economy we learn about market failures; from rational choice theory we understand more about government failures.

Despite its attraction, however, this theory is greatly limited by its own methodological requirement. For its analysis to be fully developed, this theory requires a crucial element, i.e., clear and predictable rules of the game. Various game theoretic models, for instance, depend on such rules in order to produce predictable outcomes (Kreps 1990) Hence, while rational choice theory is at its best when it is used to analyze interactions of actors inside a well-established institution (e.g., the U.S. Congress), it is almost wholly deficient as a tool to analyze political interactions and policy processes in changing societies where actors are fighting to create or to change the

believed that government could be ruled by intellectuals, who stood high above unaffected by the gratifications of political power and material interests.
rules and the institutional patterns.\textsuperscript{5}

Beside this methodological limitation, this theory is also constrained by its inability to properly explain change. When the status quo is a perfect equilibrium (say, deficit spending) which satisfies the interest of every significant actor, how could reform occur? For this theory, when individual rationality ends up in collective irrationality, the equilibrium, there are only two possible ways for change to happen: by the outbreak of catastrophic events, e.g., wars, and by the "exogenous introduction of wise statesmen or technocrats who are above petty political rationality" (Grindle 1991:58).\textsuperscript{6} These sorts of answers are not very convincing: the latter defies the theory's own assumption about utility maximization -- there is no logical basis for this theory not to apply the assumption also to the technocrats -- and the former does not square with the fact that reforms, radical or gradual, do not always need wars before they

\textsuperscript{4} For a full treatment of this difficulty of the welfare assumption in helping us to understand the practice of government in the economic realm see Deepak Lal (1985).

\textsuperscript{5} This is the reason why the best researches in the tradition of rational choice theory so far have concentrated mostly on understanding legislative processes in established democracies. For a brilliant methodological critique of rational choice theory see Green and Shapiro (1995).

\textsuperscript{6} These two types of explanation to change are given by Mancur Olson (1982) and Srinivasan (1985).
can be implemented.7

At a more substantive level, the weakness of this theory is rooted in its very narrow understanding of human actions. There is little doubt that protectionist policies, for instance, are created by politicians and economic planners because the policies can provide the means for them to maintain and to increase their power (the self-interest motive). Yet, to say that this is the whole story, as the theory does, is to oversimplify our understanding of such policies.

Protectionist policies are undertaken following a certain conception or idea about how best to achieve a particular economic goal, i.e., national self-sufficiency or national autonomy. That is why such policies were often pursued radically in countries which were under what Atul Kohli calls the frenzy of nationalism. So to understand such policies properly we also need to understand the spirit of nationalism and particular economic ideas that best meet its demands. Here to stick to the assumption that human actions are only derived from the pursuit of self-interest does not help us much to understand the relations among ideas, actors, and policies.

7 A recent good example here is the conservative budget “revolution” of the 1990s, led by Mr. Gingrich in U.S. Congress.
1.2 An alternative explanation: The Importance of Ideas

My purpose in this section is to argue that ideas matter. To study the process of policy change, therefore, we have to understand the power of ideas and how they are carried by actors within certain institutional structures.

Ideas are important because "they tell actors ... what their goal should be, the importance of these goals compared to other goals, how to pursue these goals, and who their friends and enemies are" (Adler 1986:675). As such, ideas determine whether a particular phenomenon is considered by actors as an opportunity or a threat. Economic globalization, for instance, can be understood in two different ways: as a threat to a country's national autonomy and self-reliance, or as a great opportunity to participate in international trade which will help the economy to grow further. The consequences in the forms of policy of these two different views are crucial. One would likely support dirigist policies, e.g., protectionism, selective subsidies, import-substitution strategy, while the other would promote open door or liberal policies.

In the history of great policy changes, the crucial role of ideas can be seen, for instance, in how Keynesianism influenced the direction of policy and the creation of new political ground before and after the Second World War in capitalist-
democratic countries. Keynesianism, being the most convincing idea in answering the puzzles left behind by the Great Depression, generated a kind of consensus among competing parties of the left and right to adopt the policies of demand management and to subsequently expand the reach of the welfare state. Before the spread of Keynesianism, such a consensus could not materialize, partly because there was no theory which was respectable enough to bridge the differences between the defenders of laissez-faire and the proponents of centralized planning. Here, as Hirschman (1986:150) explains, Keynesian ideas supplied "an entirely new common ground for positions between which there existed previously no middle ground whatever."  

The spread of Keynesianism, therefore, showed how ideas, far from being only a reflection of power relations and a justification for particular economic interests, molded the direction of policy and influenced the behavior of policy makers. Moreover, by preparing a new intellectual landscape for a possible policy action, an idea created "reality" and generated a new interest, i.e., the maintenance and the expansion of the welfare state. In this sense, as Peter Hall (1986a:369) puts it, an idea "had the power to change the perception a group had of its own

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8 John Ikenberry (1992) makes the same explanation about the influence of Keynesianism in a larger context, i.e., in the postwar settlement of international economic relation.
interests, and they made possible new courses of action that changed the material world itself."

True, some structural variables are also responsible for the acceptance of a particular policy. In the adoption of Keynesian demand management policies, for instance, these variables were the enlargement of the franchise, the growing power of socialist movements, and the shift from agriculture to an industrial economy. Yet, there is no automatic mechanism which connects the relevant structural factors with the actual policies adopted. In other words, there is no guarantee that the presence of both a strong socialist movement and rapid industrialization, for example, determine whether a country will pursue welfare policies. Partial liberalization in Scandinavian economies, particularly in Sweden, in the early 1990s showed that the opposite policies might also be undertaken with the "extreme" presence of these structural factors.

Moreover, as Sikkink (1991) explains from her study of development policy in Brazil and Argentina, it is highly questionable that two different countries with the same structural conditions will have similar policies. For her, the crucial factors which are responsible for the differences across the countries she studied are the perceptions and the beliefs of policy makers, who act under certain institutional frameworks, about the
virtues of developmentalism. In other words, if some structural preconditions have already existed, it is ideas and the ways they are carried by actors which make the difference in regard to the direction of policy. So, while structural factors are important, to understand more about policy processes we need to appreciate the role ideas play in influencing the actors' behaviors.

The importance of ideas can also be seen from a different perspective. Here, a good place to start is from rational choice theory. As explained above, this theory is founded on the assumption that actors always act in accordance with their own interests. It is of course hard to deny that this assumption contains a grain of truth -- it would be naive to say that politicians always act without thinking whether they would or would not be reelected. The problem, however, becomes clearer when we start to ask, What is interest? How do actors know what their interests are? How do they know how to achieve their interests, provided they know what their interests are? In the face of these questions, rational choice theory has few answers. This theory usually ends up in an explanation which is circular in logic, i.e., actors know what their interests are because they are rational.

For Douglass C. North, Judith Goldstein and Robert Keohane
(1993:10), to answer those questions of interest satisfactorily
the role of ideas needs to be introduced as an exogenous vari­
able. For them actors face many competing choices. It is very
rare that actors have before them only two mutually exclusive or
completely contradictory choices. Moreover, policies always have
multiple effects, or, in Goldstein’s words, “multiple equilib­
ria.” In other words, the relations between actors and policy
choices are clouded by uncertainty.

Under this condition, it is very difficult for actors to
know what their interests are, or if they do, it would not be
easy for them to know by what policy these interests could be
met. Here comes the role of ideas: ideas help actors in defining
their interests and in relating the interests with the means to
achieve them. It is in this sense that North says that ideas, in
the form of ideology, reduce the cost of uncertainty.7 To put it
in a different way, ideas, for actors, would not have any role
in defining interest and in selecting policy only in a world of
complete information.

This seemingly simple explanation has greater explanatory
power because of this undeniable fact: our world is increasingly

7 In North’s (1981:49) own words: “ideology is an economizing device by which
individuals come to terms with their environment and are provided with a
‘world view’ so that the decision making process is simplified” (emphasis
added).
more complex. To understand modern economic interactions, more and more technical knowledge or specific economic ideas -- about derivatives, bond markets and traders, fluctuations of interest rates, the movement of international finance and currency realignment, etc. -- are now required. For various significant actors in the process of policy making, this increasing complexity means growing uncertainty, in the sense that there are now many more choices or policies which can be associated with particular interests, while the definition of interest itself is also increasingly less simple. Under this condition, therefore, the role of ideas is becoming more crucial. This explains why, for instance, the technocrats and the centers of policy research -- actors and institutions whose main commodities are ideas -- play important roles in modern economic governance (Weiss 1991).

1.3 The Role of Ideas in Economic Liberalization

Ideas are carried by actors, who act under particular institutional settings. Therefore a study of the impact of ideas would be incomplete without understanding how institutions set constraints and opportunities for actors in policy interactions. Before I turn to this important subject, however, let me explain how movements of ideas, i.e., ideas about economic development, are connected with economic liberalization; it is from this con-
nection that we can begin to see the crucial role of actors and their institutional contexts.

In terms of ideas, liberalization is a movement away from dirigism, a dominant idea concerning development in developing countries from the 1950s to the 1970s. Dirigism -- sometimes also called developmentalism (Sikkink 1991) or Third Worldism (Harris 1986) or simply mainstream post-War development economics (Meier 1984) -- was a mixture of several different ideas about the purposes of development in developing countries and the best means to achieve them.

The intellectual inspirations from which dirigism was derived were not homogenous; they ranged from a specific interpretation of Keynesian economics, democratic socialism to dependency theory; from Prebisch's economic nationalism to naked populism or Peronism and compassionate egalitarianism. Despite this variety, there were distinctive ideas which could be said to form the core of dirigisme. To summarize, these core ideas centered around the rejection of classical economics, the hostility toward international trade (trade pessimism), and the excessive emphasis on self-reliance as well as redistribution of income rather than growth.¹⁰

¹⁰ The core tenet of classical economics is belief in the market as a self-regulating mechanism. Through the price mechanism, the economy allocates resources in the most efficient way possible (Pareto optimum). Dirigism, by re-
For more than two decades dirigism played the role of the Kuhnian normal science in development theory, which was actualized in various degree across countries in the developing world. The countries that played the leading role here were Brazil in Latin America, India in Asia, and Tanzania in Africa. In all of these countries, the policies that retained the most respected status were import-substitution strategy, planned investment, nationalization of major industries, and progressive redistribution of income.

By the late 1970s and throughout the 1980s, this dominant idea was increasingly faced by what in the Kuhnian framework are called anomalies. On the one hand, some countries in East Asia, which relied on international trade for their development -- in other words, denying the pessimistic idea toward trade -- showed both impressive economic growth and better economic distribution. On the other hand, the countries which "radically" relied on dirigist policies, e.g., Brazil and India, showed no convincing indications that the earlier expectations carried by the

jecting this notion, supplanted the price mechanism with central planning and various forms of direct government control. Another important tenet of classical economics is the notion that (international) trade is beneficial to all, poor and rich countries alike. Dirigism is much more pessimistic; trade is a zero-sum relation, which is only beneficial for the rich country in the North. This implies that to industrialize, the developing countries in the South should not rely upon international trade. In practice, this means, among others, building domestic industries through protection, i.e., import substitution strategy (Deepak Lal 1983 & 1994; Arndt (1987)).
policies had been met.\textsuperscript{11}

In the face of these anomalies, dirigisme had few answers. According to Hirschman (1981:20), who was among the most respected thinkers in the tradition of post-War development economics, dirigism produced no new synthesis to explain the growing anomalies. This inability to provide a creative answer explained why dirigisme became less popular and lost much of its prior persuasive power, which in turn prepared the condition for the liberal economic idea to emerge as the new, alternative idea.\textsuperscript{12} To put it differently, the failures of dirigisme caused a fundamental movement of ideas which, as John Toye (1993) puts

\textsuperscript{11} These failures could be seen in several manifestations. In regard to income distribution, for instance, as Albert Fishlow’s influential empirical study about Brazil showed (1972), the policies did not reduce inequality -- Fishlow showed that income distribution in Brazil was increasingly more unequal, and at the same time some sectors of Brazilian society were becoming worse off in absolute terms (see also Hirschman 1981:23). In regard to the import substitution policies, there were few examples that the domestic industries, after years of protection, were able to grow out of their “infancy” and begin to reduce the country’s balance of payment problem (i.e., reducing imports) -- in Indonesia, for instance, the domestic car industry was a perfect example of this failure. In regard to the general indicators of aggregate growth, the signs of failure were even more convincing: India, for instance, for more than two decades grew (GDP per capita) at a rate below 0.3 percent; while the figure for Taiwan for the same period was close to 4 percent (for a complete account on this record see The World Bank, \textit{The East Asian Miracle}, 1993).

\textsuperscript{12} In understanding the emergence of this liberal idea in the Kuhnian framework a small modification is required. Kuhn’s explanation (Kuhn 1970) is directed at the process of change in natural (hard) sciences. Here the alternative theory is “new” in the sense that Einstein relativity theory is not a continuation of the old theories, i.e., Newtonian and Aristotelian physics. In social science, the case is different. There is no “new” theory in the same status acquired by Einstein’s relativity theory. New theories in social science are in some ways a continuation or reinterpretation of the old ones. Therefore, the liberal economic theory which emerged as the alternative theory superseding dirigism as the “normal science” was not “new”. It was a reinter-

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it, amounted to a counter-revolution in development thinking.

Among the actors in policy interactions in the developing countries it was the technocrats who were most receptive to this movement of ideas, for the chief reason that their power resided in their knowledge about development theories and their technical expertise in turning these theories into policies. This explains why the leading actors in the process of economic liberalization in these countries in the 1980s and 1990s were mostly members of this group: Carlos Salinas de Gortari in Mexico, Fernando H. Cardoso in Brazil, Alejandro Foxley in Chile, Widjojo Nitisastro, Ali Wardhana, Radius Prawiro and Sumarlin in Indonesia, Manmohan Singh in India, Turgut Ozal in Turkey. They were, in short, the carriers of the new ideas upon whose shoulders lay the primary responsibility for its actualization into policy.

1.4 Ideas and Institution: Indonesian Liberal Epistemic Community

The emergence of a new idea and the availability of its carriers, however, cannot fully explain the idea's actualization into policy. The actors or the carriers of the idea act under a certain setting which structures and regulates their actions in pretation of classical economics in a new language and condition (hence the popular name, neoclassical economics).
the policy arena. To put it in a different way, the setting places constraints and opportunities which influence how far the actors can realize their ideas. It is at this point, therefore, that the important role of institutions should be appreciated.

Institutions can be defined as established organizations (concrete institutions) and the rules, i.e., regimes, which, as Sikkink (1991:23) puts it, "govern how ... organizations function internally and relate to one another and to society". As such, institutions are the setting which can be seen as the infrastructure of ideas, the intermediate variables which play a large role in the latter's realization. Peter Hall's study comparing how market reform unfolded in Britain (under Thatcher) and France (under Mitterand), for instance, found that organizations such as the central bank and the rules of interactions among actors and organizations were the crucial variables in explaining the differences in policy outcomes between the two countries (Hall 1986b).

For Hall, Mrs. Thatcher's market reform went further than Mitterand's, not only because the former was much more deeply convinced of the superiority of (classical) liberal ideas, but also because, among others, Britain's political institutions, i.e., the adversarial two-party competition and economic regime, i.e., the relative autonomy of the central bank, provided better
conditions and opportunities for such reform to be undertaken.

This institutional perspective therefore tells us that the impact of liberal economic ideas in influencing policy direction is mediated through certain institutional variables. In my study, the most important institutional variable is the growing network of individuals who now constitute a liberal epistemic community. This network overreaches the division of state and society as well as the division among classes. Members of this network can be found in various government offices, working primarily as professional economists, or in universities, especially in departments of economics and social sciences, in the major mass media, working as columnists as well as political or economic editors, and in centers of policy research.

Their relations to each other are both formal and informal; what bonds them together is "their shared belief or faith in the verity and the applicability of particular forms of knowledge or specific truths" (Haas, 1992). Like scientific communities, this network is based on knowledge. Unlike most scientists, however, members of this network actively involve themselves in public forums and public offices pursuing the actualization of their shared idea. In this latter sense, participants of this network can also be called, to borrow Paul Krugman’s (1994) formulation, policy entrepreneurs.
It is inside this network that the idea of a more liberal approach to development, as the new normal science, is discussed and circulated. More importantly, through this network, liberal ideas, which are universal in essence, are reinterpreted and reformulated to fit the domestic context, and hence to enlarge their potential constituency. For the technocrats working inside various government policy making offices, the existence and growth of this network provides more opportunities to actualize the new idea by reorienting policy direction. Not only do the technocrats have a suitable place to discuss and to formulate the new policies, but also a "partisan" institution whose competent and articulate members are actively engaging in public discussions to build more support for their policies, outside and inside the government.

1.5 The Case of Indonesia: Various Explanations

With its long and persistent history of dirigist policy, it is interesting to study why and how Indonesia, from 1985 until its peak in 1989, shifted its economic direction toward pro-market policies. In the context of Indonesia's economy and in-

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13 Before 1985-1989, as I will explain in Chapter 2, there was a previous major shift of policy, from dirigism to a more market-oriented policy. This occurred in the very early years of the New Order, when Widjojo and his friends helped Suharto to fight the legacy of the Sukarno era. The Malari affair in 1974 ended this liberalizing trend. In a way, therefore, the liberalization
tellectual tradition, steps of liberalization, however gradual, are signs of fresh air, which brings news that something new and profound has truly been happening.

Despite its weaknesses, Indonesia’s liberalization process has produced many positive results. In the period just before liberalization (1980-1983), for instance, manufacturing industry grew only by 3.6 percent; in 1983-1990 the number jumped to 12 percent. In 1986-1990 non-oil exports rose dramatically by 22.1 percent.¹⁴

All of these achievements have changed the basic structure of Indonesia’s economy, from a highly oil-dependent to a more diversified, outward oriented economy, much like that of other Asian little dragons. True, in 1997 and 1998, there was a financial tsunami in Indonesia, and in some other Asian countries, especially in Thailand and South Korea, which caused a major setback and let to a series of painful after-effects, including the downfall of the Suharto government. But the gains were not all lost and the positive impact of the deregulation process in the 1980s and early 1990s, such as the expanding export capability, have not been totally eliminated.

movement in the 1980s can be understood as an effort to regain the modernizing spirit of the New Order government and to apply it in a more consistent way.

¹⁴ These numbers are from Iwan J. Azis’ interesting chapter in Williamson (1994:389-390).
Why and how did Indonesia’s liberalization process unfold? Why the policy shift? How should we understand the politics of Indonesia’s policy making? These questions have been dealt with seriously by many scholars and journalists, including some of the technocrats and economists who are partly responsible for the launching of the new policy. I would like to describe some of their explanations to show that the approach I am using in my study is needed to fill the gap in the literature as well as to enrich our understanding of the major economic changes that have occurred in Indonesia.

One of the first books about economic liberalization in Indonesia is Richard Robison’s *Rise of Capital* (1986). Robison uses a structurally deterministic argument, founded on a mixture of class analysis and state autonomy theory. He explains that the history of Indonesia is a history of the unfolding of capitalism, from one stage to another, with the state playing a crucial role. When the country gained its independence, the bourgeoisie was weak and fragmented. This enabled the state to gain its autonomy, and on this basis, develop capitalism. Dirigist policies in the 1950s and 1960s, and again in the late 1970s were undertaken by the state precisely for this purpose. However, after a certain period, the domestic bourgeoisie would become stronger and more independent. And for Robison, it was in
the early 1980s that this new feature of the domestic bourgeoisie begin to emerge.

The interest of the new bourgeoisie is to preserve the dirigist policy. Protection against international competition is beneficial for them. This interest goes against the interest of international capitalism, whose role is becoming greater in pressuring the state to behave following the logic of capitalism, i.e., by adopting liberal policies. Hence, for Robison, the contradiction: on the one hand, Suharto's government needs to accommodate the interest of the new bourgeoisie; on the other, because of its demand for foreign borrowings, the government also needs to follow the demand of the World Bank and other liberal world financial institutions.

Robison does not provide a clear answer as to why the liberalization policy in the end carries the day. Yet, from his conceptual framework, it should follow that the policy shift in the second half of the 1980s reflected the triumph of international capital against the domestic bourgeoisie. The international pressures were too great for both the state and the domestic bourgeoisie to resist. Understood in this way, Robison's explanation (although he is far from developing this point fully) can therefore be also seen as another argument for the primacy of international-structural factors in determining the
direction of Indonesia’s economic policy.

Jeffrey Winters (1996) also takes more or less the same perspective in explaining the dynamics of policy change in Indonesia. In fact, he is more explicit than Robison in describing how the “structural power of capital controllers” in deploying “scarce investment resources” is behind the twists and turns of New Order economic policy, including the policy shift from dirigism to liberalism in the mid 1980s. Although the proofs upon which he rests his arguments are far from convincing, Winters’ intentions are clear: he wants to show his readers how the dynamics of economic policy making in one country cannot be seen in isolation from the international context where global capitalism reigns supreme.

A different approach is taken by William Liddle (1996). Liddle is to some extent influenced by methodological individualism, and is therefore completely the opposite of Robison and Winters. Liddle does not see the use of employing such overly macro variables as “state” and “bourgeoisie” in understanding Indonesian politics and policy interactions. For him state and relevant political and economic forces should be disaggregated, without an a priori conception of the interests of each. By doing so Liddle wants to capture a more dynamic process of policy making under the Suharto government.
In explaining Indonesia's policy process, Liddle emphasizes the important role of Suharto as a shrewd politician who uses any resources available to him to enhance his own power and to meet the goals that he thinks good for his country. Suharto enjoys a relatively autonomous position because of his success in orchestrating the instruments of power -- coercion, persuasion, exchange, and organization -- for the double aims of controlling the society and maintaining support from his core constituencies.

With this relative autonomy, Suharto leads the process of his country's economic development. His assistants, ministers, and technocrats may propose this or that policy, but in the end, it is Suharto alone who is responsible for the choice of the policy. Therefore, any analysis of Indonesia's policy direction, such as the shift from protectionism to open door policy, should start from the understanding of the constraints and opportunities faced by Suharto in managing his power.

MacIntyre (1990; 1992) shares Liddle's purpose to capture more of the dynamics in Indonesia's policy making. For him, authoritarian government is not monolithic. Moreover, government agencies are not the only parties who decide policy. After two decades of successful capitalist development, there is an emerging business class, whose power is getting stronger. These busi-
nesses have organized themselves in various pressure groups to advance their interests. For MacIntyre (1992:150), although the government is still the stronger party in the policy process, the power of these new groups can no longer be ignored. To put it another way, "[the] state's monopolization and insulation of the policy process is no longer so complete. Some sections of the business community are developing an effective capacity to project demands into the policy arena." This emergence of the new players, along with other factors such as the "externally induced" crisis of the 1980s and the changing attitudes toward the market are the reasons behind the policy reorientation.

MacIntyre explains the emergence of a potent, independent group of people in Indonesia's political landscape. Yet, while their existence is no longer deniable, the power of this new group to force the government to behave in a certain way is still highly debatable. MacIntyre's argument is based on some cases in some industries (textiles, insurance, pharmaceuticals) which are not the most important ones in Indonesia's economy. If his cases had been, say, the decisions about car or oil industries, or about policy direction in general, his conclusion would likely have been quite different. It does not mean of course that MacIntyre's conclusion is completely wrong. MacIntyre has successfully and interestingly explained to us how the
policy arena in Indonesia is now becoming larger, and will continue to be even more so with the growing power of the new forces.

My study is closer to Liddle and MacIntyre. Like them, I rely less on the so-called structural factors (i.e., the "logic" of capitalism, capital mobility, global capital, and the like) in explaining policy change. I put more emphasis on what Isaiah Berlin (1975:41-118) calls the freedom of human action. My study thus takes the role of actors and the importance of politics seriously.

What differentiates this study from Liddle’s and MacIntyre’s, however, is its focus: here the role of the intellectuals, writers, opinion makers, activists and economists is placed in a more important position as actors whose actions set the conditions or generate the pressures for policy shift. This focus is inspired by my theoretical approach to emphasize the important role of ideas as I have explained above. My aim is to enrich our understanding of the liberalization process in Indonesia by describing the impact of ideas and the role of a specific group of people that have rarely been taken into account in the literature.
1.6 Organization of Study

This study begins with an analysis of the New Order's economic policy prior to the deregulation era. The emphasis here is on the origin of the policy and how the university economists, also known as technocrats, the Widjojo group, or the Berkeley Mafia, shaped the direction of policy under the leadership of Suharto to cope with the problems caused by Sukarno's failure. Chapter 2 will also describe the intellectual counter-reactions against the technocrats, culminating in the Malari affair in January, 1974, which subsequently shifted the policy toward dirigism.

Chapter 3 deals with the economic crisis, precipitated by the declining oil price, in the early 1980s and the nature of the New Order government at that time. It was this crisis which provided the window of opportunity for the technocrats to mount their offensive against the dirigist status quo. This crisis also forced them to formulate and shape their own ideas which could be used as the basic formula to undergird their new programs, generally known as the deregulation or the liberalization programs.

Chapter 4 will show how, in the intellectual battle to convince the public and the political elite of the merits of the new programs, a very important role was played by the growing
liberal epistemic community. Here I will explain how they formulated their ideas and the intellectual network they used to spread their ideas.

Chapter 5 deals with the reach and limits of the deregulation movement. This chapter will first describe the major deregulation policies initiated by the technocrats when they were at their peak of influence. The limits and impact of their policies will then be examined.

Finally, in Chapter 6, I will explain the dynamics of policy after the deregulation movement had reached its peak. Here I will show how the anti-deregulation camp regained its intellectual strength and began to launch its attacks against the technocrats and their policies. I will also explain how Suharto’s politics in the early 1990s and the technocrats’ own weaknesses contributed to make the deregulation movement lose its momentum.
CHAPTER 2

HISTORICAL BACKGROUND:
THE NEW ORDER'S ECONOMIC POLICIES BEFORE 1986

In this chapter the New Order’s economic policy in its early years is broadly divided into two stages. The first occurred during the period of 1966-73. The most important policy initiatives in this period were guided both by the need to restore the working of the market and by the sense of urgency to rehabilitate the economy after the collapse precipitated by Sukarno’s "revolutionary economics." During this period new policy actors, the technocrats, gradually became the most decisive players, apart from Suharto himself, in the process of economic policy making.

The second stage took place from 1974 to the early 1980s, after the technocrats’ rehabilitation and liberalization policies were widely criticized by intellectuals and student activists culminating in the Malari (Malapetaka Januari, the January Disaster) affair. Here dirigist policies were the dominant steps in the pursuit of national development. To a large extent it was
the unintended consequences of this second stage which the technocrats, supported internationally by the World Bank and IMF and domestically by the rising liberal epistemic community outside the government, used as the pretext to launch liberalization programs in the mid-1980s (to be discussed in the next chapter).

With this background chapter, I want to show that before the period of my main concern (1986-1992) there had already been a policy zigzag, in which the liberal economic policies of the New Order in its early years were gradually replaced by the policies which enlarged the scope of state economic intervention. I also want to show that to a significant degree, the shift of policy from one orientation to another during the crucial period of 1973-74 was influenced by the critical role of ideas espoused by the intellectuals and the student activists in their rejection of the technocrats' economic programs.

2.1 The Opening Gambit:
The Technocrats and Their Liberal Policies

Viewed from a certain angle, the coming of the young economists, led by Professor Widjojo Nitisastro,¹ into the New

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¹ Widjojo Nitisastro was born in Malang in September 1927. He finished his undergraduate study in economics at the University of Indonesia (UI) in the early 1950s. After lecturing at UI for several years, he received a scholarship from the Ford Foundation to study economics at the University of California, Berkeley. In 1961, after he had completed his Ph.D. degree, he returned to UI and became dean of the department of economics. His major academic works
Order's policy arena since its earliest days was among the most important factors which influenced the process of Indonesia's economic development.

As policy actors, the economists were a new breed of intellectuals in Indonesia at that time. Indonesia was a republic founded by freedom fighters, intellectuals, journalists and political activists who strongly believed that the reason for the country's long subjugation under the colonial power was capitalism. Most of them were fiercely nationalistic, and the most articulate of them, like Sukarno, Sutan Sjahrir and Tan Malaka, were deeply influenced by the European leftist ideas of the 1920s and the 1930s. Even among those who were professionally educated in economics like Mohammad Hatta or the founder of the University of Indonesia's department of economics Professor Sumitro Djojohadikusumo, or who had long experience in the field of economic administration like Sjafrudin Prawiranegara, were

in the mid-1950s and early 1960s were mostly related to such topics as population, demographic trends and development.

2 The core economists in their early days, beside Widjojo himself, were Ali Wardhana, Emil Salim, Subroto, Mohammad Sadli and Sumarlin. All of them were professors in the University of Indonesia's department of economics. They were born between 1927 and 1933. Except Sadli, they all finished their undergraduate study in economics at the University of Indonesia and, like Widjojo, had their Ph.D. degrees from the University of California, Berkeley, sponsored by the Ford Foundation, in the early to mid 1960s. Sadli studied engineering at the University of Gadjah Mada, Yogyakarta, and went to Massachusetts Institute of Technology for a masters degree in economics; his professors there were, among others, Paul Samuelson and Robert Solow, both Nobel laureates in economics. His Ph.D. degree was from the University of Indonesia. He also received a scholarship from the Ford Foundation to spend a year in postgraduate
not excepted from such influence (see Rice 1983).

That is why in Indonesia's small elite circles there was always a strong propensity to rely on state economic intervention and to be highly suspicious of trade and of the working of the market in general. It would therefore not be far from the truth to say that, in relation to economic ideas, Indonesia's intellectual history up to the early 1960s was dominated by mixtures of nationalism and socialism, in various forms. It was for this reason that George McTurnan Kahin (1952:477) said that Indonesia after the revolution was remarkably homogenous in its outlook.

There are different arguments among the scholars as to why an anti-capitalism outlook was so prevalent in Indonesia at that time. Benjamin Higgins (1968:693) pointed to the impact of the Great Depression in the 1930s as one of its possible causes. The depression forced the Dutch colonial government to shift its economy "from a relatively free to a highly regulated economy." It was this highly regulated economic system that the leaders of the republic inherited from the Dutch. Hence the irony: these leaders rejected their colonial master but their economic ideas could only be implemented by continuing and expanding the regulatory framework inherited from the Dutch government.

study at Berkeley.
George McTumana Kahin (1952:50-54) gives a different argument. The anti-capitalism outlook of the Indonesian leaders, for him, was closely related to pre-independence nationalism. These leaders equated colonialism with capitalism and, hence, when they had to fight the former, they also had to find the reason why they rejected the latter. The outlook, in short, was a sort of intellectual weapon for them in their struggle to establish a new nation. Besides this, Kahin explains that some sociological factors were also important: when Indonesia gained its independence almost all capital was possessed by non-indigenous elements, which created a sense of urgency among the leaders of the young republic to use the state as the primary agency of development; three-fourths of educated Indonesians worked as government employees, “a type of employment unlikely to engender hostility to socialist ideas.”

While differing on the reason behind the prevalence of the post-independence outlook, both Higgins and Kahin agreed on its particular characteristics. Higgins (1968:678-705), an American economist who in the early years after independence assisted the Indonesian government in formulating its economic plans, describes this outlook nicely: “At the time of the transfer of sovereignty, anti-capitalistic views prevailed. Already there was general support for some kind of ‘guided economy.’ ... Capi-
talism as a form of economic organization which could be di-
rected toward the general welfare ... was an image that simply did
not appeal to Indonesian leaders." He goes further,

'Exploitation of man by man,' 'seeking the greatest possible
profit,' and 'free fight' were the sort of terms used to typify
the capitalist system. Moreover, the concept of 'liberalism' was
scarcely differentiated from this kind of capitalism, and was
mainly identified with a nineteenth-century 'freedom to exploit.'

By rejecting capitalism, Higgins explains, the leaders of
the young republic wanted to convert the colonial economy into a
national economy founded on the principle of cooperation. "All
parties pay lip service to the national goal of 'organizing the
economy along cooperative lines.'" But, Higgins continues, "this
goal lacked clear definition." Many of the leaders, however, be-
lieved that the cooperative society was the "middle way between
Communism and unbridled monopoly-capitalism."

For them the extension of the cooperative way to the national
economy meant quite simply organizing more and bigger coopera-
tives. They seemed to take it for granted that the European coop-
erative and Indonesian village communalism were the same thing in
spirit. The idea that a cooperative can be as ruthlessl
exploitative in intent as a corporation, if not more so, seems to
have occurred to few Indonesian leaders.

"Thus," Higgins concludes, "while there was no agreement
on concrete social goals [among the leaders], there was agree-
ment that Indonesia was not to be developed on 'capitalist
lines.' Rugged individualism, free competition, and private en-
terprise had few enthusiastic backers. They were associated in
the minds of most Indonesians with imperialism, colonialism, ma-
terialism, and a ruthlessly exploitative, ferociously competi-
tive, 'devil-take-the-hindmost' approach to social organiza-
tion."

The young economists were quite different. Widjojo, for
one, from his earliest years as a lecturer at the University of
Indonesia, had already argued for a reinterpretation of Article
38 of the Provisional Constitution. In his widely-publicized
debate in 1955 with Wilopo, the former prime minister from the
National Party, he explained that Article 38 was inadequate and
that private enterprises should be given a specific role beside
cooperaions and state-owned enterprises.

Widjojo also introduced something quite new to the under-
standing of economic development in general: for him the concern
for economic redistribution should not blind the country to the
need to raise the level of income per capita. "Redistribution of
income," he said, "unless accompanied by efforts directed toward
raising the level of per capita income, would almost certainly
act as a restraint on initiative and thus result in a general
decline in the rate of expansion of production" (Widjojo Ni-

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1 This article was exactly the same as Article 33 of the 1945 Constitution.
The two articles state that the Indonesian economy should be organized in a
joint endeavor based on the principle of family relationship and that the
state should control major economic sectors which were important to the well-
being of the people.
In short, while they still believed that the government had an important economic role to play, the economists were much more willing to enlarge the working of market mechanisms and to rely on private enterprises, domestic or international, to generate wealth and raise the country's overall level of development. Especially after they had finished their study at the University of California, Berkeley, they were convinced that a well-functioning economy would have to be based on market principles. They were prepared to let the government play a crucial role, as long as this role was directed at "creating the conditions in which institutions operate to stimulate the 'enlightened self-interest' of the actors" (Emil Salim 1997:55).

Of course, they were not immune from the influences of Indonesia's great heroes and framers of its intellectual traditions. Especially when they were young students at the University of Indonesia, they breathed the air of the day and absorbed the rhetoric of nationalism. But, through their study and further experiences, they changed and transformed themselves. On this point it is interesting to listen to one of them (Emil Salim) about how his study at Berkeley changed his view on the relation between the state and the market.

When he was very young, Salim said, he was a member of
Hatta’s discussion group, with other young students like Deliar Noer and Suhadi Mangkusuwondo. Hatta was his role model. He was also “very impressed by President Sukarno’s speeches criticizing capitalism.” Salim therefore naturally rejected capitalism and market mechanisms. He wanted to find Indonesia’s own economic system which would be founded on the principles of cooperation, not competition.

In 1959 he went to Berkeley to pursue a Ph.D. degree in economics (Widjojo and Ali Wardhana were already there). There he studied under several prominent economists, e.g., Liebenstein, Rosovsky and Papandreou. Moreover, besides attending classes he also, with Widjojo, Wardhana, and later Sumarlin and other Indonesian friends, conducted a Saturday Evening Discussion Group for the purpose of exchanging ideas about the Indonesian situation and about how Indonesia should be developed (the Berkeley Mafia was born out of these Saturday discussions!).

When he finished his study in 1964, Salim explained, his mind was set. No more Sukarno nor Hatta; although he understood that the market was not “value free,” he said that he “basically believe(d) in a market economy” (Emil Salim 1997).

So Widjojo and his friends, in short, were the type of new actors who came home with new ideas which, in the context of Indonesia’s intellectual tradition up to the early 1960s, were
quite radical, both in substance and in future implications.

They, too, were not passive academicians who studied the economic indicators behind their quiet chambers in the university. After their study at Berkeley they, especially Emil Salim, were actively involved in "university politics," along with other scholars and student activists in criticizing Sukarno's order. Here the most important among many of their public engagements was their involvement in helping the student activists to organize two national symposiums at the University of Indonesia in the most uncertain time in the era of political transition from Sukarno to Suharto. These two symposiums, one held by KAMI in January 1966 (Seminar Ekonomi KAMI) and the other in May by KAMI and KASI (Seminar Tracee Baru),4 gained very wide attention from the public and turned out to be among the most decisive intellectual battles against Sukarno's economic order.5

4 KAMI (Kesatuan Aksi Mahasiswa Indonesia, Indonesian Student Action Front) and KASI (Kesatuan Aksi Sarjana Indonesia, Indonesian University Graduates Action Front) were two of the most important youth organizations which spearheaded the struggle against Sukarno's government.

5 In Sukarno's political order, and also later in Suharto's, the role of symposiums, seminars, public discussions, especially the ones held by the major state universities, were always important in arousing political demand and in pursuing specific political agendas. Seminars were, in a sense, like party gatherings and mass rallies. The reason for this peculiarity, I think, lay in the fact that under Sukarno's government, and also under Suharto's after 1974, political parties and political organizations were repressed. So, because of this, there were no longer any autonomous channels by which political agendas and new demands could be aroused. Out of this vacuum came the universities. Although they were not totally free from political interference, the learning communities in the universities were relatively more autonomous and were willing to exercise their liberty, supported by the sacred formula of academic
In these symposiums, all members of Widjojo’s economic "group" participated, each speaking on a specific subject; Ali Wardhana and Sadli on monetary policy; Subroto on trade and so on. But the central thread and the big ideas were voiced by Widjojo. He criticized the conduct of economic policy during Sukarno’s years which, for him, was guided too much by political considerations, and rarely by economic rationality. He called for the government to respect more of the laws of economics and the relative autonomy of economic reality. Fighting inflation, he said, could not be done by political dictates or fiery rhetoric, but by understanding and controlling the forces of economic relations which lay behind it. Economic reality had its own "inner logic," and any government had to understand this if it wanted to play a constructive role in the country’s economic development.6

These public activities brought the economists closer to a sort of anti-Sukarno alliance; they became among the most respected critics of the old, and the most clear-headed conceptors of the need for a different policy for the coming new order.

freedom. Hence the universities became politically vital, and their seminars, especially during critical periods, became more like political gatherings and political rallies.

6 See the collections of papers of the two symposiums' The leader, the man and the Gun, published by KAMI and Department of Economics, the University of Indonesia, 1966 and Kebangkitan Semangat '66: Menjelajah Tracee Baru, (idem).
With their students and many other members of academia, they were part of the modernizing forces who demanded the ending of Sukarnoist practices and modernisasi dalam segala bidang (modernization in all fields).

It was through such activities outside the normal academic life that the economists built a close relationship with the army, through Seskoad (Army Staff and Command College), which would later prove decisive. In the early 1960s the army had gradually become one of the most powerful political centers under Sukarno. Because of this heightened position, several army leaders, most notably Colonel Suwarto, who was then the head of Seskoad, recognized that the performance and the knowledge of high ranking officers in civilian affairs ought to be improved. So in the early 1960s the army began to invite civilian leaders and university professors to regularly fill the Seskoad courses in Bandung. Among these invitees were Widjojo et al., most of whom had then just returned from Berkeley. Through these courses and lectures, Widjojo and his friends began to personally know more about the army's high ranking officers. One of the officers who attended their courses was Suharto, who was assigned to join Seskoad after he had completed his tour of duty as the commander.
of the Diponegoro Division in Semarang. 7

When the army, led by Suharto, eventually became the de facto ruler of the country after March 1966 out of the ruins of Sukarno's government, 8 the close relationship between the technocrats and the army officers paid off. When Sukarno's order was crumbling, the country was in a very critical economic situation. With GDP per capita around $300, Indonesia was then known, as Benjamin Higgins put it aptly, as a "chronic dropout." Inflation reached a dangerous triple-digit level during the period of 1962-1966, factories were operating at only around 20 percent of their capacity, the public sector was overstaffed by 30 to 40 percent, and government debts and deficits skyrocketed. Moreover, while rice production for five years had been stagnant, the number of population had increased by 10 million people. 9

So Suharto and the army faced a critical situation, and

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7 According to Hamish McDonald (1980), Suharto's assignment to Seskoad was actually a sort of punishment. When he was the commander in Semarang, he and his men (among others: Bob Hasan and Liem Sioe Liong, both of whom would later establish the biggest conglomerates in Indonesia), were involved in illegal trade and smuggling, a common practice at that time to help pay for the army's expenses. Upon knowing this activity, Nasution, then the army chief of staff, was quite disappointed, and thus released Suharto from his command.

8 The term "de facto" is used here because Suharto's formal power was sanctified by the MPR (Majelis Permusyawaratan Rakyat, People's Consultative Assembly) only in 1967, when he was appointed Acting President. Before that his power rested on an extra-constitutional mechanism granted by Supersemar, the controversial letter signed by Sukarno which ordered Suharto to restore the country's social and political stability.

9 The data are from Booth and McCawley (1981:28); Winters (1996:50-51); Woo (1994:28).
they had to choose an economic strategy to fight Sukarno's legacy and to rebuild the economy. Here the monumental event came when the army, again at Suwarto's initiative, organized the Second Army Seminar in August 1966. At this seminar, which was also attended by Suharto, Widjojo and his friends were put on the Subcommittee of Economic Affairs with the task of writing papers on the possible solutions to stabilize and rehabilitate the economy. Impressed, Suharto after the seminar called the economists for personal meetings and discussions to learn more about their ideas and their proposals -- and before long they were appointed by Suharto as his "expert advisers" (Bresnan 1993:62).

Thus the economists were now became the "technocrats," actors in the policy arena who would plan and execute policies guided not simply by the dictates of ideas but also by the availability of resources and the possibilities of political surroundings.

After this public appointment, Widjojo and his friends wasted little time to set the tone of their new economic policy.

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10 One of the economists who attended these discussions recalled the situation: "The whole purpose (of the meetings) was to give Suharto a concept and the beginning of a program. After all, he had just come from nothing...After Supersemar, Suharto had to have a program. There was really nothing else available, and the seminar was sponsored by the army, so he took it over 'skin and hair,' as the Dutch say -- the program and the people who proposed it" (Bresnan 1993:62).

11 A leftist American journalist, David Ransom, in 1970 called Widjojo and his group "the Berkeley Mafia." This term subsequently became very popular. It was
In their early days, because of their limited political resources, very often they had to convey their messages through the voices of political heavy-weights such as Sri Sultan Hamengkubuwono IX, who was one of the most highly respected public persons inside Suharto's new government. In one of his first major speeches, for instance, the Sultan announced that, apart from the reforms in the budget and in the banking sector, the development of the nation would be carried out with the help of domestic and foreign private capital. Foreign and domestic entrepreneurs were no longer seen as the Great Enemy and the extension of imperialism; instead, they were seen as necessary requirements for the country's development which therefore should be encouraged and expanded (Panglaykim and Arndt 1966). Later on the Sultan, before the forum of the American Men's Association in Jakarta, explained the new policy at length, reflecting on what the Widjojo group had had in mind when they criticized Su-

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very often used as an epithet in criticizing Widjojo and other economists.

12 Sri Sultan Hamengkubuwono IX was one of the triumvirate or the presidium (beside Suharto and Adam Malik) who symbolically held power during the transition period from Sukarno to the New Order. Subsequently, he became the chief minister of finance and economy (1966-67) and minister of the economy, finance and industry (1967-73), a position which Widjojo would later hold. In 1973-78 the Sultan became vice president. His influence came from his aristocratic pedigree and his long history of involvement at the center stage of the country's political development. In 1940, before the birth of the republic, he was crowned by the Dutch colonial government as the King of Ngayogyakarta Hadiningrat in Central Java. During the crucial years of the independence struggle against the Dutch, he made the decision to help the freedom fighters and to proclaim that his kingdom was part of the new republic. During the late 1940s and throughout the 1950s he held several important posts (defense minister and
...It is indeed the hope of the present Cabinet that private business should develop into greater bloom... since it is understood that a well developed private sector of the economy constitutes a great support for the country as a whole. ...In the case that the State wants to influence the course of economic development, it is of course free to do so, but it should do it in general through the proper handling of economic or market forces and not by replacing it with other non-economic means.

As for the popular psychological climate with regard to foreign capital I may honestly say that the time is gone that foreign capital is considered the spearhead of capitalism and imperialism. ...(C)apital, both foreign and national, is looked upon more as an economic element for development and no longer as a political weapon of capitalistic imperialists... (Sultan 1967)

With such ideas, it would therefore not be surprising that one of the first immediate actions of Suharto's government was to send a cable to the International Monetary Fund (IMF) and the World Bank carrying the message that Indonesia would like to resume its membership (Frans Seda 1992:129). Subsequently, the first IMF team arrived back in the country; and the next month, a mission from the World Bank followed suit. This immediate decision to resume the relationship with the two liberal, Bretton Woods institutions was taken not only because Suharto's economic team needed technical assistance in devising a workable plan, but also because, more importantly, the new government wanted to show its genuine intention to open itself up to the world's financial community. They realized that only by doing so could
they invite the much-needed foreign capital and could renegotiate the government’s $2.4 billion debt.

Following this immediate action, starting from the first week of September of the same year, several teams headed by the Sultan were dispatched to Tokyo and other capitals of major nations in Europe and the U.S. to attend meetings, conferences and seminars with the top officials as well as the business leaders of the world. Thus began a series of high financial diplomatic efforts by Indonesia’s new government.¹¹

From the meetings in Tokyo (September) and later in Paris (December) came a major breakthrough to set up a consortium representing such countries as the U.S., Japan, the Netherlands, France, West Germany, Britain, Australia and other Western countries for the sole purpose of assisting Indonesia’s economic development by providing funds on a yearly basis with low interest rates. The consortium was called the Intergovernmental Group On Indonesia (IGGI). In its first year IGGI agreed to lend $167.3 million; and in its second and third years $361.2 million and

¹¹ To reflect the seriousness of these missions, the Indonesian teams often went with a full array of top ranking economic officers, including several ambassadors. In Geneva in November 1997 for instance, as Jeffrey Winters describes (1996:58-76), twenty such persons attended a conference; from the Sultan himself, to Adam Malik, Sadli, Emil Salim, Rachmat Saleh, H.A. Pandelaki, Selo Sumardjan, plus two ambassadors and their staffs. Their interlocutors were no less important, representing giant companies such as Siemens, Nippon Electric, Chase Manhattan Bank, Fuji Bank, Shell Oil, Standard Oil, U.S. Steel, Nestle, St. Regis Paper, H.J. Heinz Co., and more.
$507.7 million respectively.\textsuperscript{14} Besides disbursing new aid, during the meetings in Tokyo and Paris the creditor nations also agreed to reschedule Indonesia's debts. For more than 20 years afterward IGGI played a very important role as a medium through which Indonesia obtained coordinated official funds with rates well below those of the market to help pay for its expanding developmental programs and to strengthen its balance of payments.

Especially before the oil boom in the early 1970s, the creation of IGGI was for the new economic team a big boost -- in 1967, for instance, foreign aid accounted for 30 percent of government expenditure -- which created a larger breathing space for them to take politically more difficult initiatives in rehabilitating the economy.

In the domestic arena, the crowning moment of the technocrats' effort came with the birth of Peraturan 3 Oktober (Regulation of October 3), which, in the words of the economist Bruce Glassburner (1993:64), a frequent policy consultant of Suharto's economic team, "reflected a change in the whole way of thinking about the government's role in the economy." This measure eliminated a large segment of the pervasive export-import licensing system. It also, perhaps more significantly, attacked the com-

\textsuperscript{14} Outside the framework of IGGI, in 1967 Suharto's government managed also to secure emergency loans from the US ($8.2 million) and Japan ($30 million) (see Bresnan 1993:70; Woo 1994:46-47).
plex system of multiple exchange rate control.

Under the previous system, the market for foreign exchange was divided into two separate entities, the "BE market" (Bonus Ekspor, Export Bonus) and the "DP market" (Devisa Pelengkap, Complementary Foreign Exchange). Through the mechanism of check-price/overprice in the latter market, the government exercised control by determining the amount of foreign currency earnings which could be retained by an exporter and the amount needed to be surrendered to the state. This system discouraged exports, created a black market and bred chronic corruption. The latter was a direct outcome of the fact that the exchange rate could be easily set up higher or lower depending on the preferences of the state officers as well as the bureaucratic connections of the exporters.

The October measure simplified this system by significantly reducing the range of items which fell under the DP exchange, thus broadening the scope of the BE exchange, which worked basically by following the free market mechanism. Gradually, the system was moved in the direction of unification of exchange rates. The unification eventually materialized four years later, in April 1970, with the rate of Rp387 per one dol-

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15 For a full explanation of the problems of this multiple exchange system, see Glassburner (1971:396-422).
lar. With this, one of the most vexing obstacles to the country's international trade was dismantled.\(^\text{16}\)

In the field of foreign investment, the spirit of Peraturan 3 Oktober was carried through and finally formalized by a new foreign investment law (PMA\(^{17}\) Law No. 1/1967). The major features of the new law were: a guarantee that there would be no nationalization of foreign assets, but if it did happen, appropriate compensation; the duration of operation for foreign companies was guaranteed for 30 years, which could be further extended; exemptions from import duties; tax holidays for a certain period of time; a guarantee that foreign companies were able to choose their own management and technical workers and that they could repatriate the profits or capital at their own discretion.

In the context of Indonesian economic history this new law was remarkably liberal, an almost total reversal of the old investment regime which only three years earlier had enabled the government to expropriate foreign capital. True, as we shall see

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\(^{16}\) According to Glassburner (1971:411), the program to liberalize the foreign exchange market in 1966-1967 was a high achievement. Listen to what he says: "The Indonesian economists and the Indonesian government deserve highest remarks for having moved so far so fast toward liberalization and rationalization of their foreign exchange pricing system. It would indeed be difficult to find another example of a major nation which has shown such purposefulness and intelligence in this area."

\(^{17}\) PMA is the shorthand for Penanaman Modal Asing, foreign investment.
in the next section, the law was later slightly revised. Especially when the shift in policy occurred after the Malari affair, it became the first victim of the rising protectionist pressures. It is also true that even after the creation of this new law many of the problems which were faced by foreign investors in Indonesia were not gone. Approval time for entry, for instance, took around six to nine months, while many other investment-related laws such as the labor law, tax regulations, and land titles remained highly uncertain (Hill 1988:30).

Still, despite those problems, for at least five years the PMA Law No. 1/1967 became the framework of the government's open door policy which was able to facilitate the increasing flow of foreign investments into Indonesia. In 1968 the total value of real FDI (foreign direct investment) was only $3 million; but in 1970 it was $130 million, and in 1972 $302 million (Hill 1988:35). In terms of the number of foreign investment projects approved, outside the oil, banking, and insurance sectors, in 1967 there were only 13 projects; but in 1970 and 1971 there were 84 and 63 projects respectively (Anoraga 1995:71).¹⁸

¹⁸ It is interesting to note that in the early years of the New Order the attitude of the policy makers in trying attract foreign investment was that of "desperation." This, for instance, was reflected in the words of Sadli, who was a member of the technocrats, and who was also the Chairman of the Technical Team for Capital Investment in 1967-1973. He said: "When we started out attracting foreign investment in 1967 everything and everyone was welcome. We did not dare to refuse; we did not even dare to ask for bonafidity of creden-
Besides the new foreign investment law, a year later a new law regulating domestic investment was also enacted. This was called PMDN (Penanaman Modal Dalam Negeri, Domestic Investment) Law No. 6/1968. Unlike the PMA law, this law contained more protectionist elements which can be seen, for instance, in its insistence that Indonesian companies should at least control 51 percent of the shares in any domestic investments, and that share percentage should be increased to 75 percent by January of 1971. It also strictly limited the sectors (e.g., mining, banking, forestry) which could be reached by non-domestic companies. After the Malari affair, this limitation was progressively expanded.

Apart from this, the PMDN Law, in order to attract more domestic investment, also contained some investment-friendly arrangements such as tax exemptions, tax holidays and import duty concessions to domestic companies which were able to satisfy specific capital and business requirements (Muhaimin 1990:61-61). Like the PMA Law, the domestic law seemed also to be successful in encouraging more companies to invest their capital in the country’s economy. In 1968 the amount of approved domestic

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...tials. We needed a list of names and dollar figures of intended investments, to give credence to our drive. The first mining company (which invested in the country) virtually wrote its own ticket...” (quoted in Palmer 1978:100).

19 Of course, by saying this I do not mean to imply that the increase in do-
investment was $13 million; but in 1970 it was $319 million, and in 1973 it jumped to $1,465 million (Hill 1988:36).

In relation to fiscal, monetary and banking affairs, the technocrats' major initiatives came with the legislation to re-organize the banking sector, with the steps to tighten the money supply, to balance the budget and to put the distribution of credits under stricter control. As mentioned earlier, Suharto's government inherited triple digit inflation. This problem was directly related to the fact that for Sukarno and his regime, banks, including BI (Bank Indonesia, the central bank), were the government's payment agencies; they were but another instrument of the government in enhancing its "revolutionary" aims, like building national monuments, a great mosque, the Sarinah department store, funding the war with Malaysia and disbursing credits to favorable entrepreneurs. The central bank, in the conception of its chairman, Jusuf Muda Dalam, was a bank berjuang, a fighting bank. No wonder that when the government's revolutionary appetite grew bigger, so did the money supply.20 "To the central
government," H.W. Arndt notes, "...the ever-growing volume of money needed to finance expenditure at rising prices presented no great problem. The only limit was the capacity of the printing press at Kebayoran, the Jakarta suburb" (in Glassburner 1971:374).

So in rehabilitating the banking sector and controlling the money supply Suharto's government took several related steps. The most important of these -- apart from the balanced budget legislation in 1966 and the drastic reduction in expenditures related to the expensive, showcase projects inherited from Sukarno -- was the step to partially increase the autonomy of the central bank vis a vis the government. Furthermore, the government also dismantled Bank Negara Indonesia, the so-called "monster institution" by carving it up into six different banks with a specified function for each. In this new scheme the central bank was to become a pure central bank without commercial banking activities; foreign banks were to be allowed to open their branches in the nation's capital; and state banks were to be compelled to treat state enterprises and private corporations on equal footing in the competition of credit.

and Rp1418.5 million in 1964 and 1965 respectively (Arndt, in Glassburner 1971:368).

21 This institution was created in May 1965. It was an amalgam of all the existing state banks into a single bank. This unification enhanced the power of
Related to this institutional move was the step to radically increase the bank’s monthly loan rate, from 4 to 6 percent. This step was accompanied by a new ruling that the banks would not ask any questions about the sources of their customer’s money (Nasution 1983:5). When the rate of inflation came under control in the late 1960s, the loan rate was reduced to about 3 percent, but the flow of savings into state banks did not slow down, which underlined the fact that, as Ingrid Palmer (1978:53) says, the basic confidence in the monetary authority and in the banking sector had been restored.

2.2 Intellectual Countervailing Forces: The Road to Malari

In March 1973, when Suharto was reelected for a second term, there was a rising hope in some quarters that a bolder move toward economic liberalization was about to be taken, something like Liberalization Part II, which would touch the hitherto untouchable economic areas. This hope was not totally unfounded because Suharto, in forming his second cabinet, had elevated the technocrats into a formal and powerful status in seven key cabinet positions related to economic affairs.²²

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²² Widjojo was given the position of minister of economy, finance and industry and at the same time Chairman of Bappenas; Sadli minister of mining; Emil Sa-
These new positions signaled a political triumph for the technocrats. Several years before, their formal positions were hidden behind the institution of ASPRI (Asisten Pribadi, private assistants to the president). Even when some of them held formal cabinet positions they mostly worked through highly respected figures such as the Sultan and influential military officers. That was one of the reasons why, although they had been playing a major role in forming the new economic policies since the early days of the New Order, the technocrats were until then regarded by Indonesia's political public mostly as orang universitas (university people) and not orang pemerintah (government people). Now, seven of them became ministers, a position which was supposed to grant them more leverage and power to persuade the general public and to command policy for the realization of their ideas and agendas.

As we have seen in the section above, from the very early days of Suharto's New Order to late 1972 the direction of economic policy was quite clear, with stunning outcomes in terms of GDP growth, inflation rates as well as savings and investment increases. The economy was stabilized and liberalized at the

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Lim minister of transportation; Subroto minister of labor, transmigration and cooperation; Ali Wardhana minister of finance; Sumarlin minister of state bureaucracy. So with these appointments, the technocrats gained three new cabinet positions.
same time to a degree which was quite unimaginable a decade before when President Sukarno was leading the country deeper into his romantic, nationalist "revolution."

True, the policy direction during those early liberalization years was not without setbacks and ambiguities. Moreover, even after seven years of liberal experiments, the Indonesian economic reality was still overburdened by its dirigist legacy. The state enterprises were still the dominant players which monopolized most of the major economic sectors, a role which was legitimated by the 1945 Constitution. Financial business was practically dominated by the state banks. Industrial licenses and regulations were widespread. In short, in the early 1970s, the Indonesian economy was not liberal. Compared to Hongkong at that time for instance, there was still a very long journey for Indonesia to take before its domestic market would be able to function properly without too many distortions, regulations and state interventions.

Having said that, however, if we are looking at the major trends of policy and the shifts in the patterns of economic in-

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21 For this account, see Tempo, December 1, 1973:5-6.

24 The clearest example of this perhaps can be seen in the fact that soon after the creation of the liberal investment law in 1967 (the new PMA Law), the technocrats had to give in to the demand of the protectionists inside the government by approving tariff increases for 1,292 trade items. Because of these increases, the unweighted average tariff in 1968 rose, from 58 to 65 percent (Woo 1994:49).
teractions, there is no doubt that during the period of 1966-1972 the country was moving toward a greater pro-market economy. Observers might differ about the magnitude and the reach of the movement, but not about the fact that the movement had occurred.

It was this movement which the technocrats were expected to continue further. With their new positions they were technically more in control of the process of policy making. They presided over a huge state apparatus which was the foremost agency in policy implementation. Moreover, their new positions also symbolized that Suharto, who by then had gradually become more successful in marshaling political power in his own hands, had fully trusted the technocrats and had therefore decided that the prior policy direction was to be continued.

But events turned out differently. Precisely when the technocrats had their biggest political triumph, criticism and hostility against their role, their ideas of development and the policy of liberalization began to escalate to a degree never seen before. Before, when they were still regarded as orang universitas, outside actors whose chief job it was to give professional advice to the president, the students and the intellectuals regarded them as their heroes, their "representatives" inside Suharto's New Order. In such a status, they were therefore usually spared from hostile criticism if the intellectuals and
the students launched their protests and disagreements against the government.

In fact, those protests in a way enhanced the technocrats' position inside the government. If, for instance, the students criticized Sujono Humardhani, a prominent Suharto adviser with extensive Japanese business connections, or the creation of Taman Mini Indonesia Indah (Beautiful Indonesia In Miniature Park), a project which was then considered as a grandiose one too expensive for the country to pay, the technocrats would quietly give their approval to the students. The protests benefited them because, in their eyes, one or two more obstacles in realizing their ideas were being attacked by the public.²⁵

Now, they (the technocrats) were the government themselves, and as such they became an open target of criticism from many different quarters. And indeed, as the year wore on, it was increasingly clear that they and their strategy of development

²⁵ Tempo, the leading Jakarta weekly, captures nicely the nature of the relationship between the technocrats on the one hand and the intellectuals and the students on the other when the former were still regarded as orang kita (our people): "...in the past the students and the intellectuals thought that Widjojo and his friends were honest men who worked hard without self-interest, to whom they (the students and the intellectuals) should give their sympathy as well as their support. ...the mistakes in the implementation of development policies... the inflows of foreign capital which were detrimental to development strategy, which have resulted in the death of domestic capital...-- all of these were regarded as the work of political factions inside the government. ...That was why in the past the critiques launched by the students, the young activists and the intellectuals were directed at those political factions and not at Widjojo and his friends or their development strategy" (Tempo, op.cit:5-6)
became one of the chief targets of protests from the students and the intellectuals, which culminated in street protests and big riots in January 15, 1974 (which would later be called Malari affair).

Behind this transforming event, which substantially changed the direction of the New Order's economic policy, there were at least four major intellectual figures, a Gang of Four, whose ideas and opinions were the most articulate and very influential in criticizing the technocrats' policy and model of development during the period 1972-1973: Mohammad Hatta, Sarbini Sumawinata, Soedjatmoko and Mochtar Lubis. They were all highly-respected public men who often wrote in major newspapers and magazines and who had played important roles in Indonesian history. Although their ideas were different (in emphasis, focus, scope and nuances), the four nevertheless shared a common intellectual root, i.e., democratic socialism combined with an intense sense of nationalism.26

26 I am tempted to include Prof. Sumitro Djojohadikusumo also in this group, for he was the one, according to Derek Davies of the Far Eastern Economic Review, who sparked the early debate in March 1972 about the need to increase the economic role of prihumi (indigenous, as opposed to Sino-Indonesian entrepreneurs), indirectly criticizing the policies of Widjojo (FEER, June 17, 1972:22-24). Sumitro was then the minister of trade; and he, as Davies writes, "has deliberately not identified himself with the 'inner circle' of technocrats but who continues to play his brilliant role of intellectual and maverick within the power structure." Students of Indonesian economic history will understand that when Sumitro voiced the need of lifting up the role of the indigenous entrepreneurs, he merely restated his dirigistic industrial policy once again, the failed policy which he initiated in the 1950s. Like Hatta, Lu-
Hatta, in particular, was considered by the general public as the moral beacon of the country, a former vice president and an uncorrupted man who stood tall above petty, sectarian interests, a hero whose role in Indonesian history was surpassed only by Sukarno. Hatta’s thoughts were founded on his unrelenting belief in the moral as well as practical necessity of cooperation and planning in economic development. Like most founding fathers in the Third World, his firm conviction about the superiority of planning vis a vis voluntary actions in the market carried him as far as praising the Soviet Union as an example of a great developmental success.

Mohammad Hatta was one of the two proclaimers of the Republic of Indonesia (the other one was Sukarno). Since he was a student at the University of Rotterdam in the late 1920s, he had been actively involved in the struggle for independence. He was one of the most important young leaders among the freedom fighters. After the birth of the republic he became prime minister and vice president. In the late 1950s he strongly criticized Sukarno’s move to establish his dictatorial power in the guise of Demokrasi Terpimpin (Guided Democracy). In the early days of the Republic, with the same ideas, Hatta helped the writing of the famous Article 33 of the constitution which obligated the state to control major economic sectors, which also explicitly stated that cooperation was the economic foundation of the republic. Hatta’s ideas, to a great extent, were strongly influenced by his college education as a very young man in Western Europe in the second decade of this century, a period of history when socialist ideas of various kinds were spreading rapidly throughout the European intellectual community.

Hatta’s thoughts, along with those of other Indonesian influential thinkers
For him cooperation was the middle way which fundamentally opposed the logic of individualism and capitalism. He believed that cooperation, as a common economic undertaking, would create a collective society, rooted upon the genuine Indonesian way of life -- mutual help (gotong-royong) and consultation (musyawarah). The spread of "domestic" capitalism, if left unchecked, would only empower those who were already strong, i.e., the foreigners and the Sino-Indonesian entrepreneurs, and thus exacerbate the already wide gap of social and economic wealth. Cooperation (koperasi, the business unit founded on the spirit of mutual help) was for Hatta the only organizational basis for millions of Indonesians which could be used to check such a tendency of capitalism.

With such ideas, he attacked the technocrats and the consequences of their policies. In late March of 1973, right after the new appointment of the technocrats to lead seven key economic ministries, he warned the country about the danger of foreign investment and foreign capital. He said, he was not anti-foreign investment, but that it should be planned so that gradually the investment projects would be managed and controlled by the Indonesians themselves (Indonesia Raya, March 31, 1973:1).

and opinion makers in 1945-1965, are collected in Feith and Castles (1970). My description of Hatta's ideas here is based on this book.
Several months later he proclaimed that the process of the country's development had already contradicted the constitution. The technocrats, he said, "turned the politics of our economy ... into economic liberalism which primarily emphasizes the role of private businesses. The result, with the arms of modern technology, foreign capitalists invaded Indonesia and destroyed Indonesian companies..." Hatta also said that this misdirection of economic development had already created the widening of class differences in the society and had also disproportionately benefited the Sino-Indonesians, an ethnic minority which had been favored by the Dutch colonialists before (Indonesia Raya, January 5, 1973:1; December 1, 1974:1).

Soedjatmoko, Sarbini, and Mochtar Lubis shared Hatta's basic ideas and criticisms. Soedjatmoko, however, had a slightly different emphasis. Adapting Boeke's dualism, he, perhaps the

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29 Soedjatmoko, unlike Hatta and Sarbini, did not have any formal degrees (he was a medical school dropout), but his intellectual works earned him several doctor *honoris causa* degrees from prestigious universities, including one from Yale University (in the mid-1980s he became the president of the United Nations University in Tokyo). In 1947 he became the editor-in-chief of the democratic socialist weekly *Siasat*. From 1968 to 1971 he was the Indonesian ambassador in Washington and when he returned to Indonesia he worked as expert adviser to Bappenas (Badan Perencanaan Pembangunan Nasional, National Development Planning Board). Soedjatmoko participated actively in international forums and became one of the most respected speakers advancing the causes of Third World countries. He was a member of the Club of Rome. Soedjatmoko, like Sarbini and Mochtar Lubis, was a member of the PSI (Partai Sosialis Indonesia, Indonesian Socialist Party), "the party of the intellectuals" which was banned by Sukarno because of its alleged involvement in the separatist movements in the 1950s.
most reflective and widely-read of the four, thought that the economic reality of Indonesia was primarily divided into two separate sectors, the modern and the traditional sector. Although he was not anti-modernity, he believed that the country's economic vitality, security and hope lay in the latter, the sector which was non-capitalist and non-industrialist, which also employed the majority of Indonesians.

He warned that the technocrats' strategy of development, which seemed to him only a replica of the strategy pursued by western capitalist countries in their early process of development, endangered the balance of the two sectors. The strategy would eventually diminish the role of the traditional, without substantially strengthening the modern sector.

Soedjatmoko was therefore highly skeptical as to the roles of foreign investment and the multinational corporations (MNCs) which were becoming more important in the country. In his November 1973 speech at the University of Indonesia, he repeated his message that "the coming of foreign experts and foreign companies could increase the level and the pattern of elite consumption, a trend which deprived the country as a whole, which would thus harm the effort of development in its totality" (Indonesia Raya, November 17, 1973:2). On another occasion, he also warned about the side effect of integration into the global capitalist
Non-selective messages from TVs, radios, films, videocassettes, books and magazines to the developing world tend to create unwanted problems. The demand and the appetite of consumption which cannot be fulfilled, the posture and the style of life which do not have any connection whatsoever with the situation of the country -- and worse, (these problems) suppress and strangle the creativity of endogenous culture. Hence many countries in the developing world face the risk that their country will gradually diminish into the status of being merely the customer of foreign products and foreign cultures... (Soedjatmoko 1983:76).

So what is the solution? In a style characteristic of him, he proposed a national self-renewal to establish "a new civilization" with the aims of pursuing "not [the] perpetual growth and affluence but dignified development and equally shared material fulfillment" (Soedjatmoko 1983:77). For a practical solution, following E.F. Schumacher's ideas laid out in his Small Is Beautiful, he suggested that instead of using high-level technology brought forward by the MNCs and other foreign agencies, Indonesia should choose intermediate technologies. This, he reasoned, would provide more jobs and would empower the traditional sector to help and to renew itself. He called this effort for the country to find its own model of development using a particular form of technology as nasionalisme pembangunan, development nationalism (Tempo, December 1, 1973:8).  

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10 For an excellent example of how an influential newspaper adopted and respectfully treated his views, see Pedoman, Editorial, May 12, 1972:2. Pedoman's editor-in-chief was Rosihan Anwar, who, we should note, was a very close friend of Soedjatmoko.
Prof. Sarbini’s critiques, like Soedjatmoko’s, were directed at the whole strategy of development pursued by the technocrats. But unlike Soedjatmoko, he gave more practical and in a way more workable solutions, without such grandiose words as “self-renewal,” “new civilization,” or “dignified development.” Among the Gang of Four, he was the most fluent in the technicalities and in the vocabulary of economics. Sarbini was more to the point in demanding a more protectionist strategy to cure the problems as defined by both Hatta and Soedjatmoko. What was really needed for the country, he said in his influential article in August 1972, was among others a “clear industrialization policy consciously directed at domestic industrial growth based on domestic strengths and domestic goods…” (Sjahrir 1983:187).

If the domestic market was left open, he maintained, foreign goods would overflow the country and domestic industries would suffer the consequences. Moreover, “domestic industries which were controlled by foreign capital and expertise could not support a country’s industrialization. Genuine industrialization

Sarbini Sumawinata was a generation younger than Hatta. In 1951 he studied economics under the tutorship of Prof. Tinbergen in the Netherlands, and then went to Harvard for his masters degree. In 1955 he became the first Indonesian head of the Central Bureau of Statistics. In 1963 Sarbini, with Soedjatmoko, drafted a document outlining a development program for Sukarno’s government which became widely known as Dekon (Deklarasi Ekonomi, Economic Declaration). In the early days of the New Order, Sarbini vice-chaired the subcommittee of the political section in the Second Army Seminar in August 1966, an important seminar from which, as we have seen before, many of the basic programs of the new government were derived.

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...can only develop if it is supported by, and rooted in, domestic strengths" (Sjahrir 1983:188).

Sarbini, in short, proposed to strengthen and to enlarge the country's developmental dirigism along the lines of ISI strategy; a strategy which, for various reasons, was then very popular in the developing world. Compared to Hatta and Soedjatmoko, Sarbini's ideas were more systematic. He, in Lal's (1983) formulation, could perhaps be properly called a "development economist."

Mochtar Lubis, among the intellectuals in this critical group, was the most straightforward, writing with a simple rhetorical style whose points were often very sharp like naked swords. His writing style, as well as his position as the editor-in-chief of one of the most widely-read newspapers in the country (Indonesia Raya), made him perhaps the most effective critic relative to the other three. Unlike Soedjatmoko and Sarbini, he often directed his critique at wider areas such as corruption, political openness, bureaucratic malfunction, cultural

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32 For an explanation of the roots and the basic features of such ideas, see Meier (1984). For more explanation about Sarbini, see Liddle (1996:118-119).

33 Mochtar Lubis was the youngest among the four, but also the bravest and one of the most persistent critics of Sukarno's order as well as the New Order. Like Soedjatmoko, he did not have any formal degrees. He wrote many novels and op-ed articles. He was jailed by Sukarno, and after his release, his daily newspaper, Indonesia Raya, became one of the most widely-read and highly-regarded newspapers in the country.
permissiveness and so on.

To the technocrats, his criticisms, like Hatta’s, were based on his claims that they (the technocrats) had pulled the country too far along the capitalist road, which would eventually make Indonesian society a capitalist society, a form of society which, for him, was by nature serba tidak adil (wholly unjust). According to him, this chief mistake of the technocrats was caused by the narrowness of their experience; they knew something about economics, but close to nothing about social, political and cultural affairs (Indonesia Raya, November 20, 1973:1).

After seven years of liberal experiments, Lubis said, the country had suffered from many of their negative consequences:

What we can observe right now is the widening gap between rural and urban areas; the sharpening of social differences in the cities; the total lack of just and equitable income distribution (a few superrich people have emerged); ...the nonexistence of a bold policy which can support the development of pribumi economic forces; credit policies which have greatly helped a few, non-pribumi entrepreneurs...14

He was worried that if the technocrats’ economic policy was to be continued Indonesian society would become “like American society, where the competition and the struggle of life were

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so harsh that they destroyed the values of human beings." In
American society, he continued, "the people felt that they were
being torn apart, [and they lost] their identity as well as
their relationship with other members of the society, and they
thought they were being drowned ...swallowed up by the giant
public as well as private organizations" (Indonesia Raya, Decem-
ber 22, 1973:1).

Besides Mochtar Lubis, Hatta, Sarbini and Soedjatmoko,
there was a group of people who were also very critical of the
technocrats. They, however, unlike the Gang of Four, did not em-
ploy the "vocabulary of the left," in both analytical and rhe-
torical senses. This group was centered on CSIS (Center of
Strategic and International Studies), led by Ali Murtopo and
Sudjono Humardhani, army generals who were Suharto's closest po-
litical confidants. Through the Wanandi brothers and through
Murtopo and Humardhani, CSIS was closely linked to Golkar, the
New Order's "ruling party" which functioned, under Suharto's di-
rection, as an electoral machine to gain support during elec-
tions and as the appendix of the military and the state bureauc-
-racy in the parliament.

In this group there were two prominent economists (Jusuf
Panglaykim and Daud Joesoef) who thought that the technocrats' strategy was a wrong strategy if the country was to be brought forward into a fast-track, accelerated economic modernization. The ideas of Panglaykim and Joesoef rested on their rejection of the theory of comparative advantage, a theory, we should bear in mind, which is the conceptual backbone of any defense of the free-trade system. For both men, the world, thanks to the rapid innovations in technology and the expansion of knowledge, had become globalized. This new global world intensified competition among nations; the winners would be those who, even without natural resource endowments, could make concerted efforts both in pursuing the strategy of rapid technological transfer as well as increasing the level of technical education in their society.

In the global world, Panglaykim and Joesoef believed, it would be foolish for any government not to take the leading role in the economy. For Indonesia, they proposed the Japanese model (for them, Japan was the best case that proved the truth of their ideas). In short, the government should be the leader in

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35 Jusuf Panglaykim was born in 1922 and finished his undergraduate study in economics at UI in 1956. He studied at Harvard for a year (1957) and in 1967 he got his professorship in the department of economics at the University of Indonesia. Besides his academic and political activities (he helped establish the CSIS), Panglaykim also led several major business corporations. Daud Joesoef was born in 1926 and finished his undergraduate degree in economics at the University of Indonesia in 1959. He took his Ph.D. in economics at Universite de Paris in 1966 (in Suharto's third cabinet, 1978-83, Joesoef became the minister of culture and education).
what they called Indonesia Incorporated, i.e., "a pattern of close cooperation between the government, bureaucrats, technocrats and businessmen so as to facilitate the development of a powerful entity on a national scale..." (Joesoef 1974:41)\(^a\)

So, like the Gang of Four, the CSIS group also believed in the primacy of cooperation, planning and state dirigism, but of a different sort. This group did not spurn the increasing role of foreign capital and, in general, capitalism. What they had in mind was a model of state-led capitalism, or state corporatism, in which all business elements of the country were connected together, coordinated under the supervision of the government in order to win the competition on the global scale. They didn't reject the MNCs; instead, they wanted to unify and to transform many different elements of Indonesia into a super-MNC.

Interesting as they were, the ideas of the CSIS group in the period of 1972-1973 failed to resonate deeply with the general political public. Although some members of the CSIS group would later play an important role in formulating dirigistic industrial policy in the post-Malari period, in 1972 and 1973 their role in the public debate and in debunking the techno-

\(^a\) For Panglaykim's thoughts, see *Analisa Masalah-Masalah Internasional*, December 1973. For a brief explanation of Panglaykim and Joesoef's ideas, see Robison (1986:148-151).
crats' policies was peripheral.\textsuperscript{37}

Like Prof. Sumitro, the dean of Indonesian economists, CSIS thinkers worked mostly in the inner sanctum of power, trying to influence the direction of policy from within the government.\textsuperscript{38} Their critique against the technocrats was therefore regarded by the public not as a genuine alternative to the reigning economic policy, but merely as an expression of disagreement by one group of the elite against another. Moreover, unlike Hatta et al., this group didn’t have any effective and towering spokesperson, who, like Mochtar Lubis for instance, was able to communicate their messages in plain but sharp language which could easily arouse public attention and support, intellectually as well as emotionally. Both Panglaykim and Joesoef were “academic writers” who composed lengthy articles with long sentences and dry rhetoric which made them unattractive as messengers be-

\textsuperscript{37} For an example of how Panglaykim’s ideas were highly criticized by the intellectuals and the mass media, see the reports and articles in Indonesia Raya, May 25 and 26, 1972:1; Editorial, May 3, 1972; Editorial, May 6, 1972; May 9, 1972:4.

\textsuperscript{38} It is interesting to note that during this period Prof. Sumitro was quite closely related to the CSIS group. He was personally close to Panglaykim, and it was Ali Murtopo who eased his return to the country from his exile in Western Europe after Suharto took power. Another reason for this relationship lay in the fact that Sumitro, as we have seen earlier, was the former teacher of Widjojo and other technocrats when he was the dean at the University of Indonesia’s faculty of economics. A proud man, he could not bear himself being merely a member of Widjojo’s team (interview with Harry Tjan Silalahi, September 1996; for this account, see also Ann Gregory 1976:559-560). So, when he distanced himself from the orbit of Widjojo, he naturally went closer to the CSIS camp, which by then was emerging as one of the power centers inside the government, and which was willing to treat him with more respect.
It was the Gang of Four who carried the day. Their critique was widely disseminated through major newspapers and magazines, particularly *Indonesia Raya*, *Pedoman*, *Merdeka*, *Ekspress* and, to a lesser degree, *Kompas* and *Tempo*. Their voices were also amplified, with different emphases, scope and lines of argument, by other intellectuals and activists from the younger generation, such as Dorodjatun Kuntjoro-Jakti, Sjahrir, Kwik Kian Gie, Marsillam Simandjuntak, and Mar’ie Muhammad. Among the major publications, *Ekspress* was the one that articulated its critique against the technocrats in the bluntest and harshest tones possible. Listen to one of its reports:

> The situation of Bappenas and Widjojo et al. was like being in hot water -- nervous. By their students, their own pupils, they were no longer liked; by the press they have lost their face; by their leader (Suharto) and their allies inside the government their motives have been questioned. As for the people, the answer is: Widjojo steps out of line. (Widjojo) is no longer in line with the people's aspirations... (*Ekspress*, November 23, 1973).

It is also interesting to note here that in the battle of ideas in Indonesia's major publications, sometimes the works of several internationally-known writers were translated to support a particular "cause" or to sharpen the issue of the day. *Prisma*, for instance, translated the leftist-humanist Denis Goulet's paper which argued that the term and meaning of "development" should be rejected and the term "liberation" should instead be
used in its place (*Prisma*, June 1973). But the best example here was *Kompas*' series of translations of Mahbub ul Haq’s articles (June 25-27, 1973).

Mahbub ul Haq, a former economic planner in Pakistan, was then working as a senior economist at the World Bank in Washington. Although he worked for a “mainstream” and liberal economic institution, his thoughts were far from mainstream. In *Kompas*, he praised China’s “success” in development under Mao and at the same time criticized the roles of private enterprise and foreign capital in the Third World. He even went as far as to claim that true socialism was the only realistic alternative for genuine development in Third World countries; for him even a mixed economy wouldn’t do the trick of development for it would only combine the worst elements of capitalism and socialism.\(^{19}\)

At around the same time when the criticisms from the intellectuals against the technocrats and their development strategy intensified, student activism reemerged once again on many major campuses in Java, particularly in Jakarta, Bandung and Yogyakarta. Student activists formed discussion groups and held seminars as well as *rapat-rapat umum* (general meetings) which

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\(^{19}\) These articles, according to Rahman Tolleng -- who was one of the young politicians in the New Order’s early years and a former student leader -- were timely and very influential in the circles of intellectuals, students and activists alike (interview with Rahman Tolleng, May 1996).
often invited as honorary speakers or paper presenters the critical intellectuals (most of whom were their teachers or former teachers), journalists, or even military officers. The star speakers in these discussions and meetings were Hatta, Soedjatmoko, Sarbini and Lubis, among others. So it was through these campus discussion groups and general meetings that the critical ideas against the technocrats were carried further to directly meet their most active, devoted, and strategic supporters, i.e., the university students.

The students and the young activists were of course not passive recipients of ideas. They filtered and sharpened the issues further, and with their own style and methods of protest, they were looking for a more immediate and a more obvious target of criticism. Hence, toward the end of the year, besides directly and openly denouncing the technocrats, corruption, foreign capital and foreign aid in general, they also began to condemn Japanese capital and Japanese corporations in the country,

40 For a brief account of these flourishing student discussion groups at that time see Bresnan (1993:145-146).

41 Student activism has played a unique and a major role in Indonesian history. To some extent, the idea of "modern Indonesia" was conceived by student activists in the 1920s (Sukarno, Hatta, Sjahrir were three of their best representatives). Since then, in various forms, with different actors, they have been playing a role as the catalysts of change, for instance in being at the forefront in dismantling Sukarno's order. Because of all this, student activism acquires a kind of legitimacy as the moral force of the country, a legitimacy which is not enjoyed by the political parties or any other political pressure groups in Indonesia.
For some people it remains even today a puzzle as to why Japanese capital was singled out as the students' target, not American or West European capital, for the contribution of Japanese capital to the total amount of realized foreign investment from 1967 to the mid 1970s was in fact only around half of the contribution of U.S. capital. The answer, perhaps, lies in the fact that although Japanese capital was relatively small compared to that of the U.S. during that period, the forms of investment it took were much more visible. While the Americans drilled off-shore oil wells and mined gold in the jungles of Irian, the Japanese assembled automobiles and built luxury hotels in Jakarta. But whatever the cause, by having the Japanese as one of their chief targets, the students and the activists found a volatile issue, ready to explode, with ramifications far outside their ability to control.

The trigger which launched a new momentum for student protests in Jakarta came with the visit of Prime Minister Tanaka in January 12, 1974. Two days after the visit, the protests became "public" and spilled into the streets, with mass riots, burnings and killings. For two days Jakarta came to a halt. Almost 1000 vehicles (many of them Japanese-made) and 144 buildings were burnt or damaged, eleven people were killed, more than a hundred
injured, and 820 individuals were arrested (Bresnan 1993:137). This event came to be known as Malari (Malapetaka January, the January Disaster).

It was not very clear why peaceful student demonstrations quickly turned into violent street protests and mayhem. But while the cause of it is still to be determined, one thing was very clear: the two-day event itself was the biggest and the most massive political protest against Suharto's government since the day when it was established (the same type of event, for different reasons, occurred again 24 years later, forcing Suharto to relinquish his power).

2.3 The Revival of Dirigism

Several months before Malari, when criticisms against the technocrats mounted, Suharto tried to deflate the pressure by

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42 One of the speculative explanations given on this matter relates the student protests with the conflict in the military elite, between Ali Murtopo and General Sumitro (no relation to Prof. Sumitro). Murtopo, who was then the head of a special intelligence task force, Opsus (Operasi Khusus, Special Operations), for personal reasons had deeply distrusted Sumitro, who was the joint chief of staff and who was also around that time rising as a possible Suharto successor. Murtopo was worried that Sumitro would ride the wave of student protests to power. So he (Murtopo) infiltrated the students and provoked them to be violent, by sending his agents to burn one of the biggest malls in Jakarta, Pasar Senen. But this kind of explanation contains very little academic value, for nobody ever came up with sufficient facts to prove it.

43 It was reported by some insiders of his government that Suharto, when the riots occurred in 14-15 January, was quite badly shaken personally. When Suharto called some of his close confidants to learn about the evolving unrest, he complained, with misty eyes and shaken voice, that he was not properly served and that he didn't want to be president in the first place (inter-
giving some of what the critics demanded: imports of fully-built-up cars were banned; special credits for indigenous Indonesians or pribumi were announced; some restrictions on foreign investment were introduced (of these more later). So, the tendency of increasing dirigism had actually started several months before Malari. Still, Malari was the turning point not only because it was the climax of the protests but also because, after the outbreak, the dirigist tendency increased even further, both in its scope and depth.

It is true that there was no overnight radical policy movement toward dismantling the liberal legacy. And it is also true that the technocrats were able to keep their cabinet posts, which enabled the New Order government to maintain some elements of prudent macroeconomic practice. However, in terms of policy trends, it was clear that for about seven to eight years the direction of the economy went further away from the road taken by Widjojo and his team in 1966-1973. From Malari to about 1981 there was practically no major policy initiative which could be considered as liberal, while, as we will see shortly, there were many of them which enlarged the scope of state intervention in the name of Indonesianization, pribumization, pemerataan (eco-

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view with General Benny Murdani and Harry Tjan Silalahi, December 1996).
nomic equalization), infant-industry protection and the like."

Hence the paradox of Malari. Many of the intellectuals and the student leaders who criticized the technocrats were unjustly put into prison, and newspapers such as *Indonesia Raya* and *Pedoman* were banned forever. But at the same time the demands for a more restricted capitalism and for a more nationalistic policy were accommodated. Hatta, Sarbini, Soedjatmoko, Mochtar Lubis and other younger intellectuals were in a peculiar way able to convince Suharto and some of the key members in his government that to pursue the liberal policy further would impose great economic and political costs for him and for the country. The men were detained, but not their ideas.

So here we see how ideas generated by certain actors became, in Max Weber's formulation, the switchmen of history by pushing for a change in policy from one direction to another. The ideas of Hatta, Sarbini and other intellectuals captivated

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44 For Radius Prawiro, who was one of the most liberal economists in the Widjojo team and who held several key economic positions during Suharto's long tenure, the policy turn after Malari was very costly for the country. He said in 1996, "if not for Malari, our economy now would have been like the Malaysian economy, in terms of its GNP" (interview with Radius Prawiro, April 1996). Indonesia's GNP per capita in 1996 was around $1,000 while Malaysia's was $3,800. Radius might be wrong about the numbers. But what he implied from this was that for the technocrats like him the expansion of economic dirigism for almost a decade cost the economy several percentage points of its potential growth. If, say, annual economic growth had averaged 5 percent in the late 1970s and early 1980s, without Malari it would have been 6 percent or even 7.5 percent. Radius and other technocrats, in short, saw Malari as the monumental turning point which halted their effort to further liberalize the economy and to build a better foundation for the country to grow faster.
the political public and thus set the limits of what could and could not be done in regard to the policies pursued by Suharto's government.

Of course, for the policy direction to actually change, more than the influence of ideas was needed. To redirect "history," ideas cannot stand on themselves alone. So here we have to see another decisive variable which at about the same time, or even a year earlier, came onto the scene of the New Order policy making: the oil boom. Sparked by the political ramifications of the Arab-Israeli conflict in the late 1960s and early 1970s, major countries of OPEC (Organization of Petroleum Exporting Countries) embargoed the supply of oil to the US and Western Europe. The price of oil thus skyrocketed in the world market. From April 1973 to January 1974 alone, the price of crude oil rose by almost 400 percent, from $2.96 to about $10.80 per barrel (Palmer 1978:148). For Indonesia, as a major oil producer, this boom was a blessing from heaven, a manna which came precisely at the right time when it was most needed. As Arndt (1974:31) once said, "Indonesia in 1974 is like a man who has won first prize in a lottery. The opportunities are immense, almost unimaginable."

The clearest example which reflected the immediate impact of the oil boom in expanding the New Order's public programs can
perhaps be seen in the explosion of actual government expenditures during the period of 1974-1976. In 1972/73, planned development expenditure (non-routine) was Rp314.1 billion. In 1974/75 the same entry in the government budget increased twofold to Rp615.7 billion; but the actual expenditure for the same year was close to Rp1 trillion (McCawley and Manning 1976:26).

To put it concisely, the oil boom in effect enabled the New Order to be a lot more expansive and to fulfill the dreams envisaged by the "Malari intellectuals" for a more nationalistic, protectionist, and egalitarian economy. Dirigism is costly, and to a large extent it was paid for by the windfall of oil money. It was of course possible that even without the oil boom the New Order's economic policy would still have pursued the same dirigistic path. But surely, without it, the reach and the scale of such policy would have been substantially narrower and smaller.

How did such a policy orientation evolve? Which sectors

45 Another immediate impact of the oil boom worth mentioning here was of course the Pertamina crisis in late 1974 and 1975. Pertamina is the state petroleum company with a monopoly to manage the country's oil and gas resources. Its controversial, flamboyant and nationalistic chairman, Ibnu Sutowo, expanded Pertamina's reach far outside its core business. Deluded by the promise of ever increasing oil prices, he made a basic mistake: he relied heavily on short-term loans to pay for Pertamina's long-term business expansions. Pertamina in late 1974 failed to pay its debts, and the Central Bank came to the rescue, which cost the country a great deal: from 1975 to 1980 around 25 percent of the central bank's credits went for the repayments of Pertamina's debts (Cole and Slade 1996:84). For a good assessment of the Pertamina crisis see Glassburner (1976).
were most affected by it? What was the immediate impact of the new policies in regard to the balance between the state and the market in the Indonesian economy?

On the financial and monetary front, the increasingly dirigist tendency started when the intellectuals began to criticize the government and increased their demand for more direct financial aid to support the small-scale pribumi businesses as well as for a curbing of the perceived Sino-Indonesian economic domination. In the late 1960s Bappenas introduced three credit programs with several different aims, i.e., to stabilize the price of rice, to help the farmers intensifying their production and to disburse credits to the small businesses.

Among the three programs, it was KIB (Kredit Investasi Biasa, Ordinary Investment Credit) which, according to the original plan, was supposed to become the policy tool for increasing the share of pribumi by providing for them easy access to a low-interest credit scheme. After three to four years it turned out that, according to the critics, KIB was a failure, because a huge sum of the credits was actually given to Sino-Indonesian entrepreneurs. The Sino-Indonesians, so the critics claimed, were willing to bribe state bank officials and were also, because of their existing business networks, more prepared
to use the scheme for their advantage.\textsuperscript{46}

So the government, in an effort to appease the critical intellectuals, changed its credit priority and increased the share for small-scale entrepreneurs (SSE), from 34 percent in late 1972 to 58 percent by December 1973.\textsuperscript{47} Upon announcing the credit policy shift, Rachmat Saleh, then the governor of the central bank, conceded and accepted the arguments of critics like Hatta and Soedjatmoko by saying that "a healthy Indonesian economy could only be realized based on (the efforts) of prribumi entrepreneurs." Therefore, he continued, "all in all the priority of credit policy in the future would be directed at prribumi businesses, big or small" (Kompas, December 11, 1973:1).

True to its promise, the government, besides shifting the focus of KIB, also launched two new credit schema, administered directly by the central bank under Rachmat Saleh: KIK (Kredit Investasi Kecil, small-scale investment credit) KMKP (Kredit Modal Kerja Permanen, Permanent Working Capital Credit). Here Sino-Indonesian entrepreneurs, rich or poor, were totally excluded; they were not allowed to apply for both KIK and KMKP (Cole and Slade 1996:87-88). After Malari, these two credit

\textsuperscript{46} For a short evaluation of KIB and its critics, see Kuntjoro-Jakti (1981).

\textsuperscript{47} SSE were divided into two types according to the size of their business. To each SSE on the first type (the smallest) the amount of credit granted was up to Rp25 million; and on the second type it was up to Rp100 million.
schema, along with the existing KIB, and later Kredit Mini (Small Credit), became one of the bedrocks of the New Order's efforts to intervene directly in setting the patterns of (small and medium-scale) investment in order to achieve its political objectives, i.e., lifting the economic power of pribumi vis a vis the Sino-Indonesian entrepreneurs.

In four years the number of applications approved for KIK/KMKP alone jumped from 27,093 with the total approved value of Rp36.7 billion in 1974/75 to 377,529 with Rp203.3 billion in 1977/78 (Kuntjoro-Jakti 1981:233-234). This big jump, according to Bruce Bollnick (1983:90), increased the share of total bank credit allocated to SSE, "from microscopic levels prior to 1974, to over 22 percent by mid-1981." Moreover, the schema also enlarged the bureaucratic power of the central bank over the micro-credit allocation decisions of the state banks; and this in turn contributed to a large increase of the central bank staff to administer the credit programs (Cole 1996:88).  

Apart from the new credit policy for SSE, the New Order

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48 This increasing power of Bank Indonesia, the central bank, changed the balance of monetary decision making power somewhat inside Suharto's government. In general, Bappenas and Widjojo were still the most influential institution and actor in administering the priorities and the amount of money allocated for different sectors, including the SSE. But because BI's director, Rachmat Saleh, was not one of Widjojo's men, and because the increasing administrative power to observe the day to day operation of the credit programs, the central bank therefore grew to become an actor itself, with a quite large leverage in the process of decision making.
government in April 1974 decided to reimpose once again stricter controls on state, private and foreign banks through the mechanism of credit ceilings. With this decision, the central bank was given power to determine a credit ceiling for each type of bank on the basis of both the bank's previous performances and the government's social and economic priorities. Although this decision was taken as a necessary measure to cope with the threat of inflation following the sudden increase of oil revenues in 1973 (credit ceiling was one method to manage the money supply), its direction nonetheless was much in accordance with the dirigist spirit of the day. And its impact too was shifting further the balance between the state and the market, to the detriment of the latter. As Andrew McIntyre observes:

The combination of the direct controls introduced in 1974 and the preexisting controls produced a financial system in which the market mechanism played a smaller role in the allocation of credit than at any time other than the height of state interventionism in the Guided Economy years (McIntyre 1993:143).

Another monetary policy which was less tangible but which nonetheless produced the same effect (albeit in a different form) on the state-market balance was the central bank's decision to maintain negative interest rates for quite a long period of time after Malari. As we have also seen earlier, in the late 1960s the government set interest rates high in order to fight hyperinflation and to induce people to save. When inflation was
under control, the interest rates were adjusted, and gradually declined. But when inflation rose again, following the oil boom and the sudden expansion of government expenditures after 1974, the nominal rates were held more or less constant, hence their real value became negative. The only exception, i.e., when the rates were slightly positive, occurred in 1977-78 (Hill 1996:31).

This decision to keep the interest rates negative reflected in part, as Hal Hill aptly says, "the deliberate government strategy of selective business promotion," and in effect "[it] enabled the government to subsidize priority sectors, while rationing excess demand for loan funds by administrative edict rather than through the price mechanism" (Hill 1996:34). One of the consequences of this strategy was that it suppressed the development of the financial system further by discouraging savings and deposits.

Moreover, combined with the existing restrictions and regulations like credit ceilings, this monetary strategy also retarded the potential growth of the private and foreign banks and at the same time exaggerated the importance of the state banks. The private banks were free to set their interest rates, but they could not compete when the rates of the state banks were set artificially low. Hence, during the period after Ma-
lari, the shares of private and foreign banks in the total distribution of credit remained very low, while the shares of both BI and the state banks were very high; at one point it even went as high as 91 percent (see Chart 2.1). 49

So here perhaps we can see a good example of a chain reaction process, in which one dirigist policy (selective pribumi promotion) led necessarily to the other ones (subsidized credits, negative rates), which in the end retarded the growth of the financial system as a whole and, more specifically, weakened the non-state institutions whose services were very much needed in helping the realization of efficient resource allocation.

![Chart 2.1: Distribution of Credit by Bank Type, 1973-80 (%)](image)

Source: BI, as processed by McIntyre (1993:138)

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49 We also have to bear in mind that for several years after 1975, BI had to pay for Pertamina's debt repayments.
In regard to the investment policy, the dirigist tendency was even more pronounced. As we have also seen earlier, the most liberal and perhaps one of the most important policy initiatives undertaken by the technocrats in the early years of the New Order was the open door policy. The institutional backbone of this policy which sparked the inflow of foreign investments was the PMA Law No. 1/1967. After Malari, the spirit behind this law became the first victim of Suharto’s new policy direction. On January 22, 1974, the Economic Stabilization Council, a supra-cabinet institution chaired by Suharto himself, announced that the country’s foreign and domestic investment policy would be altered and that Indonesianization in the realm of investment would be thoroughly implemented.

Several months later Widjojo himself, in a clear sign that he and his team could no longer shield themselves from political pressure to change the course of their approach, reemphasized the new investment policy before the international forum of business leaders from 24 countries (the Jakarta Meeting). He conceded, speaking much like Soedjatmoko and Sarbini several months before, that the new policy was necessary, "to fix the [structural] imbalances we inherited from history" (Kompas, Sep-
tember 11, 1974:1).\(^{50}\)

It was subsequently decided that all foreign investments should take the form of joint ventures in which at least 51 percent of the equity share should be owned by the Indonesian party, of which at least half should be in the hands of pribumi. The timetable for a full implementation of this new rule was set for up to 10 years. Some exceptions were granted for specific sectors, i.e., the footloose and labor-intensive industries in electronics whose markets were mainly abroad. To grasp the importance of this policy we can see for instance that the share of Indonesian capital in all approved foreign-investment manufacturing projects up to 1973 was on average only 15 percent (Papanek 1980:394). So, following the new rule, the local share in this particular sector should be increased by at least 36 percent in ten years.

It was also decided that Indonesianization of employment should be carried forward by imposing "a tax of $100 per month on employers for each foreigner employed for more than a year" (Arndt 1974:19). The tax money would partly be used to train Indonesian employers to acquire the necessary skills and knowledge

\(^{50}\) Robison (186:190) notes that the immediate reaction of Widjojo and other technocrats to the new policies was "one of skepticism." Despite their reluctance, Robison says, "they were nevertheless required to find ways of implementing them."
in their preparation to replace their foreign counterparts when the time came. A year later a new rule was announced which contained a requirement that the Indonesianization of employment in all but top executive positions be carried out within 3-5 years (Arndt 1975:24).

More investment sectors were also closed for foreign companies. In 1970 foreigners were already forbidden to take part in export-import activities, and in 1972 light manufactured products such as tooth paste, shoes, paints, screws were included in the government's list of protection. After Malari, the restrictive area for foreign investment was expanded much further to include major sectors such as chemical, steel and pharmaceutical industries, real-estate business, construction services as well as forestry products. Some of these were completely closed, some were partly closed, some were closed only in Java, and some were only temporarily closed.

For about two years, in the haste to expand restrictions on foreign investment, Suharto's government acted more on an ad hoc basis. There were no specific and working criteria which differentiated the treatment of one economic sector from another; no one could ever tell why one sector was only partially

51 Shortly after its announcement, this decision was modified, and aimed only at the forest industries which employed about 7,000 foreigners in Indonesia.
closed (and for how long), why the other one was completely closed. A report by the US Embassy in Jakarta during this time described the impact of the changing investment policy in this way: "Facing most new investment are high and rising costs, increased bureaucratic hazards, and continuing uncertainties about investment groundrules and taxation policies, which have all become more important during 1974" (Arndt 1975:24).

To cure this defect, the government in early 1977 introduced the DSP system (Daftar Skala Prioritas, Priorities List) which formalized and rationalized the pattern of investment and its relation to the government's long-term developmental objectives. Moreover, with the DSP, more sectors were also restricted: e.g., clove and plastic industries, dairy products, banking and distribution services (Rice and Hill 1977:14-15; Robison 1986:184-185). With these increasing restrictions, it was planned that the manufacturing sector would gradually be closed to foreign investment, and at the same time the MNCs would be directed to concentrate on the sectors which were highly capital-intensive and technologically advanced.

Despite the introduction of the DSP system, however, the

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52 For a complete list of sectors closed, see Palmer (1978:159).

53 The stated objectives of the DSP were, among others, to increase the participation of Indonesians in the development process; to establish a more equitable income distribution; to use domestic materials and resources more ex-
impact of the increasing restrictions continued to cloud the country's investment climate. After Malari, the growth rates of foreign capital inflow had never been the same as those of the period of 1967-1973. True, among observers there are differences of assessment about the impact of the new policies upon Indonesia's overall level of foreign investment, varying from slightly negative (Arndt) to strongly negative (Donges et al.). But whatever the assessments are, one thing was very clear: during the period of increasing restrictions, the overall rates of foreign investment declined, with the sharpest downturns occurring in 1975-76 and 1979-80 (see Chart 2.2).  

In regard to the industrial sector, the New Order's dirigist policy took several different forms. In the construction industry, for instance, with the monumental Presidential Decree No.14/1979 (and a year later revised into Decree No.14A/1980) and No.10/1980, the government imposed layers of control on access to contracts and procurements for all government-related projects. According to these decrees, no foreign contractors could participate in the projects extensively (McCawley 1981).

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54 As we can see in the chart, there was a slight anomaly: in 1974 the level of foreign investment was actually increasing. This increase occurred because there is always the distance in time for any policy to take effect. Investors need time to assess the merit of new policies before they make their decisions.
could be involved in projects with the value of less than Rp200 million. Apart from this restriction, the decrees also gave many advantages to *pribumi* and small contractors in obtaining projects with value less than Rp100 million. Decree No.14A, according to Muhaimin (1991:212), was the most discriminative policy instrument against the Sino-Indonesians during the period after Malari.

But the most important aspect of the decrees was that they gave substantial power to one ministry, Sekneg (*Sekretariat Negara*, the State Secretariat), to hand-pick and choose the *pribumi* entrepreneurs, with or without business capabilities, to be awarded with special contracts and huge sums of money. Sekneg was given the control to decide the winners of the bids for all projects with value under Rp500 million. It was in this sense...
that Jeffrey Winters, who wrote extensively on the power of Sekneg, said that “nothing caused more distress for the champions of free markets” than the implementation of the Decree No.14/1980 (Winters 1996:24).

In other industrial sectors, the downturn trends in overall foreign investment didn’t deter the government from pursuing an even deeper strategy along import-substitution lines, a fact which underlined the importance of the windfall of oil money in Indonesia’s industrial development. In one form, the dirigist policy led the government to closely observe and manage the organization of production by planning the steps for local-content substitution in major industries.

On this, perhaps the best and the most extreme example can be seen in the automobile industry. From early on the shape and development of this industry, like other major industries in Indonesia, was heavily regulated by the government. In the early 1970s, for instance, to protect the local assembling companies the tariff for import of CBU (completely-built-up) automobiles was generally twice as high as that for assembled automobiles (Chalmers 1996:163). After Malari, growing in tandem with other dirigist policies during the period, the government’s intervention in the automobile industry went even further.

To increase the protection of the local assemblers and to
direct the shape of the domestic market, starting from June of 1976 the import duties of CKD (completely-knock-down) sedans were raised, from 50 to 100 percent, and import and assembly taxes on cars went up from 10 to 20 percent. In the same year, through the decree of the industries minister (SK No. 307/1976) -- the most dirigist decree for the automobile industry to date -- it was also decided that beginning in 1977 the import of several car components such as batteries, tires, and paint would be completely banned; and in the next three to eight years all major components, including engines, would gradually be included on the restriction list (Chalmers 1996:196-9). So here we see how, in a stroke of a decree, the government planned to realize the nationalistic dream of having autonomous car industries which would later, it was hoped, produce the so-called "Indonesian car."

In a different form, the government’s industrial strategy also centered upon expanding and building large resource-based projects involving oil refining, petrochemicals, LNG production, fertilizer, steam and hydroelectric power plants, mineral processing, paper and steel mills and engineering works (Robison 1986:181). Even the Pertamina crisis in 1975 didn’t stop the government from continuing its industrial dirigist programs; some of the large and expensive projects associated closely with
Pertamina such as Krakatau Steel were only temporarily sus­
pended, and some others were continued with different adminis­
trative control.

It was this constant expansion of capital-intensive indus­
trial projects led directly by the government which became the
major factor that lay behind the rapid growth of the country’s
manufacturing sector, averaging 11-13 percent per year during
the period 1973-81 (Hill 1996:21). It also, more significantly,
changed further the general picture of the Indonesian economy,
from basically an agrarian economy to a somewhat industrialized
one.55

Like the impact of the policies in finance and investment,
the dirigist policies in the industrial sector tilted further
the balance between state and market. By the early 1980s, there
was almost no major industries which were not heavily regulated
and managed by the government, either through direct ownership
or through protection and licensing mechanisms.

55The contribution of the industrial sector (mining, construction, utilities,
and manufacturing) to GDP was 18 percent in 1970, 35 percent in 1975, and 42
percent in 1980. The contribution of agriculture was 48 percent, 35 percent,
and 29 percent, respectively (see Hill 1996:19).
2.4 Summary

The New Order’s economic policy from 1966 to about the early 1980s contained two major currents. In its early years, the New Order’s policy direction was strongly influenced by the young economists, Professor Widjojo et al. These new policy actors, who were also called the technocrats or, pejoratively, the Berkeley Mafia, believed that the rehabilitation of the crumbling economy inherited from Sukarno’s order could only be done by respecting the “inner logic” of economic reality as well as by restoring the working of market mechanisms and by opening the Indonesian economy to the world. They were not against the active role of the state in the economy. But they believed that as far as possible state intervention should enhance the working of the market and should be conducted by following the dictates of economic rationality.

To a large extent, the New Order’s major economic policies from 1966 to 1973 showed that such ideas were not impossible to realize. The economy was opened up, foreign investors were welcomed, the money supply was stabilized, the exchange rate regime was liberalized, and the banking sector was reformed. The results of these policies were quite impressive: by the late 1960s inflation was already under control, foreign and domestic investment soared, state banks’ credibility was restored, and
In early 1973, when the technocrats appeared to be triumphant, criticism against them mounted, culminating in the Malari affair in January 1974. The intellectuals and the student activists, spearheaded by the Gang of Four, persuaded the public that the Widjojo programs had carried the country too far in the direction of economic liberalism. The programs, they reasoned, widened the existing socioeconomic gap and brought the country under foreign economic domination. They therefore tried to convince both the government and the people that the Widjojo strategy should be replaced by one that recognized the need to promote pribumi business interests, to increase economic redistribution, to protect the domestic market, and so on.

After Malari, some of the intellectuals and the student leaders were detained by the government, but their ideas and demands were accommodated. To a significant degree, their ideas, in a Kuhnian formulation, became the new economic policy paradigm. Hence the shift of the New Order’s policy direction after Malari.

This shift was also made possible by the coming of a new factor: the oil boom. As a major oil exporting country, Indonesia enjoyed a big boost as the result of oil price increases which began in 1973. With the windfall of oil money, the govern-
ment was in a much better financial position to launch and to cover the costs of the new, dirigist policies.

The new policies covered a wide area. In the financial and monetary sector, a new credit scheme aimed at helping *pribumi* entrepreneurs was launched, private and foreign bank operations were further limited, and credit ceilings were reimposed. In the trade and investment sector, restrictions and limitations were expanded. In the industrial sector, the ISI strategy was pursued to a much deeper level and at the same time the expansion of capital-intensive, resource-based projects was strongly encouraged.

All of this changed the picture of the Indonesian economy. The country began to industrialize, and at the same time the role of the state in the economy was expanded much further. By the early 1980s, the government effectively controlled most of the major economic sectors and heavily regulated the domestic market.
The dirigist economic expansion stalled in the early 1980s, when the price of oil started to fall. After the Malari affair, the New Order government relied greatly on oil exports to pay for its interventionist programs. So, when these exports stumbled, the government was in trouble. And hence, it was forced to review its past policies and to find a new economic solution.

This chapter and the next will explain the roles of the technocrats and the liberal epistemic community in persuading both the government and the general public that there was no way to solve the country's growing problems other than by implementing more pro-market reforms, i.e., deregulation or liberalization. Without their roles, the opportunity that came with the fall of the oil price might possibly have been responded to in a different way, for instance by inflaming the spirit of economic nationalism, as Indonesia did several times before. They, in short, were the actors behind the policy reorientation in the
mid- and late 1980s which, as we will see in chapter 5, moved the Indonesian economy in a different, more market-friendly direction.

Section one of this chapter will explain the New Order political reality and the nature of the economic problems faced by the government in the early and mid-1980s. This section serves as the context to understand better the reasons why the technocrats and the epistemic community did what they did in the crucial period when they had the opportunity to change the direction of the Indonesian economy.

3.1 Political Setting and Economic Problems

By the early 1980s, a decade after the revival of dirigism, the New Order government had become much more centralized. It had also become more authoritarian. Gone were the days of relative openness, like the ones enjoyed by a large portion of the intellectuals and the students during the pre-Malari affair or during the early years of Suharto's rule. Then, student activists, writers, and poets could openly criticize the government's actions and policies from many different point of views, and the press carried those criticisms lively and openly, almost with impunity. But after the Malari affair, Suharto -- by unifying the military under his close control, using Golkar as the gov-
ernment’s electoral machine, and strengthening the state bureaucracy — was able to consolidate his government and gradually impose stronger rules and limitations on the political realm.

Thus the lively political discussions were replaced by strict loyalty and, in the mass media, boring repetitions of formal speeches underlining the importance of political stability, economic development, and *Demokrasi Pancasila*.¹ The political parties were tightly controlled, the independent student organizations outlawed, and the critical press banned; those that remained, like Tempo and Kompas, had to navigate carefully to avoid *peringatan* (warnings) and retribution from the authority. Some other potential rivals or potential critics of Suharto and his government were either punished or co-opted (Liddle 1996:185-193).²

By then, moreover, the New Order government had also achieved a degree of regularity. At the top of the New Order

¹ *Demokrasi Pancasila* (Pancasila Democracy) was a term used by the New Order to justify its authoritarian practices. By using this term, Suharto and his men, like Sukarno before, wanted to convince the nation that, because of the differences in culture and history, Indonesian “democracy” was different from Western democracy.

² On this point, however, we should remember one important qualification: Suharto was neither Stalin nor Mao. His rule and repression never achieved the degree of penetration, brutality, and mass mobilization of a totalitarian system. The point of my explanation here is only to show that the nature of the New Order government and the character of its power changed over time: from relatively open and tolerant to more strictly authoritarian.
power pyramid was Suharto himself, ruling, dividing and arranging the apparatus of government with practically very little challenge. All major decisions came through him. The members of his cabinets and other high-ranking officials gave him suggestions and options of policies, but in the end he alone made the decisions.³

Below this dominant presidency, there were the politically active military officers, mostly from the army, who provided for Suharto a relatively strong and unified repressive organization to control the society and to maintain order. Apart from (but not unrelated to) the military, were the Golkar leadership, the state bureaucracy and the state secretariat. These major "branches" of the New Order government had their own autonomous authority to exercise power, but only to a degree. Suharto never tolerated any of them to defy his major policies or to take any important initiatives without his permission.⁴

In the process of economic policy making, Suharto's position at the height of the New Order power pyramid was also unchallenged. But the military, quite surprisingly, did not have any clear role in this process, despite its very strong role in

³ Interview with General L.B. Murdani, November 1996.

⁴ For further discussion on the scope and the political process of the institutionalization of the New Order government, see Liddle (1996:15-36).
Below Suharto, the power to make economic policy was shared by three competing groups: the technocrats, the engineers, and the nationalist-bureaucrats. The technocrats' position, after the Malari affair, was relatively weak. In regard to the conduct of macroeconomic policy, they were still able to convince Suharto to follow their ideas.

But on many other aspects of major economic policy making, it was the engineers and the nationalists who, as the dirigist programs expanded, were increasingly becoming more prominent. At that time, the engineers were represented by Soehoed, Suhartono, and B.J. Habibie; they mostly occupied the formal positions around the ministry of industry and trade, technology and research. The nationalist-bureaucrats were led by Sudharmono and Ginandjar Kartasasmita (the former then headed the office of the presidency, the state secretariat, and the latter was his close adviser).

The engineers and the nationalist-bureaucrats had some important points in common in their view of development. They,

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5 To be sure, as Crouch explains (1978:273-303), the military had a lot of economic interests in Indonesia. Its high-ranking officers were involved in many big businesses. Yet, in regard to policy making, the military as an institution was excluded from the core process. According to General Murdani, when he was the military chief of staff (1983-1988), he sometimes invited some of the technocrats to his office for a hearing and consultation; the military wanted to be briefed about the latest policy moves of the government. But that was all. Neither he nor other members in the military leadership tried to impose a specific economic policy (interview with General Murdani, November 1996).
like the intellectuals who criticized the technocrats during the pre-Malari years, both refused the notion of comparative advantage and the idea that the country's economic progress could be achieved simply by relying on the market and on open trade. They strongly believed that the state was a primary agent of development capable of making a rational plan in the pursuit of a specific developmental objective (e.g., industrialization, higher growth, economic distribution, etc.).

Their difference was that of emphasis and of priority. The engineers wanted to use the state's resources to industrialize as fast as possible, by primarily relying on the high-technology and capital-intensive industries, while the bureaucrats preferred to use the resources to build stronger domestic, *pribumi* corporations. Both agreed that the state should strongly encourage protectionism, but for a different reason. The engineers believed that the state's protection should be aimed at shielding the domestic industries before they could compete freely in the market. For the bureaucrats the focus was on protecting the *pribumi* corporations, which they believed would be necessary for the purpose of obtaining a higher level of economic equality.

In short, both of these groups were, on policy matters, the arch-foes of the technocrats. Despite their internal rivalries, however, under Suharto the three groups were able to work and to
cooperate as a team in carrying out the government’s economic agenda.

Besides the increasing level of regularity, the New Order had also by then become more stable, less vulnerable to serious challenge. The last major protest occurred in 1978, when several groups of student activists in Bandung and Jakarta questioned the reelection of Suharto for his second term. There was also the elitist movement of Petisi 50 (Petition 50), led mostly by a small group of former military officers who were dissatisfied with some of Suharto’s policies regarding the role of the military and the ways the country’s constitution was used to serve Suharto’s political interests (Vatikiotis 1993; Bresnan 1993).

But all of these were nothing compared to the protests during the Malari affair. The anti-Suharto protests in the late 1970s and early 1980s failed to generate widespread support from the society in general, or even from the students and the critical intellectuals. The government, for the most part, was neither troubled nor incited to launch an open, large-scale repressive counter-reaction against these protests.

This stability and strength of Suharto’s New Order was of course due to several factors, the unity and expansion of its coercive forces for instance. But among them, the economic factor was certainly one of the most important. As I have explained
in the previous chapter, thanks to the Malari affair and to the oil bonanza, the government expanded its dirigist policies to many areas. Through this expansion, Suharto's government built industries and infrastructure, provided subsidies, jobs, and cheap credits to the targeted sectors. By the early 1980s, in short, the government, with its total expenditures amounting to 25 percent of the country's GDP, had truly become the agent of development itself, with a seemingly ever-increasing base of resources which could be deployed to bring the country to its modern, relatively affluent condition.

Because of these economic achievements, the government's means of cooptation and accommodation increased. With more money in its pockets, it could enlarge the base of its supporters. It was also increasingly better equipped to satisfy the basic needs of a larger portion of the society. And for the country's growing middle class, its programs, projects, contracts, and licenses became one of the chief sources of business opportunities. Some members of the middle class might be very critical and demand a more democratic government, but for most of them the promise of ever-increasing economic opportunities was quite enough to make them accept the role of Suharto's government as a developmental, authoritarian state. In this sense, economic development became the basis of the New Order's legitimacy, with-
out which all the political limitations and Suharto's dominant presidency would certainly be harder to justify.\textsuperscript{6}

Of course, economic development (in the sense of economic growth and distribution), however important, has its own limitations. There were some people or some elements in the society who refused to accept that the twin objectives of development (growth and distribution) could be achieved simultaneously, or who believed that the human and political costs of the economic strategy -- the "pyramid of sacrifice", to borrow from Peter Berger -- had been too high. There were also a small group of opponents who would never forget the fact that Suharto came to power by suppressing the communists and the Masyumi-based Islamic political activists. It was this kind of group to whom the Suharto government primarily used its physical force of suppression.

So, the New Order’s strength and stability depended to a large extent upon its economic achievements. That was the reason why any major disruptions to its economic programs and its developmental agenda were politically very damaging to its posi-

\textsuperscript{6} For a further discussion of the legitimacy of the New Order, see Liddle 1996:23-30. Here Liddle employs two useful concepts: "performance legitimation" and "symbolic legitimation." The former refers to legitimacy acquired through economic success and interest-based support, while the latter to legitimacy enjoyed by a particular government because its actions fits well with the society’s culture and tradition. For Liddle, the Suharto government, after more than two decades in power, was quite successful in pursuing both types of
tion as a ruling order.

It is from this point that we can now begin to see the growing economic problems, starting in 1982, faced by the Suharto government and their connections with the changing economic policies in the mid-1980s. The problems imposed severe limitations on the government to continue its role as the chief agent of economic development. Hence, to preserve its legitimacy and the stability it had successfully imposed, the government was forced to review its past economic policies and to search for a new economic solution. The growing economic problems, therefore, in the political setting of the New Order in the early 1980s became the pretext and the rallying point for policy change. But before we go further, we should at this point see the nature and the depth of those problems.

To put it succinctly, they were state fiscal and debt problems which were triggered by the progressive decline of the oil price from 1981 to the mid-1980s. The rate of the price decline could hardly be exaggerated: after reaching its peak in January 1981 (close to $40 per barrel), the oil price went down steeply

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7 The problems were also aggravated, although to a much lesser degree, by the impact of the world recession which occurred in 1979-1980. During the recession the prices for Indonesia's major non-oil exports fell. The prices of coffee and palm oil, for instance, went down by 50 percent, those of rubber and tin by 39 and 17 percent respectively. See Tempo, November 27, 1982:78.
in the middle of the year, and by the end of the year it went down to around $25 per barrel. For the next two years it fluctuated, recovered a little bit, and in 1985 plunged sharply again. In 1986 the price went down to as low as $9 per barrel.\(^8\) The impact of this decline can be seen in Chart 3.1.

![Chart 3.1: Indonesia's Exports (1979-1986)](chart.png)

**Chart 3.1: Indonesia's Exports (1979-1986)**

Source: BPIS (Indonesian Central Bureau of Statistics)

As we can see from the chart, in 1981-86 Indonesia's oil exports plunged continuously, from $20.7 billion in 1981 to $8.3 billion in 1986. The steepest decline occurred in 1985-86, which reached the level of 35 percent -- a decline of this magnitude

\(^8\) As a rule of thumb, a fall of every $1 per barrel of oil cost Indonesia around $400 million in export earnings (see Radius Prawiro, 1998:221).
was equivalent to approximately a 16 percent reduction of Indonesia’s GNP in 1986 (Woo 1994:97). Indonesia’s total exports went down almost at the same rate because most of the country’s exports during this period were oil. After the fall, the total exports were reduced to $14 billion in 1986, from $25.2 billion in 1981, a reduction of over 40 percent.

With the country’s exports so diminished, the Suharto government had to face mounting deficits in both the current account and the budget. In the current account, the deficit grew to be as large as $6.3 billion in 1983, from a surplus of $2.9 billion in 1980. In 1984 and 1985 it went down to below $2 billion, before it shot up again to a higher level in 1986 ($3.9 billion). The budget deficit grew 3.8 times, from below Rp2 trillion in 1981 and 1982 to almost Rp6 trillion in 1986, or equal to 27 percent of total government expenditure in the same year.

Facing these problems, the government -- apart from devaluing the rupiah, slightly reducing subsidies, and improving the tax system -- resorted chiefly to increasing its foreign borrowings. This course was taken apparently because Suharto and his key decision makers hoped that the oil price would soon bounce
back. But the downturn lasted much longer than expected, and hence the country's total debt stock (TDS) and debt service payments (DSP) soared.

Before the fall, Indonesia's TDS and DSP were $20.9 billion and $2.1 billion respectively; in 1984 they went up to $31.9 billion and $3.3 billion. In 1986 the total debt went higher still to $40.1 billion, which put Indonesia at that time as one of the most indebted countries in the Third World. The debt service reached an amount equal to 37.3 percent of the country's total exports, a level which was several percentage points above the "safe threshold" commonly accepted by international lending institutions.10

With those numbers mounting up, by the mid-1980s it was quite obvious that the policy to increase foreign borrowings had become a much less viable option to solve the problems imposed by the falling exports. If this option was to be continued, the country would be moving rapidly toward debt crisis and the danger of default, a condition faced by many countries in the Third World, particularly the oil-exporting ones, in the 1980 decade.

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9 Most of the high economic officials inside Suharto's government believed, during the first two years of the oil price decline, that the downturn was only temporary, one or at most two years. Even the technocrats were not free from this unwarranted optimism (interview with Iwan Jaya Azis, June, 1996).

10 After 1985, the sharp increase in both TDS and DSP was primarily caused by the dollar depreciation. 40 percent of Indonesia's debt during that period was denominated in yen, while most of its exports were paid in dollars.
So the chain of economic problems, triggered by the fall of
the oil price, had put the Suharto government in a tight corner.
For a government whose legitimacy depended to a large extent
upon its economic achievements, this difficult position posed a
clear and present threat. Before the oil bonanza came to a halt,
as we have seen earlier, the government had become the main en-
gine of economic development. Now, it was on the brink of a debt
crisis, and its pocket was emptying quickly. If the tight posi-
tion persisted, it was obviously not impossible that the legiti-
macy of the New Order would be put on the table. Strict politi-
cal limitations had been imposed on the basis of achieving rapid
economic development. If the economy continued to deteriorate,
these limitations might unravel, and hence the stability of
Suharto’s rule would be exposed to a greater risk.

Thus a new economic solution had to be found. And it did
not take too much effort to see that, because resorting to more
foreign debt had become a much less viable option, the fundamen-
tal answer lay in revitalizing the domestic economy. The logic
of reasoning was clear. The exports were diminishing, the defi-
cits growing, the debts piling up. The domestic economy, there-
fore, had to be recharged.

But how, exactly, could this be done? To revitalize the do-
mestic economy, what new policies were needed? Why did the post-
Malari policies no longer work? And how far, how fast was policy change necessary? How would the change be conceptually justified? Moreover, how would the political elite and the public be persuaded that a particular policy direction was better than its alternative? How could they be convinced that a more open and liberal economy was the right response for the approaching economic crisis? What arguments should be given to make them believe in the soundness and the promise of the new policies?

The role of the technocrats and the liberal epistemic communities begins here. As we will see in the following pages, they tried to answer those questions. Of course, other elite groups, intellectuals, and business interests also tried to come up with some sort of answers. But, as I will explain later, during the crucial years of 1986 to 1989, it was the technocrats and the liberal intellectuals' ideas and responses that won the day.

3.2 The Technocrat’s Response

When economic dirigism became the developmental paradigm of the New Order, the technocrats’ position was relatively weak in relation to that of the engineers and the nationalists. The technocrats, because of the widespread criticism from many quarters against their ideas and policies in 1972-1974, enjoyed much
less room for policy maneuver to contain the rising influence of the dirigists. True, the Pertamina crisis in 1975-76 provided an opportunity for them to regain some lost ground, but the strong influence that they had had in the years before the Malari affair could not be fully recovered. Worse, there were even some convincing indications that to some extent Widjojo and his team had drifted along in the dirigist current, especially when dirigism gained even greater momentum in the late 1970s, by supporting or initiating major pro-state policies.

This, for instance, can be seen in the involvement of Widjojo himself in setting up the mechanism for allocating the state funds channeled through the state secretariat to the targeted pribumi entrepreneurs, a policy enacted on the basis of a series of presidential decrees which we have seen in the previous chapter.

According to Pangaribuan (1995), this move of Widjojo and his team closer to the state secretariat was undertaken simply because of political pragmatism. The technocrats and Sudharmono, Suharto's loyalist who led the state secretariat, found a temporary common interest in containing the growing power of Ali Murtopo, who, after the Malari affair, was becoming one of the major political players inside the inner sanctum of Suharto's government, and who also had a very close relationship with some of
the engineers (Soehoed, Suhartoyo) and the CSIS camp, the think-thank from where many of the attacks against the technocrats’ policies were launched before the outbreak of the Malari affair. So, according to Pangaribuan, by pulling themselves closer to Sudharmono, the technocrats hoped they would gain a powerful ally in the race to influence and to gain greater access to Suharto. Therefore, Widjojo’s support for the programs held dear by the nationalist-bureaucrats should be understood as a by-product of political compromises.

This explanation makes sense. But it is not enough. As Prof. Sadli explains, political pragmatism was important, but it was certainly not the only reason. According to him, Widjojo and some of his friends at that time believed that when money was abundant (brought by the oil boom) it was not too imprudent to increase the scope of the dirigist programs, provided that they were carefully and rationally planned. They did not become dirigist themselves, but to some extent they believed then that in the context of the economic situation of the late 1970s and early 1980s, dirigism was, at the least, not harmful to the country’s economy.¹¹ So, the technocrats’ support for some dirigist programs, particularly those that came through the state secretariat, should not be understood as a purely political
move.

In the heyday of dirigism, in other words, the technocrats lacked not only political power but also to some extent intellectual will to influence the course of policy toward a more pro-market direction. They did very little to reduce the scope of the state economic expansion in the direction Suharto and his dirigist planners wanted it to go, and their conviction that the ideal course of economic development for the country could only be put back on its right track with less protectionism and less nationalism seemed to be weakening.

But all of that gradually changed when the oil price began to fall in 1982. When the price started to drop, the technocrats, like other high-ranking officers in Suharto's cabinet, did not think that the fall would last for long, but after about the second year of the fall, and especially after its severe impacts had begun to creep in, they started to change their mind and to search for a new answer. They also began to reposition themselves and, as when they were at their best hours leading the country out of its economic crisis in the mid-1960s, they became more actively involved behind the scenes to persuade

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11 Interview with Sadli, May 1996.

12 During this time (1982), the formulas given by the technocrats to lessen the impacts of the declining oil price were penghematan (economizing) and budget restraints. See Widjojo in Kompas, September 23, 1982:1; December 11, 123
Suharto and his men that the time had come to thoroughly reconsider the government's past policies and to revive the workings of the domestic economy.

The oil crisis, in this sense, became the impetus for them to rediscover their old convictions -- or in Radius Prawiro's words, "to rediscover the wisdom of the market" -- and their prior role as the leading policy actors inside Suharto's New Order. It is therefore no surprise if on many occasions they always said that, for them and for the country, the collapse of the oil price was a blessing in disguise.

The ideas put forward by the technocrats -- mostly the same people described in the previous chapter, plus some younger economists like Adrianus Mooy, Arifin Siregar, and Sudradjat Djiwandono who came to the policy scene in the mid-1980s -- in their effort as born-again liberals to change the direction of policy during this time contained two different, but related, components: (a) their review and criticism of the dirigist policies, and (b) their explanations of the new policies, the kind of policies which, according to them, would bring the country's economy back to its high-growth path.¹³ These ideas were in important ways very similar to the ones they (Widjojo et al.) had

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¹³ Interview with Radius Prawiro, May 1996.
had in mind when they were about to join the New Order govern-
ment in 1965, only this time extended more rigorously and ap-
plied in a new context.

Here, however, it is important to note that, because they
had to make their moves from inside the government, and because
the nature of Suharto's authoritarian government limited their
ability to "go public" with their ideas, most of their efforts
in persuading Suharto and other high-ranking members of the gov-
ernment were done behind the scenes: in their personal meetings
with Suharto, in cabinet sessions, in speeches before government
committees, and the like. They, moreover, consciously detached
themselves from many public activities outside the government.
To be sure, they had a close connection with ISEI (Ikatan Sar-
jana Ekonomi Indonesia, Indonesian Economist Association), the
best known association of the country's economic graduates. But
even here, most of them, especially Widjojo, Ali Wardhana and
Radius Prawiro, were content to play their roles from behind the
doors in many of the association's public seminars and meetings.

The technocrats, in other words, had to play "low politi-
cics" (Soesastro 1989:866). Thus they did not write much in the
media to systematically describe or to defend their ideas. There
were of course interviews with them and reports about their
speeches scattered in many different newspapers and magazines,
but these were mostly pieces of formal *pidato-pidato pejabat* (official speeches) or ad hoc statements in responding to a specific issue and a particular economic question of the day. The open, public campaign, as we will see in the next chapter, was mostly done by the members of Indonesia's rising liberal epistemetic community, or the intellectuals, economists and journalists as well as their supporters outside the government.

However, so far as they were put coherently into written texts, the technocrats' ideas during this crucial time were best reflected in the writings of Radius Prawiro and Ali Wardhana, both of whom, together with Widjojo, were directly in charge in redirecting the path of New Order economic policy in this crucial period.\(^{14}\) Radius Prawiro, for instance, gave a broad explanation as to why the government's dirigist policies could no longer work and therefore should be reviewed and rejected. For him, arguably the most liberal among the New Order technocrats, 

\(^{14}\) In 1983 Wardhana became the coordinating minister for the economy, finance and industry, and Prawiro became the finance minister. In 1988 Prawiro replaced Wardhana. After 1988, Wardhana, like Widjojo, no longer kept any formal ministerial position, but his important roles in helping other technocrats in formulating economic policy behind the scenes changed only a little. Personally he is very close to Widjojo. So, as long as Widjojo retained his (informal) position as the leader among the technocrats, Wardhana's influence was indispensable. Widjojo himself, after 1983, refused to hold any formal portfolio. When Suharto was reelected to serve his third term in 1983, he wanted Widjojo to be his vice president. Widjojo declined, for personal reasons (interview with General Murdani and Fikri Jufri, September-November 1996). But, even without a formal position, he kept his office and position as the *primus inter pares* among his friends, inside or outside the government. Suharto also kept his relationship with Widjojo unaltered: most major economic decisions at
the mistakes of the past could be traced back to the oil bo-
nanza. To be sure, he admitted that the windfall of oil money
made the country a lot richer and economic development possible.
But, unfortunately, it spoiled the country -- or in Ali Ward-
hana's crisp words, it created "bad microeconomic habits" -- and
prompted the government to expand its economic role in many sec-
tors without proper regard to the working of the market.

Easy money blurred the country's vision and generated wrong
incentives for the government in setting up its priorities.
"[O]ur sheer riches [from oil]," Prawiro (1989:12) wrote,
"...made us spoiled. We felt cushioned from the visible need to
diversify our export economy, particularly in manufactured and
other industrial products, as many of our neighboring countries
had already begun to do. In this way, oil and gas had an almost
'opiating' effect on our national vision of economic development
throughout the 1970s and into the early 1980s."

"Specifically," Prawiro continued, "we were drawn into a
sustained period of inward-looking economic development, and
placed an over-emphasis on strategies of import-substitution. To
make these strategies work, we engaged in extensive intervention
in the allocation of capital, pricing, and other aspects of pro-
duction. Over time, this generated inefficiencies and added

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this time were still taken after consultation with him.

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costs to our productive process, in turn prompting further gov­ernment intervention. This was in danger of becoming a 'vicious circle' of market distortions.”

Besides the opiating effect of, and the overdependency on, oil, Prawiro also explained that the biggest mistakes of the past could further be seen in the policies of regulation and protectionism. Both domestic commerce and external trade, he said, were in the past too excessively regulated. “The result of this,” he (1998:225) wrote, “was that conducting business in Indonesia was notoriously inefficient and expensive. Through years of overregulation, Indonesia’s products had become exorbitant for domestic consumers and were increasingly uncompetitive in international markets.”

One of the worse aspects of the tendency to overregulate could be seen in the government’s policy to award the sole-importer status to many firms which had close connections to the circles of political and bureaucratic power. This policy, Prawiro admitted, was taken initially to help reduce the outflow of foreign exchange when the country’s appetite for imports was on the rise. The policy, in other words, was used by the govern­ment to exercise more influence on the inflow of goods and serv­ices through a limited number of firms. But over time, he said, the policy created a certain condition which added another un-
wanted burden to the economy:

The sole-importer could raise the price of goods, delay shipment, or direct goods to preferred customers. Buyers were entirely at the mercy of the sole importer. Such practices could disrupt manufacturers' business plans and force them to adjust output and prices largely according to the wishes of the importers. By raising the cost of inputs, sole importers had a significant impact on the prices of domestically produced goods.

... Although the government introduced sole-importer licenses to stabilize the market for selected goods and services, sole-importers were invested with too much power. The sole-importers were an expedient means of trying to restrict the flow of foreign exchange. Unfortunately, this approach was inefficient, costly and difficult to remove after having been introduced (Prawiro 1998:261).

According to him, there were many more regulatory or licensing policies whose effects, although varied in degree, were nonetheless similar to the sole-importer policy. Most of these policies had created a condition which was no longer in accordance with its original intention. Once a license had been granted to one or several appointed firms, or once a new restriction had been imposed, abusive as well as rent-seeking activities would soon take their course. The government officials, the only people invested with the authority to right the wrong, were in too many cases unable to resist the temptation to become part of this circle of "unproductive" practices.15

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15 On this point, his explanations were to a large extent similar to those of the World Bank on Indonesia's regulatory and licensing mechanisms. According to the research sponsored by the bank in the early 1980s, the Indonesian economy suffered from a plethora of rules and regulations. They were opaque, extremely complicated and unpredictable (see the 1981 World Bank Report, especially the annex written by Peter McCawley). Therefore, for most investors, foreign and domestic, the rules and regulations were like impenetrable laby-
On protectionism, Prawiro (1998:261;272) explained that the government's policies to promote and protect domestic businesses, in support of the ISI strategy, had given "many firms a virtual guarantee that they would be profitable, no matter how inefficient they may have been." This, he believed, had hindered the competitive potential of the domestic market: "All evidence suggests that protectionism achieves exactly the opposite of its stated objectives. Rather than build the economy by fostering the growth of young companies, protectionism leads to the creation of fewer companies, fewer jobs, and generates less foreign exchange..."

For him, in short, protectionism, along with the government's tendency to overregulate, contributed substantially in generating a certain economic situation which in Indonesia since the early 1980s had been popularly known as ekonomi biaya tinggi (high-cost economy). The dirigist policies eroded the strengths of the country's economic foundations. It was therefore not very surprising that, when the hard times came following the collapse of the oil price, the country suffered a great deal, unprepared to adjust itself to the new situation. "We were forced," he said (1989:13), "to take a hard look at our whole economic system. We

rizhns: most often, only money, or political connections, or both, enabled an investor to overcome them.
had to face the reality that by the mid-1980s, our economic apparatus was in danger of becoming paralyzed through rigidities, inefficiencies, and a range of non-market forces which had crept into our economic system. We were forced to realize -- and quickly, too -- that many of these negative forces, if left unchecked, could soon start to drag the country backwards."

So, what should be done? How should those "negative forces" be checked and the economy revitalized? What kind of policies were required to bring the economy out of its grave difficulties? To all this, the answers from Prawiro and Ali Wardhana were straightforward, and in many important respects reflected the influence of the "new" liberal economic ideas which had begun to dominate once again the movement of thoughts in the mainstream economic discipline on the international stage since the early 1980s.¹⁶

Ali Wardhana, for instance, offered what he called a "simple chain of economic reasoning." In his own words and formulation, this reasoning went as follows:

¹⁶ On these ideas and their development to become the dominant force in the mainstream circle of academic economists, see for instance John Toye (1987) and Deepak Lal (1994). These ideas also had a strong impact on the World Bank, through renowned economists like Bella Balassa, Ian Little, and Anne Krueger for instance, especially in the bank's efforts to formulate the reform and structural adjustment programs in the 1980s offered to many countries in the Third World, including Indonesia. Needless to say, they also influenced government economic policies in many parts of the world in the 1980s decade, in various degrees and with different emphases, from Thatcher's privatization policies to Reagan's tax-reduction and deregulation programs.
- Economic growth and development is a central goal of government policy.
- Economic growth requires export growth to pay for needed imports and to service debts.
- Given the level and uncertainty of oil prices, and Indonesia's level of proven oil reserves, the only reliable source of export growth for Indonesia is a wide range of non-oil exports both from agriculture and from manufacturing.
- Non-oil exports require an efficient, low-cost productive economy to enable firms to compete in world markets. This in turn requires a competitive domestic market.
- Protection and government controls, which had been the chosen economic policy instrument for many years, are inimical to this competitive domestic market; they have created the 'high-cost' economy that the country is now trying to escape.
- To encourage exports and economic growth, therefore, Indonesia needs to dismantle its protective policies and government controls, and to 'deregulate' its economy... (Wardhana 1989:207-208).

So, Wardhana's reasoning ended up with a simple formula for the new policy: economic openness and deregulation. In other words, economic liberalization. In practice, he explained further, to make this formula work the government was required to let the key prices reflect the real values of scarce commodities and resources. Besides this, the government should also encourage the profit motive, because this motive was "the very instrument by which productivity grows, incomes can be raised, and welfare can be increased." And lastly, the government should

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17 Wardhana often used the term "structural adjustment strategy" to describe his proposed policy. He did not use the term "liberalization," because of the term's pejorative connotation in Indonesia. By not using it, Wardhana wanted to avoid unnecessary negative reactions against his policy. Among the technocrats, only Radius Prawiro was brave enough to label the new economic policy economic liberalism. He did this in public for the first time in 1989 (interview with Radius, May 1996).
trim and reform itself: “Not only must there be less bureaucracy, but bureaucrats must take a new role. Instead of intervening to control private economic agents, bureaucrats need to avoid intervention and instead to facilitate private activity...” (Wardhana 1989:211).

Like Ali Wardhana, Radius Prawiro also offered economic openness and deregulation as a broad formula for reform. On deregulation, for instance, he explained that it “represented a more deliberate and determined adherence to the principles of neo-classical economics over more interventionist and inward-looking economic policies.” And he continued further:

Neo-classical economics emphasizes the importance of prices and free markets. In every economy, prices are important economic signals to which people respond. In a market economy, the prices of goods and services are determined according to the laws of supply and demand. Deregulation represents an effort to remove those regulation that distort the prices and the markets (Radius Prawiro 1998:288).

In practice, like Wardhana’s, Radius’ proposed policies to reform the country’s economy ranged from lowering the level of control and trade protection, reducing the scope of regulation, to giving more incentives for firms to sell their products abroad.

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18 Their ideas, in many ways, were indistinguishable. Yet, between the two, Prawiro was the one who, in expressing his ideas, sometimes used the key words derived from the “liberal vocabulary.” For instance, when he explained about the banking reform program, he simply said that the only way to do it was to
3.3 Summary

After almost a decade of dirigist expansion, the Indonesian economy faced a growing problem when the price of oil began to fall in the early 1980s. The impact of the fall (combined with that of the mild world recession at about the same time) touched almost every aspect of the country's economic life because the government, which by then had become the primary engine of development, was very dependent upon oil exports to pay for its expanding programs. The fall of the oil price, in short, put the Suharto government in a very tight corner.

This, for a government that relied for its legitimacy upon its success in pursuing rapid economic development, could not be taken lightly. Suharto in 1980 had emerged as a strong leader, presiding over a centralized government and more or less stable society, with very few challenges, to a large extent because he and his government delivered the "golden eggs." So, when this achievement was threatened, the pressures were great upon him and his government to take some measures or to review his policies to overcome the growing problems. In this sense we can say that the window of opportunity to change the New Order's economic policy came when the oil price began to fall. The hard times, therefore, were a blessing in disguise.

give the banks more "freedom."
But the opportunity would not have become real (the blessing would have been forever disguised) without the role of the technocrats. It was these policy actors who seized the moment and persuaded both the government and the public that the dirigist policies could no longer work and that therefore a new formula, i.e., deregulation or economic liberalization, should be undertaken.

The technocrats did their share mostly from inside the government. During the post-Malari dirigist expansion, they were kept in high governmental positions by Suharto, but their control of the direction of the economic policy, particularly the industrial, banking, and trade policies, was weakening. It was the dirigists, supported fully by Suharto, who held the day. This picture changed when the hard times came: the technocrats knew that Suharto and his government needed them for a solution, and they seized this opportunity, as they had done in 1966-67. They were the most responsible persons in convincing Suharto and other high-ranking officers that the country would fare better by experimenting with a new scheme of policy.
Besides the technocrats, as I have mentioned earlier, the primary role in pushing the reform process forward in the mid-1980s was carried by the liberal epistemic community. Like the Widjojo group, they were the ones who convinced both the government and the people that the best solution to the growing economic problems was deregulation or liberalization. In fulfilling their roles, members of the epistemic community had a relatively higher degree of freedom in speaking their minds and promoting a new economic policy. Community members, unlike the technocrats whose responses to the economic events had to be arranged in such away that they would not be exposed too much in public, were able to use the media and the public forums, mostly seminars and symposia, to spread their ideas of reform and to discredit the failed dirigist policies.

This chapter begins with a description of the network of the liberal community. Next, an important shift of intellectual
position in this network and how its leading members attacked the dirigist status quo will be explained.

4.1 The Liberal Network

Members of the epistemic community were outsiders. As long as they did not directly criticize Suharto, his family and other high-ranking officers, and as long as they kept their criticisms strictly on economic policies, and not on "politics" or on questioning the legitimacy of the New Order, their actions would not invite direct punitive retributions from the government.¹

In a way, ironically, the New Order’s authoritarianism in the mid-1980s served the interest of the epistemic community. As I have mentioned earlier, during this time Suharto had completely consolidated his power and, as a result, party-based political opposition and organized mass movements were kept under tight control. So almost the only outlet left for critical public discourse in a limited scope was through the exercise in shaping public opinion through the media and, to a lesser degree, in the universities’ forums. These were all the public arenas in which the members of the epistemic community were best

¹ From time to time there was a case when one member of this community stepped outside the unwritten boundary of what should and should not be published and publicly discussed. If this happened, a direct punishment was in order. The best example here was the ban of Sinar Harapan, Indonesia’s second biggest daily and one of the major outlets for reformist ideas, following its Septem-
equipped to exercise their roles as producers of ideas and re-
viewers of policies.

Moreover, because discussion of controversial political
issues was strictly limited, economic affairs became the subject
through which the government's performance was analyzed, de-
bated, and criticized. Economic discussions, therefore, gained a
wider appeal. To be sure, economic issues are always important
in every society, democratic or not. But when the media are not
allowed to report on controversial political affairs, they tend
to give even wider room for discussion of economic issues, thus
adding more weight to their importance and appeal. A simple ex-
ample is sufficient to tell us about this. According to Paraki-
tri (Kompas, April 27, 1991:24), of all the seminars in Jakarta
covered by Kompas in January and February 1991, economic issues
were the most frequently discussed topic (47 percent). The sec-
ond topic (law and governance issues) was discussed substan-
tially less often (11 percent). Using slightly different indica-
tors, my research in 1989 on Kompas and Suara Karya's headlines
and editorials, found a basically similar trend (Mallarangeng

So, for the members of the epistemic community, this limi-
tation on "politics" provided an ample opportunity to spread and

ber 1986 in-depth reports on the mismanagement of state monetary policy.

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to invite attention to their ideas. Because of their knowledge of economics and economic policies, they needed only a little effort to meet their audiences and to explain to them why reforms were needed to bring the country out if its mounting problems.

Before we turn to their response to the economic crisis, we should at this point see who the leading members of the liberal epistemic community were in the mid-1980s. By profession, many of them were lecturers at the University of Indonesia’s Department of Economics, with Ph.D.s in economics from top American universities like Harvard, Cornell and the University of California at Berkeley (Iwan J. Azis, Sjahrrir, Dorodjatun Kuntjoro-Jakti). Some of these people were former ministers turned critics (Prof. Sumitro, Prof. Sadli, Drs. Frans Seda), and another was on his way to hold top governmental positions (Sudradjat Djiwandono). There were also the economists who led non-governmental research institutions (Mari Pangestu, Hadi Soesastro, Djsisman Simandjuntak, Christiano Wibisono).

Apart from this group of highly-trained economists, there were writers, businessmen-cum-writers and lawyers-cum-writers, like Kwik Kian Gie and Nono Anwar Makarim. Included in this last group were the high-profile journalists and editors like Goe-
nawan Mohammad and Fikri Jufri of Tempo, and Jakob Oetama of
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<tr>
<th>Name</th>
<th>Education</th>
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<tbody>
<tr>
<td>Anwar Nasution</td>
<td>Ph.D. in economics, Tufts University</td>
<td>Lecturer, the University of Indonesia (UI)</td>
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<tr>
<td>Iwan J. Azis</td>
<td>Ph.D. in economics, Cornell</td>
<td>Lecturer, UI</td>
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<tr>
<td>Sjahir</td>
<td>Ph.D. in political economy, Harvard’s Kennedy School of Government</td>
<td>Lecturer, UI, also leading his own research center and private business and a columnist</td>
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<tr>
<td>Kwik Kian Gie</td>
<td>Drs. in accountancy, Rotterdam University</td>
<td>Columnist, also leading his own private business</td>
</tr>
<tr>
<td>Christianto Wibisono</td>
<td>Drs. in social science, UI</td>
<td>Columnist, also leading his private research center</td>
</tr>
<tr>
<td>Dorodjatun Kuntjoro-Jakti</td>
<td>Ph.D. in government, UC at Berkeley</td>
<td>Lecturer, UI</td>
</tr>
<tr>
<td>Thee Kian Wie</td>
<td>Ph.D. in economics, the University of Wisconsin</td>
<td>Researcher at LIPI, the government’s research bureau, also lecturer at UI and a columnist</td>
</tr>
<tr>
<td>Hadi Soesastro</td>
<td>Ph.D. in policy studies, Rand Graduate Institute</td>
<td>Researcher at CSIS, also a columnist</td>
</tr>
<tr>
<td>Mari Pangestu</td>
<td>Ph.D. in economics, UC at Davis</td>
<td>Researcher at CSIS, also a columnist</td>
</tr>
<tr>
<td>Djisman Simandjuntak</td>
<td>Ph.D. in economics, Koeln University, Germany</td>
<td>Researcher at CSIS, also a columnist</td>
</tr>
<tr>
<td>Pande Raja Silalahi</td>
<td>Ph.D. in economics, Kobe University</td>
<td>Researcher at CSIS, also a columnist</td>
</tr>
<tr>
<td>Sumitro Djojohadikusumo</td>
<td>Ph.D. in economics, Rotterdam University</td>
<td>Former minister, founder of the department of economics, UI</td>
</tr>
<tr>
<td>Mohammad Sadli</td>
<td>Ph.D. in economics, UI</td>
<td>Former minister, also lecturer, UI and a columnist</td>
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<tr>
<td>Suhandi Mangkusuwondo</td>
<td>Ph.D. in economics, UC at Berkeley</td>
<td>Lecturer, UI</td>
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<tr>
<td>Mohammad Arsyad Anwar</td>
<td>Ph.D. in economics, UI</td>
<td>Lecturer, UI</td>
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<tr>
<td>Frans Seda</td>
<td>Drs. in economics, Tilburg University</td>
<td>Former minister and a columnist</td>
</tr>
<tr>
<td>Goenawan Mohammad</td>
<td>UI, Faculty of Psychology, no degree</td>
<td>Chief editor of Tempo, also a columnist, essayist, and a poet</td>
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<tr>
<td>Fikri Jufri</td>
<td>Drs. in economics, UI</td>
<td>Deputy chief editor, Tempo</td>
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<tr>
<td>Jakob Oetama</td>
<td>Drs. in social science, Gadjah Mada University</td>
<td>Chief editor of Kompas</td>
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<tr>
<td>Nono Anwar Makarim</td>
<td>SJD, Doctor of Judicial Science, Harvard</td>
<td>Lawyer, also a columnist</td>
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Table 4.1 The Liberal Epistemic Community
Kompas. Table 4.1 provides a list of the leading members of the liberal epistemic community and their professional or institutional affiliations.

The presence of these people, most of whom were not only articulate but also equipped with the knowledge necessary to understand the basic technicalities of economics and economic policy, made the "conversation" in the country's public arena richer and more intellectually stimulating. According to Benjamin Higgins, "in the early fifties Sumitro was virtually the only Indonesian who could be regarded as a fully qualified professional economist" (Higgins 1990:44). Besides Sumitro, as Higgins said, there was only a handful of Indonesians who were capable of discussing such issues as interest rates, tax structures and foreign exchange rates at a professional level. In the early 1970s, apart from Sumitro, most of the people who were highly trained in economics and were capable of understanding the technicalities of economic policy like Widjojo et al. worked inside the government. In the mid 1980s the situation was different: there were more educated Indonesians outside the government who were professionally trained in economics, and some of their younger representatives like Iwan J. Azis and Sjahrir were educated in the world's best universities. Partly because of their presence and contributions, public discussion on economic
issues was no longer conducted mostly at the normative level but also at the technical and empirical level.

Because the circle of elite in Indonesia was small, many of these economists, intellectuals and journalists had quite close personal contacts with each other. Their network of activities centered around lecture rooms, university seminars,² public discussions and research centers. Every major government department, like finance or industry or Bappenas, had its own research center. But they did not belong to this network, because most of their researches and seminars were conducted under close governmental supervision. The major research centers in the network were CSIS, LPEM (Lembaga Penelitian Ekonomi Masyarakat, the Institute of Economic Research), LM (Lembaga Manajemen, the Institute of Manajemen), LD (Lembaga Demografi, the Demographic Institute). The last four were administratively related to the department of economics at the University of Indonesia. Also included in this network were LIPI (Lembaga Ilmu Pengetahuan Indonesia, Indonesia’s Institute of Science), CPIS (Center for Policy and Implementation Study), and CPS (Center for Policy Study).

² The seminars in the most prestigious universities, like the University of Indonesia in Jakarta and Gadjah Mada University in Yogyakarta, were usually the ones that invited the greater number of the members of the epistemic community.
The professional association most of the community members belonged to was ISEI (Ikatan Sarjana Ekonomi Indonesia, Indonesian Economist Association). ISEI is the only national association for economic graduates. By the mid-1980s it had more than four thousands members (in the mid 1980s, Indonesia’s universities produced 2,000 economic graduates per year; 3 percent of their lecturers in economics held Ph.D. degrees, 11 percent masters). Its strength lay in the fact that most of the country’s popular and respected economists, inside or outside the government, as well as the high-level managers in the private sectors, were involved in it. In the mid 1980s Prof. Sumitro was appointed as its honorary chairman. Before him, this respected position belonged to Hatta, the father-figure whose criticisms contributed greatly to the unfolding of the Malari movement as we have seen in the previous chapter.¹ ISEI regularly conducted its seminars and symposia by inviting its influential members from inside and outside the government. Some of these seminars played pivotal roles because it was here that many of the community members began to build their broad consensus on how to reform the country’s economy (see the last section of this chap-

¹ In a way, this “passing of the torch,” from Hatta to Sumitro as ISEI’s honorary chairman, was very important symbolically, because it highlighted the process of Indonesia’s intellectual transformation, in a more liberal, or less socialistic, direction.
Also, the discussion rooms in the major mass media, particularly in Kompas and Tempo, often served as their meeting places. They were invited on a regular basis to give their analyses, comments, and perspectives on unfolding or coming events. Kompas, for example, started its periodic panel discussions among economists, managers and other relevant economic actors in March 1983. This panel group was chaired by Prof. Sadli, and for each discussion there were usually about fifteen to twenty rotating participants. After each discussion, which took place mostly from morning to late afternoon, Kompas would publish its reports on the issues discussed on the front page and the op-ed page. Sometimes the reports were so long that they were published in two consecutive days.

An example of such panel discussions was the one held in May 15-16, 1986. The topic was the country’s economic crisis and the possibility of reform. As usual, this discussion was chaired by Prof. Sadli, and the participants came mostly from the members of the epistemic community (Arsjad Anwar, Dorodjatun Kuntjoro-Jakti, Frans Seda, Hendra Esmara, Priasmoro Prawiroardjo, 

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* Both Tempo (weekly magazine) and Kompas (daily) are the most widely-circulated and respected media in Indonesia. In the mid 1980s, Tempo’s circulation was about 120,000 copies and Kompas more than 500,000 copies. The mid 1980s, in a way, was a bonanza period for both of these media: from 1980 to 1986, for instance, Kompas circulation increased by almost twofold, from
Sediono MP Tjondronegoro) plus some businessmen (Robby Djohan, Theodoro Permadi Rachmat, Gilbert Wiyadinata) and government officials (Salamun). On May 29, 1986, the reports of this panel discussion were published in several different articles, and one of them became the headline on the front page, with a striking title (Perlu Terobosan untuk Keluar dari Kemelut Ekonomi, A Breakthrough Is Needed to Solve the Economic Crisis).

Although Tempo, through such persons as Goenawan Mohammad, Fikri Jufri, Salim Said, Syubah Asa, Senanto Juliman and others, had a very close connection with the country’s intellectuals, economists and literary personalities, it started to formalize its regular discussion group of economists several years later than Kompas did. In March 1988, Tempo’s discussion group was formed, and was named Forum Ekonomi Tempo (Tempo’s Economic Forum). In its first year, the forum was chaired by the economist-activist Sjahrir (more about him later), with Hadi Soesastro, Mari Pangestu, Winarno Zain and Thee Kian Wie, among others, as its members.

Unlike Kompas, Tempo did not publish the reports from its discussion group. Tempo used the discussions conducted by the group mostly to give its reporters and editors background stories and in-depth information which might be useful for them to

300,000 to 530,000 copies (see Mallarangeng 1992:25).
write their cover stories for the next editions. Sometimes, though, one or two of the speakers in the discussion were asked by the editors to write a column on specific issues related to the cover stories.

4.2 Intellectual Migration

One interesting fact should be noted here: before the Malari affair, Tempo and, particularly, Kompas (along with Mochtar Lubis's *Indonesia Raya* and Rosihan Anwar's *Pedoman*) in their own way lent their support to the demands for more economic dirigism. At that time, they were part of a larger dirigist current, spearheaded by the Gang of Four described in Chapter 2 -- Hatta, Soedjatmoko, Mochtar Lubis and Sarbini -- supported by the intellectuals, student activists, and university lecturers. In the mid-1980s, though, they became one of the major networks of the liberal epistemic community, without which the demands for pro-market reform would certainly have lost some of its aura of respectability.

The same shift of position also happened to some other persons and institution in the liberal community network. As we can see in Table 4.1 there are four economists who belong to CSIS (Center of Strategic and International Studies). In 1973-74 this important institution was one of the major power centers
whose leaders, like Ali Murtopo, Daud Joesoef, and Panglaykim, were widely regarded as Widjojo's enemies. The CSIS group then was highly critical of liberal economic programs, which in its own way helped to unleash the movement against Widjojo and other technocrats. In the mid-1980s, however, CSIS' position had gone through quite a radical metamorphosis: its younger members, i.e., Hadi Soesastro and Mari Pangestu, were among the most outspoken and consistent pro-market economists. And even its older generation, like Panglaykim (Mari Pangestu's father), changed his position in a more liberal direction by suggesting that the best way to make the state-owned enterprises more profitable and productive was to privatize them (Kompas, August 4, 1986:1; Tempo, March 8, 1986:74).

Another example, which in a way was more telling, can be seen in the shifting position of the two most popular economists from two different generations: Prof. Sumitro and Sjahrir. Sumitro, who is often called the Ayatollah of the Indonesian economists, had a long history of involvement in the country's experiments with pro-pribumi, state-directed economic policies.5

5 Sumitro, born in 1917, received his Ph.D. in 1942 from the Nederlandse Economische Hogeschool, Rotterdam. He was the first Indonesian with a Ph.D. in economics, who introduced Keynesian economics to the country in the late 1940s and early 1950s. Upon his return to Indonesia, he was appointed to assist Prime Minister Sutan Sjahrir (unrelated to Sjahrir, the economist), the chairman of PSI, the Indonesian Socialist Party. From this position, Sumitro became the minister of industry and managed to launch the first systematic economic
Even after he had returned from exile in 1967 and become one of Suharto's cabinet members, he remained critical of the pro-market, outward-looking policies of his former students (Widjojo et al.), which to some extent became the reason why he was closely related to the Ali Murtopo group prior to the Malari affair.

Sjahrir, like Sumitro, was also very closely related to the PSI. In fact, he was one of the intellectual leaders of the young activists who spearheaded the Malari movement. Personally and intellectually, he was very close to Sarbini Sumawinata; it was from him, among others, that he learned about the tenets of the socialist-oriented development economics.

In the early 1980s, both Sumitro and Sjahrir changed; the former when he was no longer a member of cabinet, and the latter while he was pursuing his Ph.D. degree in economics at Harvard. In the mid-1980s both became highly respected critics of the program for the young republic, Rencana Urgensi Perkembangan Industri (Industrial Development Urgency Plan). He then became minister for several different cabinets in the early and mid-1950s, before he took part in the PRRI separatist movement, a failed political gamble which prompted his 10-year exile. When he was the dean of University of Indonesia's faculty of economics in the mid-1950s (before his exile), with the help of the Ford Foundation, he arranged with the University of California at Berkeley to send some of his students and teaching assistants (Widjojo, Emil Salim, Ali Wardhana, Sadli) for higher degrees in economics. This arrangement, in a certain way, was one of the highest moments in his long public career. For a complete introduction to Sumitro's life, ideas and career, see his interview with BIES (December 1986); Hendra Asmara (in Asmara 1987); Dawam Rahardjo (1992); Robert Rice (1982).

post-Malari dirigist policies. And by the mere fact that they were now critical of the policies they once helped to promote, they substantially added to the credibility and importance of the demand for a more liberal economic policy.

All of these shifts in intellectual position strengthened the network of Indonesia’s liberal epistemic community. The shifts themselves were a reflection of how Indonesia’s intellectual sky was affected by the movement of economic ideas worldwide, which also influenced the technocrats as I have mentioned earlier. And on a different level, they were also a product of learning: after observing the unfolding of post-Malari dirigism for several years, some of the earlier supporters of dirigism, like Sumitro and Sjahrir, acknowledged its limitations and its negative impact on the country’s economic structure.

An interesting example which will help us understand how and why this intellectual shift occurred is the story of Goenawan Mohamad, Tempo’s chief editor, who was also a poet and Indonesia’s best essayist. In the early 1970s, like many other

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7 For some examples of how rapidly the economists outside and inside the government responded to the new economic ideas in the 1980s, like rational expectation theory, rational choice theory, rent-seeking theory, neo-Keynesian approach, supply-side approach, and Reaganomics, see Suhadi Mangkusuwondo, (in Hendra Asmara, 1987); Thee Kian Wie (Kompas, March 18, 1988:4); Sudrajat Djiwandono (in Hendra Asmara, 1987 & Kompas, April 30, 1986:4).

8 Interviews with Sjahrir (June 1996), Goenawan Mohammad (May 1996), Jakob Oetama (September 1996), Sadli (June 1996).
young intellectuals in Indonesia during the period, Goenawan Mohamad was influenced by the critical ideas of development promoted Mahbub ul Haq, the Pakistani economist working for the World Bank who on many occasions praised the achievements of Mao in developing the Chinese economy.

Like Mahbub ul Haq, Goenawan Mohamad also believed that the Chinese experiment had been successful in providing the basic needs for the majority of the Chinese people, a success which many considered a vindication of the relative merits of socialism, compared to capitalism, in its application to developing societies. "We were quite romantic at that time...we knew nothing about economics," he said. "The barefoot doctors, the Dachai communes -- all of this, I thought, was some kind of proof of their sincerity in helping the poor. China showed that it was possible to achieve distribution and growth simultaneously."

But, after several years, when he knew more about China, about what in fact had happened there during the Maoist experiment, he began to change his mind and became more skeptical of socialism in general. "I met a Chinese friend in Hongkong [in the late 1970s] who told me the real stories. He convinced me

\[9\] Interview with Goenawan Mohamad, June 1996. All of the information here about him is from this interview.
that many of those success stories that we had believed to be true were in fact only myths."

At about the same time that his views about China were changing, he also began to reconsider his previous ideas about development in Indonesia. One of the most pressing problems that he saw growing was the role and the expansion of the state bureaucracy. He realized that this problem came, in part, from the great passion in the past to limit the role of private business. From his experience as Tempo's chief editor, he knew at first hand how the state bureaucracy had behaved like a "deaf monster," incompetent as well as corrupt. "Our society now is over-regulated," he said. "Whatever we want to do, we have to be prepared to bribe the officials. From our experiences in the business of journalism, we know what the peraturan (regulations) are. These peraturan are the masks of corruption and bureaucracy."

So the crucial task for the country was to deal with the problem of bureaucracy. And, for Goenawan Mohamad, the only way possible to solve or to reduce this problem was by implementing the policy of deregulation. In other words, he accepted that the "capitalist path" was now necessary and good for the country. It was true that as a humanist he had some reservations about the capitalist system in general. But he did not think there was a
better alternative to it. "If you want to get rid of the capitalists," he said, "you have to be prepared for the rule of the bureaucrats."

Moreover, he realized that in the Indonesian context "the alternative to capitalism means more Ginandjar and more Habibie." Both of these leaders were for him not much more than a new reincarnation of Ibnu Sutowo, the former Pertamina chairman who brought the biggest state company to the brink of bankruptcy. "They were all big spenders, without any convincing ideas," he said. Besides disagreeing with their ideas, Goenawan Mohamad also did not have a lot of trust in their sincerity and honesty. "Ginandjar has a very luxurious house in Boston. The interior was designed by a French designer. He lives very high and at the same time talks about pemerataan (economic distribution) all the time. How can we believe him?"

Goenawan Mohamad's shift of intellectual position was also made easier by his trust in some of the key persons in the Widjojo group, whom he had personally known quite closely when he worked for the newspaper KAMI, the most important outlet of the student activists, in the late 1960s (Emil Salim and Mohammad Sadli were regular contributors to the newspaper's op-ed page). He praised the technocrats for their integrity and honesty. Widjojo, for instance, was for him an unassuming person with a
clear idea of the things he wanted to do for the country. "I learned a lot of [practical] economics from him," he said. Moreover, he also believed that the critics of Widjojo were wrong in saying that Widjojo does not care about distribution. "Widjojo is no Milton Friedman. He is a Keynesian to the bone."

Goenawan Mohamad, though, did not reject the possibility that the Widjojo program, if implemented thoroughly, would exacerbate the problem of economic inequality. But for him this was simply one of the ugly facts of life. "People tend to forget that the early stage of economic growth will always produce temporary inequality. Everywhere the same thing happens."

To be sure, not all of those people who moved closer to the liberal camp shared Goenawan Mohamad’s reasoning. Some of them, like Sjahrir and Sumitro for instance, had never romanticized the “success” of the Chinese experiment, or any other socialist experiments in Tanzania, Cuba or elsewhere. Some others were less convinced of the sincerity of the Widjojo group to tackle the problem of inequality. However, most of them shared the belief that the expansion of the state bureaucracy had made the problem of inequality worse. They also believed, as Goenawan Mohamad did, that the biggest problem for the country then was the role of the bureaucracy, and that there was no workable alternative to solve this problem other than by introducing de-
regulation policies and expanding the role of the market.

Furthermore, most of them were convinced of the honesty, personal commitment, and knowledge of the members of the Widjojo group. They had personally known Widjojo for a long time (many of them were Widjojo, Sadli, Salim and Wardhana’s former students at the University of Indonesia’s department of economics) and were impressed by how unassuming he was and by his ability to explain difficult economic problems in simple words and formulations. They, in short, believed, as Goenawan Mohamad did, that the Widjojo group was much more reliable and competent compared to its alternatives, the engineers and the nationalist-bureaucrats.

4.3 The "System" Attacked

To turn now to the response of the liberal epistemic community, we should understand at the outset that their efforts to change the direction of policy were mostly unorganized intellectual campaigns. They were involved in networks and professional organizations, but they did not have any central command directing their agendas or priorities of actions. It is true that all of the members of the community shared more or less a broad consensus on how best to respond to the falling oil prices, on the policies best pursued by the country to achieve a higher level
of economic development, and on the dangerous impact for the
country if the dirigist policies were not dismantled. But all
this was intellectual consensus. They agreed little on the ap­
propriate course of action.

More precisely, they did not think that in their efforts
to influence the direction of policy, they needed a leader or an
entrenched organizational basis which would coordinate their ac­
tions and opinions. Most of them were, to borrow William Lid­
dle's term, "improvising individuals" whose public activities
were conducted out of their own concerns and passion for creat­
ing a new Indonesia (Liddle 1996:143-172).

Their first major intellectual response to the post-Malari
dirigist policies came when the oil price started to spiral down
in the early 1983.\(^\text{10}\) It was symbolically launched by Sumitro. In
April, the government planned to devalue the rupiah in its ef­
fort to curb the deteriorating impacts of the exports downturn.
Sumitro, in his public comments on this policy, which became the
headlines in the major newspapers, acknowledged that devaluation
was a good policy at that time. But, he said, devaluation was by
itself far from enough to solve the country's growing problems.

\(^{10}\) Before 1983, nobody was talking about deregulation or economic liberaliza­
tion. Like the technocrats, economists outside the government were mostly dis­
cussing ideas of budget streamlining (penghematan), subsidy reductions and de­
valuations as the ways to respond to the combination of the oil price decrease
and recession.
He then explained that it was time for the government to dismantle many of its existing policies and regulations.

In particular, he criticized the existing banking regulations which, as we have seen in the previous chapter, were set up by the government to achieve some politically desirable ends, like helping the pribumi entrepreneurs, providing subsidies (i.e., lower interest rates) for small firms or limiting the scope of the foreign banks. "What was good five or ten years ago," he said, "is no longer appropriate now because the situation has changed" (Kompas, April 4, 1983:1). He explained that the regulations had severely limited the ability of the banking sector to play a more active role in mobilizing the society's financial resources. The state banks, which altogether controlled around 80 percent of the total credits, had become merely government credit agencies. And worse, he said, many of their politically-designed credit schemes and subsidies had actually ended up not in the hands of the small firms but in the purses of the rich and the politically well-connected entrepreneurs.

So he proposed that the regulations be simplified and the state banks be freed to follow their own plans. Here, he specifically argued for a policy which would let interest rates "float," freely responding to the mechanism of supply and de-
mand. In 1982/83 the lending rates in the state banks were 15 to 18 percent, while those in the private banks were 24 to 30 percent. This meant that the firms and individuals who borrowed money from the state banks were subsidized by the government. By floating them, Sumitro explained, the rates would of course be moving upward (in the state banks), but this would save the government a substantial amount of money -- something which it surely needed when the country's exports faltered -- and would also encourage the banks to compete and to mobilize funds in the society by offering competitive saving and deposit rates.

Besides the banking sector, Sumitro also voiced his concern about the multitude of regulations in many other sectors of the economy. The complex but unnecessary regulations (peraturan yang berbelit-belit) in many sectors had created what he called a license economy (ekonomi perizinan). "Whatever we do," he explained, "we have to ask for a license. And to acquire the license is not easy, especially for the small firms... In a license economy, it is the small entrepreneurs who become the pri-

11 The impact of the multitude of regulations and licenses in Indonesia had been discussed among the economists and liberal-leaning intellectuals in the late 1970s and early 1980s. The World Bank sponsored-research conducted by Peter McCawley in 1980 on the nature and impacts of those regulations was one of the empirical proofs as to how extensive and negative their impacts were to the economy (see the World Bank 1981, Annex 3). This research was widely known among the Indonesian economists, but among them, as I learned from my reading of all the major media in Indonesia published in the early 1980s, it was Sumitro who started in early 1983 the public campaign against the proliferation of regulations.
mary victims, because they are often abused by those who are fortunate enough to acquire power" (Kompas, April 4, 1983:1)\(^\text{12}\)

For Sumitro, in other words, the "enemy" of the weak or small entrepreneurs was no longer the big firms, the non-pribumi entrepreneurs, the multinationals, or the capitalist system in general, but the state's regulations and limitations imposed upon the economy, the effects of which were disproportionately shouldered by the weak. By saying this, Sumitro therefore directly attacked the popular myth, the kind of belief which lay behind the Malari movement and the subsequent expansion of the dirigist policies, that the state was good and the capitalists bad.

Along with Sumitro, other economists also began to question the prevailing policies and started to argue for a totally new solution to the country's growing problems.\(^\text{11}\) Sadli, for example, said that the fall of oil prices would not likely stop

\(^{12}\) Apparently, Sumitro's emphasis on this point was a direct response to Ginandjar Kartasasmita, the junior minister for domestic production, who stated a week earlier that the government, facing difficult times, would increase its protection for domestic industries to an even higher level (Kompas, March 23, 1983:1). This intention, if carried out, would surely be accompanied by more regulations and licensing mechanisms. So, from one point of view, Sumitro's criticism here should be viewed also as his effort to discredit Ginandjar's ideas and to discourage the government to follow through on those ideas.

\(^{13}\) It should be noted that, not totally accidentally, Kompas also started its regular panel discussions among the economists, chaired by Sadli, in early 1983. This panel discussion subsequently became one of the major avenues of reformist ideas. In its first meeting, the topic of the panel was the balance of role between the government and the private business (see Kompas, March 18, 1983:1, 4).
soon, at least not in the next three years. So he argued for the government to start changing its course (banting stir) by expanding new economic resources and reforming its policies (Kompas, March 3, 1983:1). Sjahrir (1995), from a different perspective, also said basically the same thing in his editorials for Business News.

Kwik Kian Gie, for another example, wrote a long column for Kompas (March 30, 1983:4) with a striking title, Reorientasi dan Restrukturisasi Perekonomian Kita (Reorientation and Restructurization of Our Economy). Here he also explained that the falling oil price was a signal that the government’s economic policies should now be reviewed thoroughly. The economy, Kwik said, suffered not only from the export downturn, but also from its own weaknesses. And among the major weaknesses he discussed, he underlined the problems related to the policy of import substituting industrialization (ISI).

This ISI policy, for him, had been one of the sources of the high-cost economy. It forced the domestic consumers to pay higher prices for goods which could otherwise be imported with much lower prices, and it also made the Indonesian exports less competitive. From here he concluded that the industrial policy should be reoriented by applying the principle of comparative advantage and by relaxing the rules imposed on imports so the
domestic consumers could buy the goods they needed with cheaper prices in the international market.

The voices of these economists in early 1983 were amplified further by one important factor: at around the same time both the World Bank and the IMF, following their so-called structural adjustment programs, began to push more vigorously for more market-oriented policy reforms as part of Indonesia's response to its deteriorating economic conditions. In June 1983, for instance, at the IGGI meeting in Den Haag, the World Bank's representative, Peter Bottelier, presented a report to the Indonesian and other IGGI countries' delegations. In this report Bottelier explained that to achieve its target of 6 percent growth in the coming years, Indonesia should reduce its dependency on oil by expanding its non-oil exports. And, he said, much as had been said by the Indonesian economists above, that the only way at that moment for Indonesia to do so was to change the government's policies on trade and industry because these areas had been "overregulated" and had been excessively directed toward carrying the government's vision of inward-looking development (Kompas, June 13, 1983:1).15

14 For a good description of the evolution of the bank's policies toward the developing countries, including Indonesia, see Davesh Kapur, Richard Webb, and John Lewis (1997).

15 This report at IGGI was in spirit not very different from the bank's 1983
With voices like that, which the Indonesian media like Kompas and Tempo enthusiastically reported on their front pages or cover stories, the World Bank and IMF boosted the credibility and the urgency of the demands for policy change aroused by the Indonesian liberal epistemic community. Of course, both the World Bank and IMF had their own way to influence the course of policy in Indonesia, which was mostly done behind the scenes. But when they let some of their important reports be widely discussed in public, the effects were undoubtedly helpful in strengthening the cause pursued by such people as Sumitro, Sjahrir, Sadli, and Kwik Kian Gie.

After it started in early 1983, the effort of the epistemic community came into its full force in 1985. On April 8, as the honorary chairman of ISEI, Sumitro, along with Arifin Siregar and SB Joedono (ISEI's chairman and vice chairman, respectively), went to Suharto carrying the messages from ISEI's plenary session in Batu, Malang, held a week earlier. They tried to convince Suharto that, as the plenary session concluded, the annual report. Here the bank showed that, for instance, the extent of Indonesia's inward-looking industrialization could be seen from the fact that 96 percent of Indonesia's industrial output was for the domestic market. The domestic industries, in other words, exported very little of their products.

16 The World Bank in Jakarta worked mostly through Widjojo and his friends. Like Widjojo, its staff members were politically constrained from arguing directly in public for the policies they wanted the government to pursue. Bappenas, the stronghold of the Widjojo group, was the institution in Indonesia with whom the bank had the closest working relationship.
country's economic protectionism had created a high-cost economy. They suggested to him that the country would suffer endlessly if the uncompetitive state and private industries continued to be protected (Kompas, April 9, 1983:1).

Sumitro himself, in his public comments after the meeting with Suharto, said that the whole purpose of the new industrial policy was to increase the overall level of efficiency of the domestic industries. This purpose, he said, criticizing those who had been favored by the protectionist walls, "was often seen as a way to reduce the pemerataan of the kelompok yang bercokol." "But for the people in general," he continued, "...[It] means more justice" (Kompas, April 9, 1983:1). By saying this, Sumitro therefore directly attacked another popular myth in Indonesia: pemerataan (implemented through protectionist policies) meant justice, and efficiency injustice.

Five month after the ISEI plenary session, an even more important meeting among the economists was held. This time, in celebrating its 35th anniversary, University of Indonesia's de-

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17 It should also be noted that by this time, Sumitro had become Suharto's relative: Suharto's daughter, Siti Hediyanti (Titiek), married Sumitro's son, Prabowo Subianto, who would later become a three-star army general with a crucial political-military role in the New Order's final years in 1996-1998.

18 Pemerataan literally means economic equalization. But here Sumitro used the word in its pejorative sense, meaning unearned benefits. The words "kelompok yang bercokol" also carried negative meaning: the groups who did nothing but gain a lot of money, who therefore did not want to lose their privileged position.
partment of economics, the intellectual home of most of Indonesia’s influential economists, held a symposium on the problems and prospects of the country’s industrialization. This symposium -- which Hadi Soesastro (1989:850) called “the culmination of the intellectual attack against the system" -- was filled with the actors who had been directly or indirectly involved in the policy process during several different periods of the country's history. Many important members of the community like Iwan J. Azis, Anwar Nasution, Hadi Soesastro, Dorodjatun Kuntjoro-Jakti, and Mohammad Arsyad Anwar had their share in explaining the need for reform and in discrediting the post-Malari dirigist policy from many different perspectives. But the star was Sumitro. He was the keynote speaker whose words became the headlines in many newspapers the following day.19

Here Sumitro continued his criticism against the supporters of protectionism who often justified their arguments by referring to the trade-off between equality and efficiency. "There seems to be a confusion," he wrote, "in some economists and economic policy makers in regard to the problem of efficiency and

19 Kompas was quite up front in its coverage of him: besides putting his words as the headline on the front page, with a title that captured the whole essence of Sumitro’s ideas (Efisiensi Merupakan Prasyarat bagi Keadilan dan Pemerataan, Efficiency Is a Precondition to Achieve Justice and Equality), it also wrote one leading editorial explaining and supporting his ideas. See Kompas, September 11 (p.1) and 12 (p.4).
equality/justice.\textsuperscript{20} These people, Sumitro said, fed the public the idea that pursuing one would necessarily sacrifice the other. Such an idea, he explained, "was often used as an excuse to continuously protect the vested interests in various economic sectors." Moreover, he believed that protectionism was not the appropriate mechanism to pursue justice and equality, because, among other things, protectionism would always breed injustice and inequality in a new form.

Justice and economic equality, he explained further, could only be achieved if the country's limited resources were to be allocated in the productive fields, which in the end would increase the income level of the majority of the population. "In this context," he said, "economic efficiency will create a true justice and equality among groups and regions.... [It] was a precondition in giving ... operational meaning to the concepts of justice and equality."

Besides that, Sumitro also touched a broader problem, i.e., the proper relationship between the state and the economy. He reminded his audience about one of the underlying economic principles the New Order had preached in its early years. The principle was summed up in one slogan: de-etatism (de-etatisme)

\textsuperscript{20} Sumitro's paper in this symposium was later published, with some of his later pieces in \textit{Perdagangan dan Industri dalam Pembangunan} (1985). The quotation here is from page 74-75.
or de-control. By this principle, he said, the New Order wanted to emphasize and restore the importance of market forces. State intervention was accepted, but it was maintained for the purpose of reducing or eliminating the existing economic distortions, not vice versa. Now, Sumitro explained, the same principle should be revived again, in the form of deregulation policy:

"Though the situation has changed a lot, there have recently arisen many economic distortions in new forms which strangle the economic life. To overcome the distortions, a consistent...
deregulation policy is one of the important ways to promote the society’s economic life in a predictable business climate" (Sumitro 1985:77-78).

21 In a different academic celebration held a month earlier at IPMI (Institute Pengembangan Manajemen Indonesia, the Indonesian Institute for Management Development) Sumitro had also said more or less the same thing, by strongly criticizing Widjojo’s rival, i.e., the engineer camp, which by then was led by the German-trained Habibie, who replaced Sumitro as the minister of research and technology. Habibie was known for his view in promoting the application of the value-added (VA) principle, in opposition to the principle of comparative advantage. With this principle, Habibie wanted the state to build a large number of high-tech, capital-intensive industries, especially in the aircraft industry where he was the chairman. He believed that only by mastering and applying high-technology in the process of industrialization could the country be developed further. For Sumitro, this view was economically very costly to the country’s economy. Such high-tech industries sucked up the country’s limited resource into the sectors where the country could not compete and produce goods productively. Besides that, Sumitro said, the implementation of the principle of value-added required the government to erect an even higher level of protectionism. This would certainly make the matter worse: the country had suffered enough already with the level of protectionism it had had. So far, he explained, the industries that enjoyed the highest level of protection were the ones that were the least efficient. Attacking all these distortions and inefficiencies, for him, were the most important things for the government to do now, not adding their complexities and scope by erecting a new form of protectionism under a new label.
After this symposium, the intellectual momentum for the cause of economic policy change was kept alive by the outpouring of articles, academic writings and journalistic reports through 1985, and continued on through 1986 and 1987 as well. It was during this period that the idea of deregulation and the liberal consensus among the pro-market economists went almost intellectually unchallenged. Prisma, for instance, an academic journal which used to be associated with Indonesia's social-democratic camp, printed a series of articles in two of its numbers in 1985 emphasizing mostly the urgency of deregulation (Prisma 1985, No.1 & No.7).

In the same journal, Sjahrir wrote his lengthy academic articles explaining in detail many aspects and problems of the Indonesian economy and how those problems should be understood (see Sjahrir 1987). Thee Kian Wie, using the new political-economy theory on rent-seeking activities, explained the proliferation of rent-seeking activities caused by the multitude of dirigistic rules and regulations as well as the negative effects of the oil boom (Kompas, February 3, 1986:4; May 19, 1986:4; and December 10, 1987:4). Kwik, Christianto, Anwar Nasution, Hadi Soesastro, Sadli and others had their own contributions.

In the same vein, Kompas, besides its reports and its regular discussion panels, wrote many supportive editorials dur-
ing the period whose contents could be easily understood simply by glancing at their titles, such as _Menanggulangi Ekonomi Biaya Tinggi_ (Overcoming the High-Cost Economy), _Orang Bilang: Kita Harus Kembali Ke Basis_ (People Say: We Have to Go Back to the Basics), _Mendesak, Pemberantasan Rente Ekonomi_ (Urgent, Fighting Against Economic Rent-Seeking), _Swastanisasi Adalah Kebutuhan Zaman Ini_ (Privatization Is the Need of Our Time), _Mereka Menyebutnya ‘Perestroika’, Kita Menamakan Deregulasi_ (They Called it ‘Perestroika’, We Name It Deregulation). And at the same time, _Kompas_ was also becoming more intensive in its coverage on IGGI meetings, of the visits of high-ranking World Bank or IMF officials, and of the regular World Bank reports which, after presenting many data and analyses of the Indonesian economy for a certain period, usually ended up agreeing with the bank’s suggestions as to the particular economic sectors that needed to be reformed.22

Furthermore, quite interestingly, if in the period just before the outbreak of the Malari affair _Kompas_ published or translated the works of some world-renowned left-leaning thinkers like Mahbub ul Haq, during the high-tide of the intellectual

22 In respective order, these editorials were published in March 25, 1985; May 17, 1986; September 17, 1986; March 19, 1987; November 7, 1987.

23 See _Kompas_ June 16, 1986 (editorial); June 20, 1986:1; March 24, 1987 (editorial); March 25, 1987:1; June 18, 1987:1; July 1, 1987:1; July 4, 1987 (editorial).
battle for deregulation it published and reported the ideas of Peter Drucker and Alvin Toffler, both of whom were widely known for their views in emphasizing the importance of human creativity, efficiency, rational organization and the like in overcoming the challenges posed by the ever-changing economic reality.  

*Tempo*, through its clever investigative journalism as well as its witty linguistic style, brought to the public the empirical confirmations of what the economists had said all along about the negative impact of protectionism or the costs and "irrationalities" of regulation. In its cover story on the export-import procedures, for instance, it reported that in Medan's port 63 different official signatures were required before an exporter was given the permit required to ship his goods (in this case, vegetables) to Singapore; in Jakarta's port, Tanjung Periok, it was a bit "better": only 38 signatures, according to one estimation. Here *Tempo* also reported a complaint of an exporter who said that for every single signature, he had to provide *uang perdamaian* (literally, money for peace, which actually means bribery), which unmistakably showed one side of the high-cost economy in its naked practices (*Tempo*, April 13, 1985:13).  

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24 See *Kompas*, December 6, 1986:1; December 8, 1986, p.4 (editorial); April 9, 1987:4 (column), September 6, 1988:1; September 8, 1988:1.

25 In a different story, *Tempo* also reported, based on its interview with a
I wrote earlier that after the monumental symposium held by the University of Indonesia’s department of economics in early 1985 to about 1987 the ideas of deregulation and economic liberalization went almost unchallenged. Indeed, during this period, there were very few counter-arguments defending the existing dirigist policies in the major media or respected publications.

Among the few who did so from inside the government, for instance, only Ginandjar Kartasasmita and Hartarto, both Suharto’s cabinet members, said that the existing protectionist and import-substitution policies should be continued or even increased. But even then, their defenses contained very little explanation as to how they could use the existing protectionist policies, for instance, in answering the country’s fundamental economic problems as defined by economists like Sumitro, Sjahrir and Kwik Kian Gie. The dirigists, in other words, did not have any arguments explaining the constructive connections between

Japanese exporter, that so “irrational” was the regulation on shipment in the Indonesian ports that an exporter would have to pay more than twice as much if he sent his products from Japan to Jakarta, rather than from Japan to Singapore (Tempo, May 17, 1986:76). For many other stories with the same basic information, only in different economic sectors, see for instance Tempo’s reports in March 23, 1985:73; January 24, 1987:70-71; January 17, 1987:67-68.

Hartarto, though, would later change his position: he moved closer toward the Widjojo camp in about mid-1987. After he had converted, he declared that the ministry under his authority (the ministry of industry) would implement the deregulation program, albeit in a gradual manner. See Kompas, May 21, 1987:1.
the policies that they defended and the gravest economic problems of the day.  

From outside the government, the story was not much different. Before the negative impact of the falling oil price had become more obvious, the left-leaning, anti-capitalism intellectuals like Mubyarto, Arief Budiman, Adi Sasono, Dawam Rahardjo, Farchan Bulkin and others -- they were the younger Indonesian "socialist" thinkers who replaced the role of their seniors like Hatta, Mochtar Lubis and Sarbini -- had written a lot about the characteristics and dynamics of Indonesian development. But after 1983, and especially when the liberal consensus gained a greater momentum in the mid-1980s, there were surprisingly very few counter-arguments that came from this camp of intellectuals. Their major conceptual devices, like "state-capitalism", "poe-

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27 See for instance Ginanjar's column in Kompas, October 23 & 24, 1985:4 and Hartarto's speeches as reported in Kompas, September 18, 1985:1.

28 Most of them, borrowing widely the analytical tools from the Neo-Marxian and the dependencia school, believed that the process of capitalist economic development, which had occurred in Indonesia since the birth of the New Order, had strengthened and bureaucratized the state, at the expense of the society. The state officials and the capitalist class, according to these people, had conspired to weaken the society in an effort to continue their domination, political and economic. So they came to the conclusion that in order to pursue a "genuine," society-based development process, a different, radical development strategy was needed. Although they were rarely explicit on this point, this conclusion, if pursued to its ultimate logical end, would end up suggesting that the only way to have a better economic development was to nationalize and bureaucratize the economy, to increase economic protectionism, which would therefore increase the scope of dirigism much beyond what had been tried ever since the Malari affair. Among them, only Mubyarto believed a bit differently; he, like Hatta before him, believed that a better strategy was to expand the role of the cooperative, small-scale firms in containing the negative effects of capitalism.
ple-based development”, “radical development strategy”, “eco-
nomic dependency” and the like, seemed to be almost utterly use-
less in explaining the country’s major problems of the day, not
to mention offering a realistic solution. In an era when even in
the Soviet Union, with Gorbachev’s perestroika, the role of the
state was being gradually dismantled and, at the same time, the
pro-market ideas were becoming more respectable, it was very
hard for them to make their “radical strategy,” to borrow Arief
Budiman’s term, appear attractive in the public eye.

4.4 Summary

The technocrats, however important their role was, were
politically very limited: they were part of Suharto’s govern-
ment. They therefore could not become, to borrow John William-
son’s (1994) term, the technopols. They had to be content doing
their job in Suharto’s shadow, behind the scenes. So they could
not publicly build or enlarge the constituency of reform by dis-
crediting the old policies or argumentatively defend the new
ones. If they appeared too much in public, or were too pushy
with their ideas, or appeared to become too popular before the
public, Suharto would surely make their effort in changing the
policy much more difficult.

That was precisely the reason why the role of the growing
network of the liberal epistemic community was crucial. Members of this community were the only group of people who took on the job of discrediting the old policies, debating the dirigists, explaining to the public the fundamental economic problems as well as the virtues of the liberal solution. It was not the industrialists, the capitalists, the bankers, or the middle class in general, who proposed or who came to the defense of the new solution. It was the economists, the intellectuals, the writers and the journalists.

They began their efforts in 1983, and their greatest intellectual momentum came in 1985. From then on to about 1987, their ideas became, in Kuhn’s formulation, the “normal science” of the day. It was also the time when their intellectual response to the hard times became much more accepted by the public, which in effect enabled the technocrats to change the government’s economic policies at a faster speed, as we will see in the next chapter.
This chapter deals with the implementation of liberal ideas, in Indonesia often called kebijakan deregulasi (deregulation policy). As we saw in Chapter 3, when the oil price fell in the early 1980s, several policy actors began to argue for the need for a new policy. As a response to the growing economic difficulties, they wanted to dismantle the dirigist legacy and swing the policy pendulum back in a more liberal direction. After 1985 the force of their arguments became, in Andrew MacIntyre's words, "steadily less resistible" and at the same time, because the oil price continued its steep fall during the same year, the dirigist policy itself was becoming increasingly less sustainable (MacIntyre 1992:145).

So it was after 1985 that clear indications of a policy shift from dirigism to greater economic liberalism emerged, which, in its spirit, resembled the sharp policy turn that occurred in the early years of the New Order when the Widjojo group, supported fully by Suharto, began to dismantle the poli-
cies inherited from Sukarno’s Old Order.

The first section of this chapter describes the changing policy direction in 1983-1989. It will explain the major policies undertaken during the early years and at the height of the deregulation era. In the second section, before describing their limits, it will discuss the reach and the impact of the new policies on the Indonesian economy.

5.1 From Uncertainty to Resolution

In the early 1980s, the conduct of economic policy in Indonesia was plagued by uncertainties and contradictions. Habibie, Sudharmono, Ginandjar and other high officials in the dirigist camp still commanded the course of policy in many sectors, while the technocrats were not really sure when or even if the oil price would decline. The technocrats had already begun discussing the idea of reforming some sectors of the economy, but mostly inside their own group. Following their political calculations and realizing that the oil price might move sharply upward after a year or two, they thought that the condition was not quite ripe yet to introduce their ideas (at that time, what they had in mind was about reform, not deregulation or liberali-
The continuing protectionist trend during the early years of the 1980s was reflected in the sudden proliferation of non-tariff barriers (NTBs). The NTBs were designed to grant monopoly status -- sole-importers -- to some domestic firms in importing particular trade items\(^2\) and to expand the list of import items subject to quotas and licensing. The list consisted of a large number of items, from agricultural products like cotton, wheat flour, soybeans, sugar, to industrial materials like steel, plastics, chemicals, textiles. In one estimation, by 1985, of the 5,229 items imported, 1,484 required import licenses and 296 were under quotas (Woo 1994:113). According to Pangestu (1987:28) and Bresnan (1993:247), all of these items on the list amounted to more than half the value of Indonesia's total imports in 1985, or around $2.75 billion. With the new NTB measures, in short, the scope of the post-Malari ISI strategy was further expanded and made more complicated.

According to some sources in the Suharto government, the decision to increase the NTBs during the early 1980s was undertaken because the government was worried about the soaring defi-

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\(^1\) Interview with Radius Prawiro, May 1996 and Iwan Jaya Azis, May 1996.

\(^2\) The mechanism used in implementing this policy was called Tata Niaga Impor (Approved Importers System).
cit in the trade account. Although the measure was negative in the long run, in the short run it was believed that the only way to tackle this problem was by curbing or controlling imports. So, the NTBs were guided by necessity, imposed by a particular condition at that time (see Radius Prawiro 1998:261-262). Of course, to some extent, this explanation makes sense. The deficit was the first deficit since the founding of the New Order. Hence, it was understandable if Suharto's policy makers overreacted, grabbing whatever policy options were available to solve the problem immediately.3

But that is only part of the story. The recipients of the new import licenses or the sole importer status were the state enterprises and the private firms, many of which were very closely related to Suharto and the power centers inside his government. In regard to the import of various items under the category of steel and iron for instance, the business was reserved mostly for the state-owned company, PT Krakatau Steel, which, in accordance with the post-Malari industrialization

3 In a way, the case of the proliferation of import licenses following the deficit in the early 1980s can be offered as proof that the decline of the oil price, or the threat of economic crisis, by itself does not necessarily lead to a policy shift toward liberalization. As this case shows quite clearly, when the ideas of liberalization and the political or public pressure in connection with them had not yet been on the table, economic crisis might be responded to by the policy makers simply by adopting more dirigist measures, thus increasing the scope of the state intervention which, ironically, had been considered part of the problem that led the country into the crisis in the first place.
scheme, had been given monopoly status to import and distribute the products in the domestic market since 1979. In 1984, a private company, PT Giwang Selogam, was given the sole-importer license to import and distribute cold-rolled steel on behalf of PT Krakatau Steel. And finally, after 1985, all other firms, except the two companies, were excluded from the business. Who owned and controlled PT Giwang Selogam? Liem Sioe Liong, Sudwikatmono and their business associates. Both Liem and Sudwikatmono were widely known to be directly protected by Suharto (Sudwikatmono is Suharto’s close relative while Liem is Suharto’s close business associate and perhaps Indonesia’s richest businessman).

So here we can see one good example of how political and economic connections played a role too in causing the proliferation of the NTBs: the opportunity, i.e., the need to reduce the trade deficit, was seized by both the nationalist-bureaucrats who controlled the state industries like PT Krakatau Steel and Suharto plus his cronies to impose greater control on a lucrative business (more of this subject in the next section). So it was quite clear that the sudden increase of import licenses in the early 1980s was not only caused by the need to reduce the trade deficit immediately, but also by some pressure which di-

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4 For a more detail description on this, see Tempo, March 31, 1984:69-70; Bresnan 1993:250.
rectly came from the very top of the New Order’s power pyramid.

The most significant policy initiative in respect to its impact on changing or reducing the role of the state during this early period occurred in June, 1983 (McKendrick 1989:192). In contrast to the trade policy as we have seen above, in June the government introduced policy changes toward the banking sector, underlining to a certain degree the willingness of the Suharto government to shift its course to a more pro-market approach in regard to banking operations.

The initial policy input of this new banking scheme was given by the World Bank and the IMF. But to the surprise of many, according to Cole and Slade (1996:101), co-authors of an excellent book about the Indonesian financial sector, “the final mix of policy went well beyond either the Bank or the IMF proposals.” Ali Wardhana (the coordinating minister for economic affairs) and other technocrats expanded the proposals submitted by the World Bank and the IMF further without much consultations with other high-ranking officials in the sectors affected by the new policy.®

® For me this was one of the good cases which proved the argument that although the role of the World Bank and the IMF was important, it was the technocrats themselves who shaped the final form of the deregulation policy. It was also a good case which showed to us that the origin of the liberal reform was not imposed upon them by any external actors. On this listen to Radius Prawiro: “I can trace the origin of my personal involvement in the deregulation movement to a day I spent with Widjojo. A few weeks after being appointed
With the new policy, some of the post-Malari regulations imposed on the state banks -- credit ceilings, interest rate regulations, general liquidity credits -- were dismantled. For the first time the state banks, whose total assets and credit disbursements dwarfed those of the private and foreign banks in the country, were given the opportunity, albeit limited, to compete with one another and with the private banks to offer their credits as well as to collect funds from the society. Their deposit rates were allowed to fluctuate freely following the law of supply and demand.

The most crucial part of the new policy was the removal of the credit ceilings. With this, the state banks were partly freed from their role as mere instruments of the central bank, Bank Indonesia, in controlling total credit. The banks, in other words, were given greater space to fulfill their role as true financial intermediaries, moving and reallocating the society's savings to the business sectors where they could yield higher

Minister of Finance in March 1993, I spent the day traveling with him ...to several industrial sites around Java... Deregulation as a general concept had been circulating among economists and academics, but the government had not embraced it, nor had the government decided to try to deregulate any particular industry or sector. At one point, Widjojo and I were seated in a Hercules military airplane between inspections and engaged in an intense conversation. Given my new responsibilities, I wanted to find some way to reinvigorate the banking system. As the conversation progressed, we concluded that the only way to help the banking sector was to give it more freedom. The exact nature of that freedom needed to be studied, but in that conversation we both confirmed our conviction that progress in the financial sector would require deregulation. Upon returning to Jakarta, we immediately set ourselves to the task of
returns (McKendrick 1989; Pangestu 1996).

Important as it was, though, this new banking initiative affected mostly the state banks. Many of the regulations limiting the role of the private as well as the foreign banks remained untouched. Moreover, even with the new policy, the state banks were still directed to allocate some of their funds to meet the politically defined objectives, like increasing the role of the *pribumi* and the weak firms. They, in short, were still obliged to play their designated role as "agents of development", a role they had to share with the state-owned corporations in many different sectors.

Apart from the contradictory policies relating to the trade and banking sectors, most other major policies during the early years of the 1980s were undertaken as prudential macroeconomic responses to the declining oil price. To ease the increasing pressure on the budget, for instance, the government took risky decisions to cut the oil subsidy in 1983 and 1984, thus in effect raising the domestic price of petroleum and kerosene, and at the same time freezing the salary of state employees (around 3 to 3.5 million people in the early 1980s). Also, the govern-

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6 In 1982 the oil subsidy was Rp1.5 trillion; in 1984 it was "only" Rp698 billion. For a more detailed description of this, see *Kompas*, January 13-14, 1984:1.
ment devalued the rupiah drastically, reforming the tax system and rescheduling mega projects, especially those that relied highly on imported capital goods like the olefin factory in Lhok Seumawe and the crude oil refinery in Musi (Kompas, May 7, 1983:1).

In sum, during 1982-1985, we did not see any clear policy trends: on the one hand there were some measures intended to reform the banking sector, and on the other there were also some major policies which increased the scope of the post-Malari dirigist policy, particularly in the trade and industrial sectors. At that time it was still far from certain that the dirigist trend could be halted, or that the initial reforms in the banking sector would be followed up by tougher policies in other areas. What was quite clear then was that, because the dirigists’ interests were so entrenched in the country’s economic system, it would take a considerable amount of effort and political will to start dismantling even some of them.

The first sign that something more serious was to come occurred in April 1985. With one stroke through a presidential decree (Dekrit Presiden No.4/1985), the government’s customs agency was almost completely privatized. The agency, with 13,000

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7 On the tax reform in Indonesia, the best account so far is Malcolm Gillis, in Musgrove et al. (1994).
employees, was responsible for monitoring and inspecting the flow of goods, international and domestic, in the country’s ports. It functioned as a kind of gatekeeper of trade. This function, due to the geographical nature of Indonesia, was very important. In the late 1970s, there had been several attempts to improve the operation of this agency, but they did not seem to work. Worse, by the early 1980s it was widely believed that, as Radius Prawiro said (1998:265), the agency had become “a law unto itself.”

Instead of facilitating the flow of trade, the agency became the source of delays and corruption. It often took weeks, or even months, for exporters/importers to wind their way through the bureaucracies in the ports. No wonder, when the government finally decided to freeze the operation of this agency in April 1985, and replace it with a fully private, Swiss-based agency (Société Générale de Surveillance, SGS), it was considered a big move and was applauded widely in the country’s major media (Tempo, April 13, 1985).  

Some skeptics believed that this decision was not so important as it might appear. Yoon Hwan Shin, for instance, maintained that this decision should not be seen as a prelude to at-

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8 For a more detailed information about this, see Dick (1985) and Liddle’s Of Virtue and Vice..., FEER, May 16, 1985.
tackling the inefficient bureaucracy. Nor should it be seen as a promising early assault on the entrenched economic interests of the military or the political class. Moreover, regarding its effects on the overall performance of the country's trade, the decision, for Yoon Hwan Shin, was "more symbolic than real" (1989:150).

It is true that the customs agency was only a small segment of the whole state economic activity in Indonesia. Although it served an important function, the agency was not directly connected with the major economic interests of Suharto, the military, Golkar or any other important players inside the New Order power's structure. So there was really no big loser when the agency's operation was terminated. In this sense, Yoo Hwan Shin's skeptical view was warranted. As to the impact of the decision on the overall export performance of the country, the skeptics might also be closer to the truth. Trade activities are not enhanced suddenly simply by removing delays and corruption in the ports. The customs agency is only one part of the long chain of institutions that affect a country's overall export performance.

Having said all that, however, we have to remember that by deciding to freeze the operation of its own customs agency, the New Order government undertook something which it had never done
before: trusting a private company, and a foreign one at that, to serve a vital public role. In the context of Indonesia, where private, not to mention foreign, economic agencies were always regarded with suspicion by the public and the political elite, the decision was therefore something that could not be considered lightly. Moreover, it also showed for the first time that the government was willing to face the issues of corruption and inefficiency head-on. By relieving the agency of its function, the government practically removed about half of the agency's 13,000 employees, all whom were native Indonesians and state employees (pegawai negeri). Following this decision, moreover, the government shortened the trade procedures in the ports, for instance by reducing the signatures needed to import goods from twenty to one (Radius Prawiro 1998:266).

In short, the decision was important because it showed at that time that the government was willing to take a new measure, a breakthrough, in order to improve the country's trade performance. It was also important in a different way: the decision was a sign that the technocrats had strengthened their position in the policy making process. The decision to terminate the operation of the agency came directly from the ministry of trade, led by Radius Prawiro. Two months before the decision was approved by Suharto, Radius Prawiro had relieved the Directorate General
of Customs and Excise of his position and assumed the responsibility himself, an intra-bureaucratic move quite uncommon in Indonesia at that time, which in a way was quite comparable to the drastic action in the mid-1970s when the technocrats moved to take control of the hugely-indebted Pertamina.

Prawiro subsequently held the position for two years. He was among the persons who convinced Suharto that employing a foreign firm, SGS, in providing customs services would actually be beneficial for the country as a whole. And when the decision turned out to be popular, it was he and other technocrats who were given much of the credit by the public, the media, and the business elite. All of this, of course, increased the credibility of technocrats, who were becoming more convinced during that time that the country was ready for bolder moves (Radius Prawiro 1998).

The long-awaited policy shift finally came in 1986 with a policy package called Pakmei (shorthand for Paket Mei, May Package). The policy package was a milestone, as Radius Prawiro (1998:268) explained, not because it was comprehensive or radical, but because it "represented the government's most firm and explicit confirmation of what would be a long struggle to re-

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9 From this time on all major deregulation policies would be grouped in policy packages, consisting of several measures applied to different sectors. The
structure the Indonesian economy without the prop of oil."

This policy, in short, symbolized the beginning of what he called "the deregulation movement". Intended as a measure to give a boost to the country's non-oil exports, the focus of this new policy package was on trade and investment, which had been singled out as the sectors of the economy most responsible for contributing to the high-cost economy and uncompetitive exports.

In regard to trade, the new policy had several major components. First, it was a tariff reduction measure: the country's average weighted tariffs were reduced from 22 to 13 percent. Second, more importantly, it contained export incentives. Here the government permitted the companies that exported 85 percent or more of their products to bypass the licensing system if they needed to import the components of their productions. The rule also allowed the exporters in manufacturing sectors to import their components free of quota restrictions. So with this new measure, the government wanted to reverse the trend of NTB proliferation.

The third and fourth components were the creation of new bonded zones where goods were permitted to enter the country without paying import duties and the establishment of a new system of procedures, namely the import duty drawback system. Here term paket (package) for a group of new policies began also at this time.
the government established a new office, called the P4BM (Pusat Pengolahan Pengembalian dan Pembebasan Bea Masuk, Center for the Management of Import Duty Exemption and Restitution), intended to simplify the rules and help the exporters to reduce their production costs.\(^\text{10}\)

In regard to investment, the new policy was chiefly intended to relax the post-Malari regulations in order to encourage higher inflows of foreign investment. (Until 1985, foreign investment levels in Indonesia were still well below 1975 levels.) Here the government increased the level of foreign equity permitted in the export-oriented firms. For the firms that exported at least 85 percent of their products, 95 percent of foreign ownership was now permitted. The relaxation of rules was also applied to companies that brought in a certain level of capital from abroad or operated in designated areas the government was promoting, as in eastern Indonesia. Besides this, the new policy also made several adjustments regarding the duration

\(^{10}\) This new system replaced the SE (Sertifikat Ekspor, Export Certificate) scheme. The SE scheme, according to Hal Hill (1996:114), was a "costly, blunt and much-abused instrument." The exporters received direct payments according to the specified amount shown in their export documents; the government officials oversaw whether the documents were correct. In practice, as Hill indicated, the exporters and the officials often colluded and, hence, the payments "often bore little relation to the actual export performance" (ibid). Under the new system, exporters were able either to import their inputs duty-free or seek reimbursement for such duties through a much-improved mechanism, e.g., exporters could only send their documents by mail or courier, they were not allowed to meet the officials processing their documents. The whole procedure was computerized and the length of time it took shortened, thus reducing the

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of permits for foreign investment, specific tax exemptions for imported capital goods and the like (Muir 1986; Pangestu 1996).

As Radius Prawiro said above, this new policy package might not be as comprehensive and radical as it should be. There were still many segments and interests left untouched. Still, as a first step, it was a bold one, indicating that the government was finally willing to reverse the basic course of its policy which had been in place for around two decades.

After this May package, the government subsequently produced one new package after another for several years. And as the liberal consensus grew stronger thanks to the persistent effort and arguments of the country's epistemic community as well as the continuing pressure, from behind the scenes, of the World Bank and the IMF, these new packages were becoming wider in scope and deeper in impact.

To continue the policy shift further, the government produced major policy packages in October 1986, December 1987, November 1988 and May 1989. In regard to foreign investment, for instance, the package in December 1987 (Pakdes) -- consisting of no less than 48 different decrees signed by the president, 9 ministers and several other high-ranking officials in the state technical departments -- either substantially reduced or com-

opportunity for corruption (see also Barichello and Flatters 1992: 282-284).
pletely dismantled much of the post-Malari restrictions which had been imposed, as we have seen in Chapter 2, by the government in order to accommodate the growing sentiment of anti-foreign capital in the country at that time.

The new investment policy in this package permitted 100 percent foreign ownership in a designated area (Batam), lowered the level of domestic participation in PMAs (foreign investments) from 71 to 51 percent, or to 45 percent provided that 20 percent of the shares were sold in the capital market. For the PMAs which fit a certain criterion, i.e., were highly export-oriented, the new policy provided several other important incentives in regard to the minimal capital requirement and staff recruitment -- they were now permitted to hire as many foreign staff as they would like to, for whatever positions (Tempo, January 2, 1988:89; Pengestu 1996:158).

Besides all this, the new policy also replaced the DSP system with a new one, called DIN system (Daftar Investasi Negatif, Negative Investment List), which was much better in terms of its simplicity as well as clarity. Unlike the old one, the new system contained only a list of activities closed to foreign investors; any activities unspecified in the list were open to them. More importantly, with the new system, the government significantly expanded the area of business activities open to foreign
investment, from 475 in 1986 to 926 in 1988 (subsequent packages in 1989 and the early 1990s reduced further the number of activities on the list). Some of the upstream industrial activities which were previously considered "strategic" were now declared open to foreign investors, such as machinery, chemicals and metallurgical industries.

The liberalization process in respect to trade activities was no less impressive. The December package (Pakdes) in 1987, for instance, relaxed 111 items which had been imported via designated importers and cut import monopolies, from 278 to 70.\(^{11}\)

One of the important achievements here was the substantial reduction of the monopoly status enjoyed by PT Krakatau Steel (the new rule covered up to 50 percent of its imports). Along with the previous measures that reduced the monopoly status of the country's state enterprises, particularly in the textile industries, this policy was a testimony that to some extent the technocrats were able to expand their reach in shifting the general direction of the New Order's economic policy into the areas previously considered impossible to touch.

The December package was followed up by an even more deci-

\(^{11}\) For the items which were not covered by the new measures, the government usually applied a two-stage mechanism. First, the form of protection was shifted, from non-tariff to tariff. Second, the tariffs were gradually reduced through several different decrees over the years.
sive one in November 1988 (Pakno). With this package, which contained 18 different new measures, the government substantially liberalized the country's interisland shipping industry, reduced the coverage of quantitative restrictions or import licensing system on 318 trade items, and continued to reduce further the scope of the monopoly power enjoyed by PT Krakatau Steel.

Along with this, more importantly perhaps, the November package also made an important breakthrough by completely freeing the import of plastics from the coverage of the licensing system. Like steel, plastics was used by many downstream industries to produce a multitude of consumer products, from utensils, furniture, cars, kitchen wares, to television sets. Previously, the import of a variety of basic materials for the plastics industry was controlled by three state trading corporations, PT Panca Niaga, PT Mega Eltra, and PT Cipta Niaga.

In their operations, these three companies appointed a single private company based in Hongkong, Panca Holding Ltd., which was owned by Sudwikatmono (two of Suharto's sons, Sigit and Bam-

12 For a good report on the deregulation of the shipping industry, see Kompas, November 27, 1988:1,13.

13 Before this new rule, the value of various steel imports controlled by this company was $600 million; after Pakno, it was reduced to $100 million. See Tempo, November 26, 1988:86-88; Djasman S. Simandjuntak 1989:24-26.

14 In 1986, only PT Mega Eltra retained this monopoly power.
bang, sat on its board of directors), as their sole agent for all plastics imports. So, in effect, it was this palace-connected private company which controlled the trade of plastics, and in the process managed to make a lot of money out of it by practically doing only the paper work; in 1985 the company earned $30 million (Bresnan 1993:249). The cost of all this, of course, had to be borne by the consumers. According to one estimation, the monopoly of plastics imports resulted in 30 to 40 percent rise in cost to consumers (Woo 1994:114).

So, with the November package, the technocrats managed to dismantle a big-ticket collusion between the state corporations and the "palace businessmen" and, in effect, reduced another major source of the country’s high-cost economy. With this, and previous packages, the New Order’s trade policy had clearly become more pro-market in its approach. All in all, by 1988, 839 non-tariff barriers had been removed and tariff levels were lowered in 2,481 cases (Conroy and Drake 1990:21). To put it in a different way, from 1986 to 1989 the coverage of the NTBs was reduced from 43 percent of imports by value to 17 percent. In terms of the number of manufacturing production covered by the NTBs, the reduction was also no less striking: from 68 percent in 1986 to 38 percent in 1989 (Hill 1996:114).

The shift in policy after 1985 did not leave the banking
and financial sectors untouched. In fact, because these sectors were among the most restricted and politicized ones in the Indonesian economy, it was here that the deregulation movement went the furthest, the consequences of which often surprised even the country's most ardent supporters of liberalization. For three to four years after the 1983 banking deregulation, the government made some adjustments to deal with the expanding complexity of the money market by introducing indirect measures of monetary control, i.e., *Surat Berharga Pasar Uang* and *Sertifikat Bank Indonesia* (Titin Suwandi 1995). And particularly in the period of September-October 1984 and May-June 1987, the government's monetary actions were concentrated upon finding the appropriate answers to the recurrent speculative attacks against the rupiah, culminating in what was widely known as *Gebrakan Sumarlin* (Sumarlin's Strike). The real breakthrough which destroyed the age-old structure of banking and finance came in October 1988 (Pakto). It included 47 different decrees. Several weeks after

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15 Sumarlin was the acting finance minister during this period. He launched this preemptive move as a response to the threat of a speculative run against the rupiah in early and mid 1987. In December 1986 and January 1987 it was estimated that as much as $1.7 billion and $500 million, respectively, were taken out of the country. In March the flight calmed down, but in May it picked up its momentum again. To calm the market, the government raised interest rates by a small margin, but to no avail. Faced with the threat of possible collapse of the rupiah, Sumarlin made his move on June 22. He ordered four giant SOEs to withdraw large sums of their funds in the state banks to purchase SBIs. Accompanied by some other measures several weeks later, *Gebrakan Sumarlin* achieved its desired effect in halting further attacks against the rupiah (Hill 1987:5-7).
this policy package was launched, an American observer com-
mented: "...Pakto, if fully enacted, would make Indonesia among
the most open banking environments in the third world" (McKen-

As we have seen in Chapter 2, because of the strict limita-
tions imposed upon private and foreign banks, the country's
banking and financial sectors were practically dominated by the
state banks, which were in turn controlled tightly by the cen-
tral bank and the ministry of finance. The 1983 deregulation re-
laxed this control, but not completely. Very few foreign banks
were allowed to operate, and they could only operate in Jakarta,
with strict regulations regarding the proportion of their owner-
ship, capital requirements and credit disbursements. The domes-
tic private banks had a bit more freedom, but they also suffered
greatly from the same restrictions (McLeod 1984; Titin Suwandi
1995). The October package changed all this, and much more.

For the first time, foreign banks were allowed to set up
branches outside Jakarta, in six of the country's major cities,
provided that they disburse 50 percent of their loan portfolio
to export-oriented firms. Foreign banks were also permitted to
open joint ventures with domestic banks, with a very relaxed
regulation regarding their share of ownership and capital re-
quirements. Up to 85 percent foreign ownership was permitted,
with at least Rp50 billion paid up capital.

In regard to domestic banking, the new rules now permitted practically any Indonesian who could provide a minimum paid up capital of Rp10 billion -- not a huge sum of money for many rich Indonesians at that time -- to open up a new bank. For the existing private banks, they could now open branch offices anywhere in the country; and for them, no license was needed to open a sub-branch. There was also a new rule reducing substantially the reserve requirement, from 15 to 2 percent, which enabled banks to expand their lending as a proportion to their deposits.

In addition to all this, the October package also provided more incentives for competitive banking practices by freeing the state enterprises from their obligation to put all their deposits in the state banks. The enterprises now needed to put only 50 percent of their deposits in the state banks; for the rest, they were free to choose any private bank to manage their funds as long as they did not deposit more than 20 percent of their funds in a single commercial bank.  

Besides that, as a follow up to the October package, the government launched another important package in December (Pak-

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des). This package was chiefly intended to expand non-bank financial resources by, among others, reviving the long-dormant stock market, the Jakarta Stock Exchange (JSE). As we know, since the government reopened the JSE in 1977, there had been very few significant activities in this vital institution. Like other financial institutions during that time, the JSE was strictly managed by the government, through Bapepam (Badan Pelaksana Pasar Modal, Capital Market Executive Board) and PT Danareksa, in order to achieve the post-Malari policy objectives of economic equalization and Indonesianization. PT Danareksa, for instance, was given the privilege to subscribe to at least 50 percent of any public offering approved by Bappepam. To avoid competition, no foreigner was allowed to take part in the process of selling and buying of shares in the market. In 1987, the first step to improve the JSE was undertaken, which was followed up by the December package in 1988 which was mentioned above.

With these new measures, many of the restrictive rules were relaxed and the prior politically-designed priorities imposed upon the JSE were abandoned. PT Danareksa's privilege to buy at least 50 percent of all new issues was eliminated. Up to 85 percent foreign share ownership in security companies was permitted. The 4 percent fluctuation limit on listed shares was abandoned, and for the first time the creation of privately operated
stock exchanges in several cities was permitted (Radius Prawiro 1998:243).

5.2 The Limits of Economic Liberalization

By the end of 1989 the liberal initiative to change the New Order's economic policy had reached its fourth year. During this period, there were consistent efforts by the technocrats to reform the country's trade, financial, and industrial sectors. However, despite all the efforts and the demands for change, there were some major sectors of the economy left untouched. In some sectors the reform process was substantial, even radical. But in others, it was no more than a cosmetic change which was far from solving the basic economic problems inherited from the past. To these problems and limits of reform we now turn.

5.2.1 State Enterprises

The most important among these unresolved problems was the status and operations of the state-owned enterprises or the BUMNs (Badan Umum Milik Negara). As a group, the state enterprises were the largest business conglomerate, controlling the largest pool of domestic capital, in Indonesia. Numbering 215 in the early 1980s, their activities ranged from simple to the most complicated modern businesses like aircraft manufacturing, built
and led by the German-trained Dr. Habibie, an arch-rival of the technocrats. Most of the big state enterprises were concentrated in the public services (airlines, utilities, constructions), mining (oil, gas, tin), finance and banking, and basic manufacturing industries. Because of their sheer size and influence, an Australian observer once said that the state enterprises in Indonesia were in practice "states within the state" (Hill 1996:101).

Many of these companies held monopolies or enjoyed extensive favoritism given by the government. Pertamina, Bulog, PT Krakatau Steel, PT Tambang Timah, Garuda, PT Danareksa, PT Nurtanio, PLN, and the five state banks, among others, became giants of the Indonesian economy precisely because of such monopoly and favoritism. Together, according to Christianto Wibisono, they accounted for almost 60 percent of the country's domestic investment in the late 1970s and early 1980s (Tempo, March 14, 1981:70-72). In the mid 1980s, during the oil crisis, there was no sign that these enterprises were declining. On the contrary, measured by their sales as percentage of GDP, their operations expanded over the years (Hill 1996:104; Booth 1998:200).

Despite the extensive favoritism that they enjoyed, however, most of the state enterprises were inefficient, some hopelessly so. Empirical research conducted by Dick (1987), Funk-
houser and MacAvoy (1979), Gillis (1982), and Hill (1982) on the performances of these companies in different sectors produced various but consistent results: their performance was uncompetitive and generally inferior to that of the private firms. Some of the big state enterprises had never even earned any profits at all for decades.

The rate of return on capital for all of the companies was a low 3 percent in the mid 1980s, a rate which would be considered untenable by the standard of private firms. For those which were directly controlled by the department of industry the returns were even lower, ranging from 2.5 to 2.8 percent. And for the companies controlled by non-departmental groups, like those defined as strategic industrial firms, the returns were lower still, less than 0.5 percent in 1985 and 1986 (see also Hill 1996:104-105; 1997:324-340). With such actual performances, no wonder that many of them became part of the national problem, reducing the ability of the government to manage its way out of the crisis in the mid 1980s.

Realizing such problems, some of the technocrats began to voice the need of fundamental enterprise reforms, as part of the deregulation process as a whole.¹⁷ Even some of the New Order's...

¹⁷ Before 1986 there were various attempts to reform the working of the state enterprises. The most important of these was the effort to lessen the control
high-ranking officials who were not known to be members of the Widjojo group went further, by suggesting that the best solution for the problem was *swastanisasi* (privatization), selling them to the private sector. One of such officials was Ruchyat Kosasih of BPKP (*Badan Pemeriksa Keuangan dan Pembangunan, The Auditing Board for Finance and Development*). At a seminar commemorating the 37th anniversary of the University of Indonesia in January 1986, he delivered a paper arguing for such privatization. For him there were a lot of state enterprises in various sectors, e.g., trading companies and contractors, which were not strategically important to the country. These companies, he said, should be sold or liquidated (Habir 1995:49).

A voice like Kosasih’s was very controversial in the context of Indonesia’s intellectual landscape, even in the mid 1980s. Hence his paper was subsequently picked up by the media and became the source of heated public debate. The controversy, surprisingly, persisted for quite some time, continuing until the early months of 1987.

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of the technical departments, whose interventions over the enterprises’ operations were often pointed to as the major reason why they were so unproductive, by giving more autonomy to the managers of the state enterprises and by strengthening the role of the finance ministry, which at that time was led by one of Widjojo’s men. This reform effort was started by a government decree (Decree No. 3/1983). This effort, however important, was far from enough to solve the basic problems. There was no evidence that after it was announced, the state enterprises’ operations changed substantially, or that they became more profitable over the years.
The result? Nothing much. To be sure, the coordinating minister of finance and economic affairs, Ali Wardhana, responding to the idea of privatization and the need to reform the state enterprises, formed a small team to study the issue further, starting in December 1986. This team was led by Yusuf Indradewa and Nasruddin Sumintapura, both Wardhana’s close confidants. Its chief task was to review the performance of the state enterprises, and on this basis, submit a report to the coordinating minister, who would then consider which of the companies needed to be sold, liquidated, or reformed. Even more important, President Suharto himself, in March 1987, formed a team led by Ali Wardhana, with Sumarlin, Radius Prawiro, Sudharmono, Arifin Siregar, and Sugandhi as its members, to evaluate the conditions of the state enterprises. Like the team formed by Ali Wardhana previously, this new team was also given the task to help Suharto in making his decision as to whether the privatization program should be undertaken.

But even a year after these teams were formed, there was practically no substantial policy initiative in the direction of privatization. While other sectors of the country’s economy were substantially deregulated in 1988-1989, the operations of these companies -- excluding those in the banking and financial sectors -- went mostly unaltered. "The year of 1987," said Habir
(1985:88), who wrote a dissertation on the state enterprises in the 1980s, "had begun with optimism that the government would finally begin to be serious about state enterprise reform." It was soon proven that the optimism was unwarranted.

Why the failure? If the technocrats managed to successfully liberalize the regulations of trade, for instance, why couldn't they do the same thing to the state enterprises? The answer to these questions, I think, lies in the interplay between interests and ideas. In regard to interests, the chief problems of reform ultimately lay in the fact that the vested interests surrounding the operations of the companies were too great for the technocrats to tackle. At one level there were the interests of the technical departments, who were the beneficiaries of the existing arrangements. On the relationship between these departments and the enterprises, Hal Hill said: "State enterprises under their [the departments] control constitute a valuable source of additional funding. It is common practice for senior bureaucrats to sit on the board of such companies, the fees from which often exceed their official government salary. These enterprises frequently provide additional perquisites for departmental staff, ranging from housing to international travel..." (Hill 1996:105).

At another level, there were also the interests of the core
political institutions of the New Order. Many of the officials who sat on the boards of the companies were directly picked from the military, mostly from the army, especially the high-ranking officials who were preparing their retirement. Even Suharto himself was directly involved: 5 percent of the annual profits of the state enterprises were to be contributed to his yayasan (semi-public foundations). For Suharto, moreover, the possibilities and luxuries provided by the companies to the elite in his government meant that he had a wider opportunity to satisfy the social and material needs of his core and loyal supporters.\(^{18}\)

So, with such interlinkage of interests, it was not surprising that the leaders of the technical departments, including Ginandjar Kartasasmita and B.J. Habibie, mounted strong counter-reactions against the ideas of privatization (Habir 1995). And it was also quite obvious that, because Suharto and other military leaders were also deeply involved and were the beneficiaries of the existing arrangements, the technocrats lacked the ultimate prerequisite -- i.e., political backing from the top --

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\(^{18}\) The foundations were formed in the early years of Suharto’s rule. Some of their objectives were social, i.e., to give grants to the sons and daughters of war veterans; to build mosques around the country, and the like. Some others were purely political: to financially support Golkar, the political party of the Suharto government, to win election every five years. On a wider perspective about how Suharto, as an astute political actor, managed to use the state’s resources to achieve his specific objectives (distributional, developmental, patrimonial), see Liddle (1996:107-140) and Liddle in R.H. Taylor (1996).

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to win over the reactionaries.

In regard to ideas, the core problem here was related directly to the intellectual ambivalence toward the ethnic or racial consequences of privatization. If the state enterprises were sold, who would be the most likely buyers in the country? Undoubtedly, the majority of them would be the big Sino-Indonesian businessmen. A survey conducted by the weekly Warta Ekonomi in 1989 found out that among the 40 biggest private business conglomerations at that time, 28 were owned by Sino-Indonesians. The biggest ten were all owned by them (Warta Ekonomi, July 31, 1989).

Their domination in the economic landscape (they comprised only 3 percent of the whole population), had long been one of the major sociopolitical issues in the country’s history. It had caused many riots and in the past had strengthened the resolution of the nationalists to launch economic programs to help the prihumi firms, which, unfortunately, created more opportunities for the bureaucrats and their cronies rather than truly helping the intended targets. In short, it was this issue which was used by the foes of the technocrats to block any plan to privatize the companies.

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19 For instructive discussions on this issue, especially its economic dimension, see Dorodjatun Kuntjoro-Jakti (1989); Richard Robison (1986); Glass-
This issue was very effective, because even the technocrats and the liberal epistemic community were uncertain and divided in their reactions to the possibility that the state enterprises might be taken over by the private firms controlled by the Sino-Indonesians. Only a few of them were as resolute in suggesting privatization of the state enterprises as when they were talking about the liberalization of trade.  

This point can be understood well if we see that even Tempo, the weekly magazine led by the poet-journalist Goenawan Mohammad, undoubtedly the first in its class which had been standing at the forefront of the public discourse on the need to deregulate the economy, was not free from some sort of fear that the Sino-Indonesians might increase their power over the economy, at the expense of the native Indonesians, the pribumi. "The gap between pribumi and non-pribumi," said one of its reports, "looks more transparent because the Indonesian economic cake has not been distributed proportionally. According to a businessman, three million non-pribumi control 60 percent of the Indonesian economy... If the pribumi are allowed to remain weak, later, by the year 2000, the pribumi may have no power at all" (see Hill 1996:106).

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burner (1971).

Interview with Harry Tjan Silalahi (November 1996); Sjahrir (July 1996);
Among the technocrats, the same kind of concern over the non-pribumi economic domination was also present -- maybe even more so. Prof. Sadli, for instance, who was the most intellectually productive and, second only to Widjojo, the most perceptive among the technocrats, was in no doubt that if the privatization program was to be undertaken, the Sino-Indonesians would prevail. "If that happens, are you prepared?" he asked dejectedly on one occasion.\(^{21}\)

For him, instead of a full-scale privatization, it would be better for the country if the policy makers pursued commercialization programs. These programs, unlike privatization, Prof. Sadli said, "will force the state enterprises to behave like private companies. They will become more profit oriented, without transferring their ownership... If that sounds a little bit nationalistic, so be it." He continued,

We also know that in the end you have to pay a price for such a nationalistic sentiment. We could run faster, maybe, with privatization. But if we liberalize everything, the Chinese [sic] will take everything. They can do anything they want. Sure, our growth rate will be higher, perhaps like Thailand, 9 to 10 percent per year or more... The western countries would like that... But Widjojo and I do not support it.\(^{22}\)

It is here that we can clearly see the limits of liberali-

\(^{21}\) Interview with Prof. Sadli (May 1996).

\(^{22}\) Interview with Prof. Sadli (May 1996).
zation. Not only that the vested interests of the major actors of the state were too deeply entrenched, but also the intellectual will of those who were supposed to fight for the privatization programs was irresolute. In other words, the Weberian switchmen of history faltered, uncertain of themselves. The liberals were tough on many other issues, but they were intellectually and politically unprepared to face the possible consequences of the ultimate liberalization policy in regard to the workings of the state enterprises.

Unconsciously, perhaps, in this matter they still shared some of the deep beliefs of the nationalists that the state enterprises, besides their role as profit making institutions, carried some sort of political mission to defend or preserve a specific pattern of economic interaction in which the interests of the pribumi, whatever they were, could be safeguarded. On this matter, in short, the difference between the Indonesian liberals and the economic nationalists like Ginandjar and Habibie were only in degree, not in kind. Hence, it should surprise no one if the momentum to pursue the fundamental policy in solving the problem of the state enterprises which came in 1986 failed to produce anything but ad hoc committees whose tasks were mainly to write reports.
5.2.2 Cronyism

Besides the state enterprises, another major economic problem which was mostly left out by the process of deregulation was the one related to the working of the country’s emerging, private big businesses and their relationship with the bureaucracy and the centers of political power inside the state. Often, in Indonesia during that time, this problem was called the problem of the real (as opposed to financial) sector. Its characteristics were obviously present, for instance, in the rent-seeking relationship that occurred in the plastic and steel industries discussed earlier.

In both of these industries, there were two or three private firms who enjoyed monopoly licenses in importing crucial inputs, which increased tremendously the prices (sometimes by more than 40 percent) of those inputs in the domestic market. These private firms were mostly owned or controlled by those who had a special personal relationship with the elite of the government, and in many cases with Suharto himself.

At the height of the deregulation period, the monopoly status in both plastic and steel industries, as we have seen in the previous section, was dismantled by the technocrats, with Suharto’s reluctant support. For many people, this was quite surprising; it signified one of the highest achievements of the
Widjojo group. But the trouble was, there were many more cases of such high-level rent-seeking activities or cronyism outside these two industries. In almost all major areas of the economy, the same relationship, with different degrees of intensity, could easily be observed. The giant actor in the cement, auto, flour-mills, and agro-industries, for example, was Liem Sioe Liong, who had been personally very close to Suharto since the 1950s, and who had also been working very closely with Suharto’s close relative, Sudwikatmono, in building his economic empire. In the timber industry and real estate businesses, there was Bob Hasan, who was Suharto’s regular golf partner and the one who helped manage his (Suharto’s) giant foundations. In 1989, Liem owned 350 firms and Bob Hasan 110 firms (Warta Ekonomi, July 31, 1989:72).

Beginning in the early 1980s, and especially in the mid 1980s when the early liberalization policies had begun to open more business opportunities, these relationships changed as Suharto’s children appeared on the country’s business landscape. The proliferation of the NTBs described earlier was the first major occasion which provided huge opportunities for them to enter some of the country’s most lucrative businesses, like oil trade and refineries, construction, and chemicals. When the technocrats managed to dismantle or reduce many of the NTBs in
the mid and late 1980s, the Suharto children's business empires were already big enough to be able to fully exploit the looming opportunities opened up by the process of economic liberalization.\textsuperscript{23}

It was this second momentum which substantially elevated them and, in a very short time, made them among the richest people in the country. Bambang Trihatmodjo, Suharto's second son, owned 65 firms in 1989; Hutomo Mandala Putra, the youngest son, who was still in his mid 20s, owned 33 firms; both Sigit Hardjojudanto and Siti Hardianti Rukmana, the eldest son and the first daughter respectively, held 32 percent of the shares of BCA (Bank Central Asia), Indonesia's biggest private bank, owned by Liem Sioe Liong. During this robust expansion, the Suharto family was unstoppable, taking and participating in almost all major business deals, which flourished during that time chiefly because of the robust revival of the country's economy from a crisis induced by the falling oil price.

Against all this, unfortunately, there was no open public criticism. The country was silent. Suharto in the mid 1980s was at the very peak of his power. He was willing to let the public discuss or openly talk about the difficulties or the uncompeti-

\textsuperscript{23} For good explanations and descriptions of the family's business empires during the 1980s, see \textit{The Asian Wall Street Journal} (November 24-26, 1986:1);
tiveness of the state enterprises, or almost any other major economic problems. But not about his children’s business empires or about those of his or his wife’s immediate family like Probo-
sutedjo and Sudwikatmono. On these matters, a strict boundary was set. To those who were stubborn enough to step outside this boundary, like the weekly *Fokus* and *Expo* in 1984 or the daily *Sinar Harapan* in 1986, no quarter was given -- they were all banned. To safeguard his family, Suharto was even willing to kick out his own right-hand man, General L.B. Murdani, who was then the armed forces commander and whose real power in 1983-1988 was surpassed only by Suharto himself.24

The only report and criticism against the Suharto family at that time therefore came from abroad. David Jenkins, an Australian journalist, for instance, published a lengthy report in the *Sydney Morning Herald* (April 10, 1986), a timely one whose journalistic worth perhaps lay -- besides being the first complete report on the family’s economic empire -- in its comparison be-

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24 Among the men at the top inside the Suharto inner circle, apparently only General Murdani had the stomach to tell Suharto privately that his children were behaving in such a way that his larger interest to develop the nation might be in jeopardy. Murdani told me in a long interview (November 1996) that in one of the many private meetings he had with Suharto in 1987, he politely gestured to him that “the children’s” business activities had gotten a bit out of hand. In a very subtle way, Murdani said, he was asking Suharto to do something about the children, for the interest of the government as a whole. According to Murdani, and this was also believed by many people whom I interviewed, that was one of the reasons why he was pushed from the center of power in 1988.
tween Suharto and Marcos, the Philippines' dictator who several
days before the publication of the report had fled from his
country. Besides Jenkins, on November 26-28, 1986, Raphael Pura
and Steven Jones of the Asian Wall Street Journal, a Hongkong-
based daily, also published a series of reports on the reach and
expansion of the Suharto empire. Unwilling to compromise even
with foreign publications, Suharto also banned the sale of the
two newspapers in Indonesia, which, ironically, only made their
reports more attractive and, thanks to photocopy machines,
widely distributed in Jakarta (see also Bresnan 1993:257).

Radius Prawiro (1998:291) once said that in the struggle to
deregulate the economy it was often the case that "economic the­
ory met face to face with political realities and theory was
forced to yield." By saying this he wanted to show that he and
his friends often encountered political barriers which forced
them to realize the limits of their ideas and reformist actions.
If there was one best example of such limits, the stubborness of
Suharto in protecting his children and their business interests
must be it. It was on this matter that the technocrats, even if
they believed that Suharto's protection of his children was cer­
tainly negative to the country's economy, were simply unable to
do anything significant. Like the rest of the country at that
time, they fell silent -- and they called this silence political

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expediency or pragmatism.

5.3 The Impact of Economic Liberalization

The problems described above were real and certainly costly for the country's economy. However, despite all the problems, we should not fail to see the larger picture of policy movements in Indonesia and the substantial achievements of the technocrats during the period of 1986-1989. We have seen that after 1985 the direction of policy in general shifted toward the market. The reach and speed of this shift varied across sectors, but its general direction was unambiguously moving closer toward the ideals and objectives championed by both the Widjojo group and the country's liberal epistemic community. The practical effect of this shift was to help the Suharto government overcome the difficulties it suffered during the depth of the economic downturn in the early years of the 1980 decade. But at a more fundamental level its impact went deeper, affecting the balance or the relationship between the state and the market.

As I mentioned earlier, after the Malari affair the role of the state in the economy expanded and practically became the most important institution in generating growth and development. With the policy shift, this trend was halted and reversed: the state's role was restructured and reduced, and that of the mar-
ket was expanded. In 1989 Suharto’s national development minister, Saleh Afiff, acknowledged: “We [the government and its agencies] are not the main players any more” (PEER, February 9, 1989:48). This acknowledgment, albeit a bit exaggerated, captured the whole essence of what the policies of deregulation had accomplished.

To be sure, this changing balance has to be seen in perspective. If we look at several indicators, the ratio of government expenditure to GDP for instance -- a ratio which is universally used in comparing state-market relationship across countries -- there seems to be nothing much that changed in the country in regard to the role of the state. In 1975 the ratio was 12.3 percent, while in 1990 14.9 percent (Booth 1998:200). And if the state enterprises are taken into account the ratio was even higher, 31 percent in 1990.

Hence Anne Booth, a long-time observer and historian of the Indonesian economy, is perhaps closer to the truth when she says that “the government sector including state enterprises almost certainly accounted for a larger share of GDP in the late 1980s than in the early 1960s when ‘Indonesian socialism’ was the official ideology” (Booth 1998:202). From this view, in short, the role of the state in Indonesia in the late 1980s remained as big as, or even slightly bigger than, it was before the deregulation.
era.

Yet, if we look at some other major indicators, the picture is completely different. The deregulation policies on trade, for instance, spurred the country's non-oil export activities, which were conducted mostly by the private actors. In 1981 the value of non-oil exports comprised less than 18 percent of the country's total exports. Oil was then the backbone of the Indonesian economy, a lucrative source of revenue controlled solely by the government. But, because of their tremendous growth thanks to the deregulation policies, non-oil exports surpassed oil exports for the first time in 1987; in 1989 they exceeded them by 50 percent.\textsuperscript{25}

The significance of this shift of revenue source was obvious: oil revenues tend to increase the centralizing power of the state, while non-oil exports strengthen the private sector. So even if the ratio of government expenditure to GDP remained the same, the state’s position vis-à-vis the private sector or the market was changed. Before the deregulation era, the state’s expenditures relied mostly on its own sources; now, it had to rely on the private sector. This new condition, therefore, imposed a certain fiscal constraint upon the former, to the advantage of

\textsuperscript{25} This high-level growth continued for the whole decade: between 1985 to 1996 non-oil exports rose by 629 percent! (Radius Prawiro 1998:274).
the latter.

Furthermore, the rapidly expanding non-oil export base also brought in many new players, mostly medium-sized, into the economic scene whose interests and source of profits were not directly connected with the state but with the international market. Some observers, like MacIntyre (1990), Hal Hill (1993), and Anne Booth (1998), have detected this new phenomenon, and most agree that in the late 1980s for the first time in the country there emerged new pro-export lobbies, a group of business players for whom international competitiveness was of more concern than bureaucratic licenses, who could potentially become solid constituencies of the open economy. Of course, their power then was still limited due to several reasons, one of the most important of which was that many of them were Sino-Indonesian. Yet, as MacIntyre (1990) has observed, despite their weaknesses, some of these new lobbies or pro-export firms have made the process of policy formulation inside the Suharto government more dynamic as well as less monolithic.

Other indicators also point in the same direction. For instance, the deregulation policies produced no less striking results in the banking sector. Before the 1988 Pakto, there were

26 This pattern of dominance of Sino-Indonesians in non-oil exports reflected the general pattern of the relatively stronger position of this group in the
only 559 private bank offices around the country; in 1990 the number jumped to 2,052. During this period, the private banks' assets and credit grew by 76.4 and 80.7 percent per year, respectively, leaving the state banks far behind (their growth rates during the same period were 27.5 and 36.7 percent). Because of this tremendous growth, the country's financial landscape was transformed: in 1982 the share of total credits disbursed by the private banks was only 9.5 percent, but in 1990 it went up to 36.7 percent; at the same time that of the state banks plus the central bank went down from 85.3 percent in 1982 to 56.9 percent in 1990 (Pangestu 1996:134). Had it not been for what Ross McLeod called "the incestuous relationship" between the state banks and the state enterprises, the role of the former in the national economy during that time would have been substantially lower.27

Besides this, we also need to add the surprising impact of the deregulation policies on the non-bank financial institutions. On this there was nothing more important than the sudden outpouring of activities and energies in the Jakarta Stock Exchange, which before the deregulation era had been practically a non-factor in the country's financial landscape. At the peak of country's economy, as I have mentioned earlier.

27 Interview with McLeod (July 1996).
the deregulation period, the number of listed companies rose by 400 percent. During the same period the trading values in this newly emerging stock exchange rose by astronomical numbers, 490 percent in 1988 and 3,052 percent in 1989, which made it among the fastest growing exchanges in the world. With this, the long-dormant JSE, as Radius Prawiro (1998:246) said, "suddenly became the 'rock star' of the Indonesian economy."

Along with the growing importance of private banking, this tremendous increase of trading activities in the JSE pushed the state to play a relatively lesser and different role in the economy. Of course, the state banks, controlling around 56 percent of the total credit in 1990, were still the major players in the country's financial activities. But now they were no longer the only important ones. For the first time in the country's history, the possibility was now wide open to many business firms to finance their investments without relying on the state and its agencies. In other words, the private sector -- and even the state enterprises, since many of them were listed in the stock exchange -- were becoming less dependent on the state banks for their growth and expansion.

Moreover, the tremendous growth of the JSE in particular tied the country's economic activities much closer to the international economy. The distance between the stock exchange in Ja-
karta with those in New York, London, Hongkong and Tokyo, as the
defenders of economic globalization often say, is only one
mouse-click away. This, like the effect of the increasing role
of the private sector mentioned above, added more constraints to
the state in exercising its dominant role in the economy, given
the fact that the international market was able to react rapidly
and severely to any major policies which were considered impru-
dent. The state, in short, might still retain its previous role,
but in order to play it well it had to be more respectful of the
rules of the market.

To all this perhaps we should also add another important
impact of the deregulation policies on the changing attitudes
toward ideas commonly associated with business or capitalism in
general (see also MacIntyre 1990:255; Liddle 1996:107-140). Of
course, since empirical, time-series research on this matter has
yet to be conducted, any explanation about cultural changes, or
shifting attitudes in particular, in Indonesia should be re-
garded as a suggestive proposition which requires serious scru-
tiny. Yet, there were some visible and interesting facts in the
late 1980s which might reasonably be pointed to as the signals
of changing attitudes, however limited, both inside the govern-
ment and in the public.

Inside the government, for instance, given the fact that
the deregulation policies had produced some impressive economic results so necessary for maintaining the New Order's legitimacy, by the late 1980s the key vocabulary of the liberal economy, such as "market", "efficiency", "private undertaking", "profit motive", and the like, were becoming more commonly used not only by the technocrats but also by many other high-ranking officials. Along with this, the idea of deregulation itself was becoming more widely shared among some key persons in the government. Hartarto, who was in charge of a ministry long-known to be the stronghold of the protectionist camp (the department of trade and industry), changed his mind and proclaimed that the public office he led would support gradual deregulation of the key industrial sectors. Rudini, a four-star general and former army chief of staff, who was leading a huge bureaucracy formally responsible for managing major aspects of the country's internal politics as well as the relationship between the central government and the provinces (the department of internal affairs), proclaimed in early 1988 that his office would reform local administrative laws to support further deregulation policies at

28 In 1985, when the Widjojo group started to launch its full-scale deregulation movement, it was Hartarto and Ginandjar who came to the front of the stage to defend the old policies (Kompas, April 11, 1985:1 and September 1985, p.1). But in 1987 Hartarto changed his position, and did so publicly, as we can see from some reports about his intention to support further deregulation policies in the sectors which fell under his responsibility (Kompas, May 21, 1987:1).
the national level.

Some might suggest that people like Hartarto and Rudini were acting like normal politicians, whose public statements did not really reflect the change of their hearts and minds, but only of their interests. They proclaimed their support of the market economy only because they wanted to stay in power, not because they were becoming more liberal. But, if true, that was precisely what was interesting and revealing: making public statements in support of the deregulation policy was considered important and necessary to stay in power or to acquire popularity even by those whose hearts were presumably more sympathetic to economic nationalism. This, if anything, suggested that for more people inside the core of the Suharto government during that period there had emerged a new acceptance that the market economy was now, at the least, an unavoidable reality which ought to be courted, not rejected.

In regard to the shifting attitudes of the public, some signals might be worth mentioning. First, the sudden proliferation of business magazines and, more importantly, of business schools offering MBA degrees not only in Jakarta, but also in most major cities like Bandung, Surabaya, Yogyakarta, Ujungpan-dang (now Makassar), and Medan. To be sure, this was a natural reaction to the rapidly expanding private business sector which
created both demand for more business information and for a new class of highly professional young managers. But this possibly also reflected an emerging new attitude in the society, in particular among the younger members of the elite and the middle class: pursuing a career in bureaucracy was no longer seen as the only respectable possibility for the young and the brightest; private firms and profit motives were increasingly becoming more socially respectable or, at least, acceptable.

A second signal is the public reaction and the rise of optimism following the deregulation of the JSE. When its trading values began to rise astronomically in 1989, it was of course perfectly natural if the JSE was looked upon by many people as a new, attractive place to make higher as well as faster returns for their money. What was surprising, however, was that so many of them -- and "them" here also included taxi drivers, owners of small restaurants, housewives, university students -- came regularly to the JSE and literally stood in long lines overnight waiting to be among the first buyers in the initial offering of any promising firms (Radius Prawiro 1998:246).

The Indonesian media called this new trend demam bursa, stock market fever. It was also surprising that there was practically no serious cultural criticism against the new trend, much less outright rejection of it as subversive toward the
state ideology or the cooperative spirit championed by the country's founding fathers. Instead, judging from the way the public reacted during that time, there seemed to be a growing realization that the stock market was an integral part of a dynamic market economy, and that the frenzy of selling and buying shares, or even speculative trading, which accompanied it were but the consequences of this dynamism.

Again, as I mentioned above, it would be too speculative to determine the extent of the shifting attitudes in Indonesia without proper empirical research. The shift might only be skin-deep, but it might also be deeper, substantially altering the view of a greater number of members of the society in regard to the working of the market economy or stimulating further development of what Max Weber called the culture of capitalism.

What was quite clear, however, was that the deregulation policies which were intended initially only at solving the practical problems faced by the Suharto government had by the late 1980s and early 1990s stimulated some interesting reactions beyond the economic sphere, which, in their own ways, challenged the country's long tradition of dirigism.
5.4 Summary

In the early years of the 1980s, when the oil price had started to fall, the course of economic policy in Indonesia was far from certain. The dirigists still held the upper hand in the arena of policy making, while the technocrats had barely begun to realize that the country needed a new breakthrough to solve its problems. During this time the dirigist policies, in the form of licenses, quotas, and other NTB measures, proliferated. The beneficiaries of these measures were mostly the state enterprises and the private actors who had built a close relationship with the political and bureaucratic elite. Despite this increasing dirigism, however, there was also a sign that Suharto and other leaders of the government had agreed to reform the economy. This, for instance, can be seen in the banking reform in 1983.

The decisive shift of policy finally occurred in 1985 and 1986, when the technocrats managed to dismantle the customs agency and pursue deregulation in the banking and trade sectors. After these substantial reforms, package after package of new policy measures were implemented in three consecutive years. It was the high tide of economic liberalization in the country. The sectors which were affected most by these new measures were trade, industry, finance, and banking.
There is no case in history in which a country has managed to turn its economy around fundamentally without encountering substantial resistance and difficult dilemmas. Indonesia is no exception. Here the challenges to economic liberalization came from two fronts: the state enterprises and the rent-seeking firms whose business expansions were possible primarily because of their close relationship with the elite in the government. To these challenges, there was little the technocrats could do.

These problems aside, by the end of the 1980s the deregulation policies had produced significant effects on the country’s economy. The growth rate had climbed up once again, led by the outpouring energies of the non-oil export firms. The barriers of trade were lowered; the financial and banking sectors were quite radically liberalized, the outcomes of which surprised even the most optimistic of the liberals.

Moreover, the deregulation policies also had a certain effect beyond the realm of the economy. They affected the balance between the state and the market, raising the power of the latter at the expense of the former. This, I think, in the long run will count as the most important outcome of the whole process of policy shift. As long as the trend is not radically reversed, this changing balance will provide a sound economic and social basis for the country to build its accountable, open system of
government.

In the cultural and ideological realm, interesting changes were also present. At the end of the 1980s, many indications could be used to point out that the constituency for liberal economic policies was becoming larger. There were more people who came to the realization that, to a certain degree, the rules of the market were neither evil nor exploitative. It is true that it remained unclear how deeply such ideas were felt by this new constituency for reform. But the most important thing was that the early signs of acceptance of the relatively new ideas were there. It might become stronger over the coming years, given the right leadership and circumstances.
CHAPTER 6

NEW CHALLENGES AND RESPONSES,
1990-1992

The process of economic deregulation was not discontinued in the early 1990s. In fact, there were several important policies that opened the economy further, which shifted even more the state-market balance in the country's economic landscape. However, unlike in the period of 1986-1989, the course of policy change in 1990-1992 faced new challenges which forced the technocrats to slow down and narrow the scope of their initiatives. This period was characterized by some observers as the beginning of deregulation fatigue in Indonesia.

This chapter will describe the major policies during this period and the factors behind the deregulation fatigue. It will show how the technocrats increasingly became the target of attack by their critics, who thought that Widjojo's economic deregulation had created new monsters, the conglomerates, and pushed the level of socioeconomic inequality to an intolerable height. To a degree, the increasing criticism reminds us of the
same situation faced by the technocrats in the early 1970s, before the Malari affair. This chapter will also show how Suharto, as the supreme leader of the land, increasingly began to initiate his own policies which, to some extent, diverged from the basic course set by Widjojo and his friends.

6.1 Reforms and Counter-Reforms

In the early 1990s, the technocrats initiated further reform measures in several major economic areas. These measures were largely taken to complete the process of the deregulation movement which began in 1985. The first major initiative during this period was the two policy packages in early and mid 1990, Pakjan (Paket Januari, January Package) and Pakmei (Paket Mei, May Package).

These two packages were quite substantial in scope. They reduced further some of the remaining non-tariff barriers (NTBs) which had been causing domestic prices for some industrial inputs to be artificially high, particularly in pharmaceuticals.

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1 It should also be noted that these packages contained some controversial measures. The Pakjan, for instance, contained a new ruling which made it compulsory for banks to allocate 20 percent of their credits to small-scale firms (defined as firms whose total assets were below Rp600 million). It was in practice not much different from the failed dirigist measures to financially help the pribumi firms undertaken after the Malari affair, as we saw earlier. In short, this ruling, because of its practical implication in giving a new footing for the state to expand or maintain its intervention, went against the spirit of the deregulation movement (see Sjahrir in Kompas, February 26, 1990:1; see also Tempo, February 10, 1990:92).
and agriculture. All in all, out of the 9,250 remaining tariff classifications, tariff levels were reduced in 2,481 cases. Besides this, the non-tariff import barriers of over 1,000 industrial products were either totally abolished or simplified (Warta Ekonomi, June 4, 1990:22-25; Conroy and Drake, 1990:21-23). To be sure, some categories of items were given more protection, particularly the items in the manufacturing category. But it should be seen as part of the “one step backward, two steps forward” strategy employed by the technocrats to achieve their objectives. The important fact was that there were more tariff reductions than there were additional protectionist measures contained in the packages.

After the two packages, the technocrats managed to launch some other liberal initiatives, the most important of which occurred in June 1991 and May 1992. These packages continued further the reduction and simplification of the tariff and non-tariff barriers for many trade items. Some of the rulings which stood out in these packages were the abolition of import bans on cold-rolled steel and sheets, tin plates and several categories of built-up commercial cars. Import prohibitions on some products like copra and palm oil were abolished and on some others like beef, chicken and fishery products were shifted, from NTBs to tariffs. In all, with the June 1991 package, there were re-
ductions on 562 tariff items, tariff surcharges on 365 items, and abolished surcharges on 137 items (Anwar Nasution 1991:7-8).

In the foreign investment sector, there was a new ruling which permitted 100 percent foreign ownership for certain types of investment and extended the general phase-down requirement to 20 years. The targets of this ruling were the investments located in specific areas like eastern Indonesia or the bonded zones. Besides these the minimum capital requirement was lowered substantially to US$250,000 for labor-intensive operations (employing more than 50 persons). The minimum level of Indonesian share holding in these investment projects were also lowered to 5 percent at the starting period of commercial operation (after 20 years, the domestic share was required to be 51 percent). The same ruling also applied to some other investment sectors (Pangestu 1996:161-162).

Besides these packages, there were some other initiatives which, although somewhat different in their objectives, were nonetheless important in supporting a more friendly atmosphere for the market economy to function. One such policy was the reduction of oil subsidies in July 1991, which was always considered a risky and controversial policy move because of the possibility of mass demonstrations. The impact of this reduction was directly felt by the society across the board: the domestic
prices of petroleum increased by 20 percent, diesel oil 22.4 percent, and kerosene 15.8 percent (Kompas, July 11, 1991:1).

Apart from that there was also the selling of three major state cement enterprises to the public in the Jakarta Stock Exchange (JSE). The amount of shares sold varied, but in general it was in the range of up to 30 percent. Granted, this was not privatization. But, as Iwan Jaya Azis said,² it was nonetheless an important policy which, apart from inducing the state enterprises to be more commercially oriented and competitive, kept the ideas and expectation of privatization on the table, at least among some of the technocrats and their supporters.

All of these packages and policy initiatives should not be taken lightly. However, we also should not fail to see the larger picture of policy movement during this period, especially in comparison to that during 1986-1989. As I mentioned earlier, the process of economic deregulation in this period was incomparably slower. In the previous period, with all their limitations and shortcomings, the series of packages initiated by the technocrats opened up many more new possibilities and abolished more dirigist rulings inherited from the past. This, for instance, was very clear in regard to the trade sector. As we can see from

² Interview with Iwan J. Azis (May 1996). See also his piece in Williamson 1994:397.
Chart 6.1, the slope lines decreased substantially from 1986 to 1989, demonstrating that the reduction of NTBs during this time was quite far-reaching. After 1989, the lines went down still more and then gradually flattened. This showed us that from 1991 to 1993 there was little change in the country’s economy in regard to the level of NTB coverage.

![Chart 6.1: The coverage of Non-Tariff Barriers (%)](chart)

The conclusion that we can draw from this is that, after the peak period in 1989, the deregulation policy in the trade sector gradually lost its momentum. That is why, as Anwar Nasution explains (1991:8), despite all the efforts by the technocrats, "NTBs and a web of non-transparent regulatory frameworks are still widespread" in both traded and non-traded sectors. In
this regard Nasution mentioned some of the economic activities and commodities which were still strictly or unnecessarily regulated, such as the procurements of rice, sugar, and wheat flour, the distribution of textile quotas, the quasi-monopolistic control in regard to rattan and timber industries, and many others.

Another example which signified the downward trend of economic deregulation during this period can also be seen in the banking sector. From the previous chapter we have seen that starting in 1983, the country’s banking sector underwent a tremendous change to the point that, from being one of the most highly-protected sectors, it became one of the most open in the developing world. This transformation was the direct consequence of the liberalization policies undertaken during the period. But after 1990, the trend was somewhat reversed. Triggered by some high-profile banking crises\(^1\) and the unhealthy, head-to-head competition among the domestic banks to attract savers, particularly by offering unreasonably high deposit rates and drawing

\(^1\) There were two events which highlighted the problems faced by the banking sector in this period, i.e., the crisis of Bank Duta in 1990 and Bank Summa in 1992. Bank Duta was basically controlled by Suharto through his semi-public foundations. The bank suffered a heavy foreign exchange loss (US$420 million) almost overnight, chiefly because Dicky Martadinata, its flamboyant chairman, made a wrong prediction in his forex gambling. Bank Summa was owned by the Astra Group, the country’s second largest conglomerate. In December 1992, it collapsed and was subsequently liquidated by the central bank after the announcement that it had an intolerably high level of non-performing loans, US$720 million. This crisis precipitated the downfall of the Soeryadjaya family from its position as the country’s second richest family (Cole and Slade 1996:136-137; Hill 1996:37; Warta Ekonomi’s cover stories in November and De-
lotteries, the government shifted its basic policies by emphasizing more control and more regulation.

In February 1991, for instance, the government announced new rulings to limit the freedom of the domestic banks to open new branches. These rulings were basically a correction of the policy launched in the 1988 deregulation package. Other new initiatives to streamline banking activities further, especially those which were related to foreign-exchange trading, were also enacted (Stephen Parker 1991:30-31).

Of course, with these new policies, it did not mean that there was already a clear departure from the deregulation course undertaken earlier. But it was clearly not its continuation, either. Previously, the solution to the perceived fundamental problem of the banking sector was, as Radius Prawiro said (quoted in Chapter 3), to give the bankers more freedom. Now, the government’s effort to answer the perceived problems was disposed toward more controls and restrictions, without substantially abandoning the legacy of previous deregulation policy. In other words, the government’s policy at this time toward the banking sector lacked clarity and consistent direction.

Such inconsistency was not an isolated case. In fact, more than before, the big picture of policy course during this period...
was marked by major cases in various sectors which highlighted the difficulties faced by the technocrats in maintaining the consistency of the government’s economic policy. The case of Chandra Asri, for instance, showed clearly how, after setting up a prudent foreign investment policy in order to reduce the pressures on the balance of payments, the technocrats were by-passed by Suharto and his cronies which rendered the policy practically toothless.

Owned mostly by the big four -- i.e., Bambang Trihatmodjo (Suharto’s second son), Prajogo Pangestu, Henry Pribadi, and Liem Sioe Liong -- Chandra Asri was a mega project in petrochemical industry, with a total investment of US$2.4 billion, the largest domestic investment since the enactment of the domestic investment laws in 1968 (Warta Ekonomi, April 29, 1992:31). According to the existing policies, the project should not be continued, because it would disproportionally burden the state banks and put more pressures on the balance of payments. Moreover, it could also be predicted at that time that after its operation, Chandra Asri would require a high level of protection -- by one estimate, as high as 20 to 40 percent -- to be profitable.

After some months of policy maneuverings, labeled by the American journalist Adam Schwarz (1996:152) “the test of wills”
between the technocrats and their foes, in April 1992 Suharto finally instructed his economic ministers to let the project be continued, with some adjustments in regard to Chandra Asri's investment status and methods of financing.

An even more controversial example was the case of BPPC (Badan Pusat Penyanggah Cengkeh, Cloves Central Supporting Agency), a private consortium led by the most flamboyant and outspoken of Suharto's sons, Hutomo "Tommy" Mandala Putra, which obtained a monopoly right from the government in clove trading. For over a year, the BPPC case was one of the major news events in the country. Nobody could find convincing reasons as to why the government should protect clove trading and make BPPC the sole agency. The BPPC was a newcomer in the arena and was financially ill-equipped to carry such a crucial role. Moreover, the last thing the farmers and the consumers needed at that time was a monopoly agency with very broad powers (Schwarz 1996:153-154). The case of BPPC, in short, produced all kinds of losers: farmers, consumers, producers. And on this list should also be included the technocrats. The case was, in a way, a direct challenge to the technocrats.

According to Schwarz, Suharto's final decision was taken one day after he had received a personal letter from Prajogo Pangestu. The letter apparently convinced him that the project was vital and strategic to the nation. In addition to this we should not forget also that it was Prajogo who rescued Bank Duta two years earlier when the bank, which was mostly owned by Suharto's semi-public foundations, was on the brink of collapse. For a good journalistic report on how Prajogo Pangestu managed to by-pass the presidential decree of
lenge to them and the policy they championed (Tempo, July 7, 1990:80-84 & April 18, 1992:84; Warta Ekonomi, March 9, 1992:22).

There are more events or cases that we can put on the list here, with varying degrees of importance and impact on the whole process of economic policy making: in the telecommunication business; in the launching of the Palapa satellite; in the creation of monopolistic associations in the timber industry; and so on. But it should be sufficient at this point to say that together, they made the big picture of policy direction in this period more Janus-faced or ambiguous. On the one hand, we can still see that the technocrats managed to push the deregulation policy forward, at a slower rate. On the other, dirigism was creeping back, increasingly putting the technocrats on the defensive while at the same time providing the nationalists and the bureaucrats, as well as their cronies, more opportunities to exploit the country’s economic resources. The situation, to a certain extent, reminds us of the same situation in the early 1980s or early 1970s, when the direction of economic policy was quite uncertain, squeezed in the middle of the conflicts and maneuverings between the technocrats and their foes.

6.2 Explaining Weak Reform: "Sadli's Law."

How do we explain the shift and the dynamic of policy during this period? Why was the deregulation process slowing down and dirigism creeping back? What factors were most responsible for the new trend? According to the prevailing view among Indonesian economists, the answer to these questions was quite simple: the deregulation policy was the victim of its own successes.

After four to five years of successive openings, reforms and liberalizations, the country's economy bounced back rapidly at the end of the 1980s. With the average growth rates back on track again, at around 6 to 7 percent per year, the looming crisis which plagued the economy in the early and mid decade was gone. In fact, the rapid revival and the subsequent structural transformation of the economy -- i.e., more exports and manufacturing industries, less dependency on oil -- showed that the country's prospects were better than ever. This, according to the economists' view, freed the New Order government from the pressures it had experienced earlier. Economic deregulation therefore provided new opportunities for Suharto and his government to succumb once again to the old, dirigist temptation.

In other words, as Prof. Sadli once said, good times make bad policies. If the economy was bad, so his argument went,
Suharto sought the help of the technocrats; and the Javanese autocrat was willing to back up their programs to a great extent as long as they delivered renewed growth. But once the economic condition rebounded and the burden lifted, Suharto would reduce the role of the technocrats again and do some other things they might not agree with. It had happened in the 1970s and 1980s. So there was no reason why it could not happen again in the early 1990s.5

This explanation is clever and quite persuasive. And it should also be interesting to note that this view was made popular by the economists who used to be members of Suharto's economic team, like Prof. Sadli himself.6 However, it only captures half of the story, at best. In fact, the starting point of the economic revival was not 1991, but three years earlier. At that time, the process of economic deregulation was moving faster, not slower, even when the pressures faced by the Suharto government had started to fade. Moreover, the argument that the swing of economic policy only follows the good-and-bad-times cycles is a little bit too simplistic, because it does not tell us very much about the policy dynamics in a particular time. Indonesia in the mid 1980s was in bad shape economically, but even so it

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5 Interview with Prof. Sadli, May 1996.

6 On one occasion I called such an explanation "Sadli's Law" (Mallarangeng,
was still a much better place relative to Indonesia in the early 1970s in regard to its GDP level, or to Indonesia in the mid 1960s in regard to its level of GDP growth. So, there must be other factors at play here which defined why a particular mixture of economic conditions in a given period was considered a bad time, which necessitated or created the conditions for the government to pursue a specific policy.

Finally, there is really no logical or necessary connection between the good times and the bad policies. If anything, the reverse is in fact more plausible: good times make good policies. Economic liberalization, in the short term, will always impose certain costs and produce losers (Haggard and Kaufman 1992; Gourevitch 1987). This dilemma is magnified if liberalization, the good policy, is undertaken during a crisis or during an economic downturn because there are fewer resources available to the government to reduce such costs or to reimburse some of the losers. In short, it is riskier for any government to pursue a liberalization policy if the economy is in bad times.

In good times, on the contrary, the government has plenty of resources available at its hands. So the government is more prepared to tackle or to reduce the political and social costs

Kompas, August 28, 1997:4).
of the good policy. Hence, other things being equal, it is more rational for any government to become less dirigistic and more forceful in pushing the reform process forward when the economy is moving upward.\footnote{For a more technical discussion on this matter, see Bruno Frei in Greenaway}
exploit them. Those who did it extraordinarily well managed to build their economic empires in a relatively short time. Included in this group were not only some business leaders who were relatively “clean”, like the Soeryadjaya family (Astra Group), the Rachman Halim family (Gudang Garam), the Riady family (Lippo Group), but also some others whose track records were different, or those who were often called the cronies, like Bob Hasan, Prajogo Pangestu, Liem Sioe Liong, Probosutedjo, and the Suharto children.

The extraordinary rate of their economic expansion can be seen in the following facts: based on their estimated revenues from 1990 to 1992, Liem Sioe Liong’s empire grew by 50 percent; Prajogo Pangestu’s by 34 percent; Eka Tjipta Widjaja’s by 82 percent; Bob Hasan’s (with Suharto’s son, Sigit Harjojudanto) by 40 percent; Hutomo Mandala Putra’s by 59 percent; Bambang Trihatmodjo’s (with his brother-in-law, Indra Rukmana) by 25 percent; Probosutedjo’s by 88 percent; Bakrie’s by 20 percent; Mochtar Riady’s by 123 percent; The Ning King’s by 30 percent. Taken together, according to Warta Ekonomi’s estimation, the country’s 200 biggest conglomerates grew by 46 percent from 1990 to 1992 (their revenues increased from Rp88.4 trillion to (1985) and Mohammad Chatib Basri (2000).
Rpl 28.7 trillion, respectively). Never before in any period had Indonesia experienced such a tremendous leap in the development of private business empires.

For the critics, who had never been supportive of, or had little sympathy for the technocrats since the beginning of the deregulation programs, this "new reality" provided a pretext, a new cause, to launch their attacks. The role and growing power of the conglomerates, and the perceived economic inequality which accompanied it, became the rallying point of various groups of people in denouncing the deregulation policy and demanding its correction.

In particular, outside the government, there were at least two groups of critics who played pivotal roles. The first group was the populist intellectuals and university lecturers who continued the socialist tradition championed by Hatta, Soedjatmoko, Mochtar Lubis, and Sarbini (see Chapter 2). The most outspoken among them during this period were Prof. Mubyarto of Gadjah Mada University and Prof. Sri Edi Swasono of the University of Indonesia, who was also Hatta's son-in-law and the chairman of Dekopin (Dewan Koperasi Indonesia, Indonesian Council of Cooperatives).

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8 The data are based on surveys taken by Warta Ekonomi (February 11, 1991 and May 3, 1993).
The second group was the LSM activists (Lembaga Swadaya Masyarakat, Non-Governmental Group), who were relatively new in the country's political and intellectual landscape. Since the late 1980s these group had flourished and, more importantly, as Philip Eldridge (1995) explains, had undergone a process of radicalization within themselves to become more openly confrontative against the New Order's repressive policies. The leaders of these groups came from various professions and social backgrounds, like T. Mulya Lubis (lawyer and activist), Dawam Rahardjo (Muslim intellectual and activist), Adi Sasono (former business manager and former student activist), Abdul Hakim Garuda Nusantara (social worker), Adnan Buyung Nasution (lawyer), Y.B. Mangunwidjaya (novelist, architect, and Catholic priest).

The views and voices of these people were not uniform, nor were their interests singular. Mubyarto and Sri Edi Swasono, for instance, placed more emphasis on building a cooperative-based economy, derived from the state ideology, Pancasila, while others in the LSM group like T. Mulya Lubis and Dawam Rahardjo refused to take seriously the idea that the state ideology could become the foundation of the ideal society. What they wanted instead was the application of universal social democratic values in the Indonesian context. Moreover, even among the leaders of
the LSM group, there was no singular view.®

Yet, against the Widjojo group and their policies, and against the increasing power of the business conglomerates, they all seemed to be united under one flag. They pointed their fingers accusingly at the unbridled liberalization policy as the chief reason why the conglomerates were enjoying such disproportional advantages. They were convinced that the growing power of these business empires could only happen at the expense of the people's welfare in general, and of the small firms in particular. They, therefore, demanded tough policy corrections. Both groups wanted to establish more "economic democracy" by empowering "the people" as well as by controlling the development of the market economy.

Unfortunately, in facing the rising intellectual challenge, the technocrats and their supporters were less vigorous and not so enthusiastic as when they were mounting their own offense against the dirigist status quo in the mid 1980s. In fact, only Prof. Sumitro and some other younger economists like Sjahrir, Iwan Jaya Azis, and Mari Pangestu took up the challenge head-on and argued in public for more economic deregulation, not

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9 For an instructive outline and summary of the ideas of these critics, see Chalmers and Hadiz (1997) and Warta Ekonomi's cover story, January 7, 1991. See also Mubyarto (Tempo, July 21, 1990:100); Sri Edi Swasono (Warta Ekonomi, September 3, 1990:68); Dawam Rahadjo (1987); Adi Sasono, with Sritua Arief (1984).
less. Prof. Sumitro, for instance, in 1989 started a series of controversial polemics in the mass media on the issue of economic inequality, where he argued that as a group, the poorer segments of the society had actually become much better-off and poverty had substantially been reduced because of the rapid expansion of the economy. Sjahrir, for another instance, took up the challenge by stating in public that Hatta’s ideal economy which inspired most of the populist critics was a sort of utopia. For Sjahrir, the building of more cooperative enterprises did not automatically mean that there will be more justice and economic efficiency (Swasembada 1989:78-81).

Nonetheless, the technocrats’ defenses stopped short of answering the most fundamental issues raised by their critics. In the popular media during the period of 1990-1992, we could not find even one of them who argued, for instance, that in fact it was the small and the medium-sized enterprises, not the conglomerates, who had enjoyed the tremendous benefits of the lib-

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10 The polemics were started by Sumitro when he made a speech before ISEI’s plenary session in Bukit Tinggi, June 1989. The important point of the speech was its blunt description that in 1976 40 percent of the people were living under the poverty line, while in 1987 the number was “only” 17.42 percent. This, according to him, was a great success of the New Order. The speech became the headline in Kompas on the next day (see Kompas, June 30, 1989). Some of his critics charged that the Sumitro speech was plesoi Orde Baru, a plea for the New Order. For a general review of the polemics, see Sjahrir’s news analysis in Kompas, July 14, 1989:1.
eralization policies. Similarly, none said forcefully and clearly enough that, since the rise of business conglomerates in any modern market economy could not be avoided, there was no better alternative than to push for more liberal policies so that big money could become more efficient and rely less on political as well as bureaucratic patronage; or that most of the negative problems surrounding the operations of the conglomerates were not the consequences of deregulation but of the weaknesses of the country’s economic institutions and the widespread high-level cronyism the deregulation policy was supposed to fight against.

Worse, there were even growing indications that precisely at the time when they had to become more forceful and persuasive, members of the liberal epistemic community, who had been

\[\text{\underline{\text{11 According to Hal Hill (1992:37), the popular belief among the critics that}}}
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\[\text{\text{the conglomerates were the ones who reaped most of the benefits of growth and liberalization policies was "without empirical foundation." Citing the research conducted by Thee Kian Wie, Hill explained that from 1983 to 1990, a period when the deregulation policy was at its highest point, "the small firms have grown just as rapidly as larger ones" and that, if the data was appropriately adjusted, the growth of the small industry exports would become substantially higher.}}\]

\[\text{\underline{\text{12 I suspect that this less-than-vigorous response had something to do with the fact that most of the conglomerates were Sino-Indonesian (in 1992, according to Warta Ekonomi's survey, of the 20 biggest conglomerates, 18 were Sino-Indonesian; the only pribumi on the list were Suharto's sons, Bambang and Tommy). As I explained in the previous chapter, the so-called Chinese dilemma served as a constraining factor in the liberalization process because even those who were supposed to fight for it were not free from anti-Chinese bias. Deep in their hearts, like the populists and the LSM activists, most of them also resented the fact that the Sino-Indonesians, for whatever reason, were over-represented at the highest level of the non-public economic arena. Hence their half-heartedness, or their unwillingness, to face the critics head-on.}}\]
the main counterpart of the Widjojo group during the height of the liberalization period, seemed to lose their consensus and become ambivalent and uncertain of the priorities the country should set in dealing with the new challenges. Some members of the community maintained the position that, despite the shortcomings of the deregulation policy, the most important agenda for the country was to pursue economic deregulation even more vigorously. For such people, because of the fact that there were still a lot of distortions and inefficient interventions in the market which should be fought against, the time was far from over to soften the pressures for liberalization or to seek a different policy agenda. But a growing number of members of the community thought differently, or were less convinced of the need for such an agenda.

ISEI, for instance, which played a pivotal role in advancing the voices of the pro-market economists in the mid 1980s, seemed to be willing to accommodate the voices of the critics when it was asked by Suharto in mid 1990 to formulate the conceptual framework the government should employ in improving and correcting the course of the country's economic development. Led by Prof. Sumarlin and Prof. Adrianus Mooy, after conducting a

13 A good example of such ideas can be seen in Sjahrir's column in Warta Ekonomi, August 31, 1992:8. A more nuanced explanation can be seen in Mari Pangestu, Tempo, March 3, 1990:90.
series of meetings and seminars, ISEI representatives reported to Suharto their final conclusion that the ideal economic system for the country was ekonomi pasar terkendali (guided market economy), inspired by the values of Demokrasi Pancasila (Pancasila Democracy). In such a system, the market played an important role and the policy of deregulation should be continued. But, according to ISEI, there would still be ample room for state intervention, and the cooperative enterprises should be given kesempatan seluas-luasnya (the broadest opportunity) to participate in accordance with their nature as socially-inspired economic units (Kompas, August 21, 1990:1).

For any observer familiar with the ways words are shaped and articulated in Indonesian public discourse, there should be nothing surprising in the report. What was surprising, however, was that the report and its ambivalent, pleasing-to-all suggestions came from ISEI, which was expected to sweep away all the nonsense about Demokrasi Ekonomi and the cooperatives at a time when both the ideals and the merits of the deregulation policy were being increasingly questioned. To hope that the ISEI economists would stick their neck out for the liberal ideals under the circumstances of the day or that they would speak with dazzling clarity defending the Widjojo policies might of course be a bit unrealistic; after all, some of them also craved influen-
tial positions in the Suharto government. But at least they would not add more confusion into the public discourse by introducing or lending their credibility to loose concepts such as *Demokrasi Ekonomi*, guided market economy and the like, which might be exploited by the populists and other critics to strengthen their cause.

Besides ISEI, some other members of the epistemic community took a similar position, in a different way. The University of Indonesia economist Dorodjatun Kuntjoro-Jakti, for instance, surprised some of his friends when he stated with apparent conviction that “if the privatization programs were not controlled, or were even let free as we have conducted the deregulation programs, Indonesia will succumb to become a liberal-capitalist economy” (*Kompas*, September 5, 1991:1). If that happens, according to him, “not only the small people but also the middle class will be swallowed by the owners of big capital.” So, to avoid that condition, he concluded that Indonesia should stick to the 1945 constitution which instructed that the national economy should be ruled by combining the roles of the cooperatives, state enterprises and private firms. With a friend like Dr. Kuntjoro-Jakti, the pro-deregulation camp no longer needed enemies.

So, hearing those errant voices, we should not be wonder-
ing for long why the anti-deregulation camp seemed to become more and more intellectually forceful during the period of 1990-1993. This camp might not have sound and convincing arguments, but they surely had legitimate questions, to which the defenders of liberal policies failed to answer or did not have enough stomach, for whatever reasons, to answer them fully in explaining the merits of their cause.

In regard to politics and interests, the slowing down of the deregulation movement was directly caused by Suharto's choices in achieving his objectives. Sensing that the deregulation policy had been increasingly perceived to widen the gap between social groups and that the technocrats were largely blamed for it, the Javanese autocrat made several moves which surprised many people.

In his budget speech before the parliament in January 1990, Suharto started an important initiative when he stated that it was time for the big businesses which had been growing rapidly in the last couple of years, known also as the conglomerates, to contribute directly some of their benefits to the welfare of the whole society. For this, he said, he would ask the cooperatives to participate more as partners or part-owners of the big businesses. Two days after the speech, the coordinating economic minister Radius Prawiro, who was not consulted by
Suharto about his plan, in an effort to soften the image that the government was about to purge the business class, explained to the public that the president did not mean that his ideas would be enacted into new policies or new rulings. The speech, Prawiro said, was only a himbauan, a non-binding suggestion.

But, to Prawiro and other technocrats’ dismay, Suharto continued his plan anyway, and just two months later, in an even more eye-catching event, invited all of the country’s leading conglomerates to his private farm in Tapos, including Liem Sioe Liong, William Suryadjaya, Eka Tjipta Widjaja, Bob Hasan, Prajogo Pangestu, Sofyan Wanandi, and The Ning King. He asked all of them to allocate gradually 25 percent of their company’s shares to the cooperatives. The event thus became a national as well as international issue, widely referred to as the Tapos Meeting. The national television broadcast this event for two consecutive hours. Suharto, with his charming smile, was shown lecturing the money bosses about how important it was to strengthen the cooperatives and to preserve the spirit of togetherness based on the country’s state philosophy, Pancasila.

After Tapos, there were several other moves by Suharto, the most significant of which was his decision in 1992 to suddenly cancel the government’s relationship with the Intergovernmental Group on Indonesia (IGGI). IGGI had assisted the New Or-
der practically since the day it was born and was also widely known to be one of the technocrats' major supporters outside Indonesia. The background of this decision was the increasingly irritating role of the Dutch government in leading IGGI which, in Suharto's eyes, intervened too far in the country's domestic politics.

In initiating this bold policy turn, Suharto ignored the technocrats, who did not have many choices other than trying to convince the public, domestic and international, that the decision should not be seen as a sign that Indonesia would embark on a radically different path in regard to its relationship with international donors. Two weeks later, IGGI was replaced by CGI (Consultative Group on Indonesia), which was basically similar to its predecessor, only with the exclusion of the Dutch government, signaling that Suharto was quite successful in achieving the objective of his nationalism-driven action, without endangering the country's relationship with the donor countries and the international lending institutions.\(^\text{14}\)

All of these events were significant in showing how Suharto in the early 1990s began to counter-balance his own eco-

\(^{14}\) To know more of the details of the Tapos Meeting and the replacement of IGGI with CGI, besides the collections of articles and reports in Kompas and Tempo during the period, the best resource is the Bulletin of Indonesian Economic Studies (BIES); in particular see its surveys conducted by Conroy and Drake (August 1990); Pangestu and Habir (April 1990); Hill (August 1992).
nomic ministers after giving them a substantial degree of freedom to launch their deregulation programs for four or five years. This counter-balancing act was even more significant if we remember that at about the same time Suharto was also supporting the growing political role of ICMI (Ikatan Cendekiawan Muslim se-Indonesia, Indonesian Muslim Intellectuals Association), a loose organization at the elite level, led by one of the technocrats’ biggest foes, the German-trained Habibie, with the chief aim of making Indonesia more Islamic and at the same time more technologically sophisticated (Schwarz 1994:162-193).

It was true that, as Liddle said (1996:254), ICMI might only be Suharto’s “short-term tactical political instrument” which was useful at that time for him to strengthen his power. But the fact that, for such a purpose, he chose ICMI, whose high-ranking members like Amien Rais, Imaduddin Ibrahim, including several LSM activists like Adi Sasono, Dawam Rahardjo, not to mention Habibie himself, who were very critical of the Widjojo group, meant that the latter’s maneuvering room would become significantly narrowed and their policy initiatives made more difficult to carry out.¹⁵

¹⁵ In an interview with Amien Rais (August 1996), I was quite surprised at his deep hostility against the technocrats. For him, the technocrats’ economic policies were directly responsible for widening the gap between the rich and the poor and for increasing the economic power of the Sino-Indonesian conglomerates. He also believed that the technocrats were behaving like pawns in en-
We might perhaps never be able to understand precisely why Suharto turned away from his technocrats after they had delivered for him something he needed most -- a robust economy -- to convince the country that he was a successful leader. But I think, following Liddle, the reason had something to do with his grand strategy to preserve his own power as long as possible, before he had to pass the torch to someone of his own choice (by 1990 he had been in power for 25 years).

If this strategy was to be successful, he had to accomplish several important things, such as keeping the military under his close supervision, maintaining the loyalty of Golkar functionaries, keeping the potential opposition in check, courting the Muslim majority, and so on. Also, in regard to his economic policy, he had to reintroduce some of the populist or redistributionist policies in order to avoid the growing public perception that his government was working mainly for the benefit of the big firms and for those who were already affluent. And in particular, he had to deflect the criticism aimed directly at him by showing that he was able to control the Sino-Indonesians, and that the rapid growth of his family business empires was actually a good and necessary thing to do for the

hancing the interests of American global capitalism. Consequently, for him, ICMI's economic programs should be aimed at, among others, reducing or if possible replacing the position of the Widjojo group in the policy arena.
pribumi business class to counter-balance the power of the con-
gglomerates. In other words, he had to convince the public that, as Prof. Mubyarto once said, rightly or wrongly, "if not for Suharto's children, all those businesses would go to the Chinese [sic], and that would be worse" (quoted in Schwarz 1994:298).

Whatever his personal motives, the effect of Suharto's ac-
tions was quite clear. As I have described earlier, the course of economic policy after 1990 was no longer as clear as it had been in the mid and late 1980s. Before, the technocrats could count on Suharto to launch their most difficult initiatives. True, Suharto even in those years had never given them a carte blanche or let them get away with their programs without some strings attached. But, more or less, the technocrats, Widjojo in particular, could convince Suharto most of the time that their deregulation programs were necessary for the benefit of the country and his own government. Now, things were more compli-
cated when Suharto did no longer trust them fully and had his own political agendas whose implementation necessarily affected the way economic policy was conducted by the government. In short, the good days were gone and from then on the Widjojo group had to face an uphill, even Sisyphean, battle.
6.4 Summary

After its peak in 1989, the deregulation process slowed down. In 1990-1992, the direction of economic policy was more ambiguous. The Widjojo group launched several major liberal initiatives, but there were also many events which showed that the dirigist measures and other policies which were against the spirit of liberalization were on the rise.

The factors which were behind this flip-flopping policy direction could be found in the interplay of ideas, interests and politics. In the realm of ideas, in 1990-1992, there was increasing dissatisfaction with the technocrats and their policies. The liberalization policies were accused of creating new monsters, the conglomerates, most of which were Sino-Indonesian owned. This, so the critics claimed, reduced greatly the possibilities for the small firms to flourish, and hence the economic disparity between the affluent and the majority of the people became more and more intolerable. In meeting this new challenge, the technocrats and the members of the liberal epistemic community faltered. Unlike in the previous period, they did not seem to be able to come up with coherent and convincing arguments. So, from this perspective, the lack of clarity of New Order economic policy during the period occurred simply because of intellectual failure: the liberal coalition failed to answer the le-
gitimate questions of their critics.

It was this increasing criticism against the liberalization policies, among others, which Suharto used as the pretext to start his own moves that counter-balanced his economic ministers. He appeared to become more nationalistic and pro-equality during the period by launching several policies without consulting Widjojo and his friends. Increasingly, he gave the foes of the technocrats more room to participate in the process of policy making.

It would be hard not to see that Suharto’s decision to counter-balance the Widjojo group suited very well his own political interests and strategy to continue in power as he became older and as his own family’s business empires were rapidly expanding. Suharto, whatever his weaknesses, was an astute politician, with a sharp nose to smell the direction of the wind. After 25 years in power, he wanted to go on. And for this purpose, he did not hesitate to tie the hands of the men who had helped him for many years, including his own technocrats.
CHAPTER 7

CONCLUSION

The previous chapters have explained the important role in shaping the movement of economic policy played by ideas and the actors who fight for them in the public arena.

Chapter 1 described how New Order technocrats, led by University of Indonesia economist Prof. Widjojo, played a crucial part in dismantling Sukarno's "revolutionary economy" by initiating major liberal policies. For several years in the late 1960s and early 1970s, the technocrats' ideas of development were without serious challenge.

In early 1973 the situation began to change. The government's economic programs were perceived by the public, especially the student activists and the intellectuals, as breeding more corruption, moving the country too far in a liberal direction and, hence, putting it too much under the control and influence of international, particularly Japanese capital. The intellectual battle to change the direction of Suharto's early economic policy culminated in 1974 in the Malari affair, the
first major riot and mass protest in the history of the New Or

der.

Malari was the pretext for Suharto to shift the direction of his government's economic policy. The previous liberal pro-
grams were not totally dismantled, but there were more and more dirigist measures to protect domestic industries, to subsidize targeted groups of people, and the like. Here the oil boom was a great blessing for the New Order; it occurred precisely when it was needed most to pay for the costs of growing state interventionism. During this period the technocrats were able to retain some of their power, but Suharto also let the bureaucrat-nationalists and the engineers play a growing role in the economic decision making process.

In the early 1980s the oil price declined sharply. This decline, described in Chapter 3, produced major economic prob-
lems, which, if not resolved, could threaten the legitimacy of the Suharto government. Thus a window of opportunity came once again for the Widjojo group to play a major role in redirecting the course of economic policy. With their renewed conviction of the primacy of the market economy, they seized the opportunity to convince the New Order elite and the public at large that the best way to cope with the problem of the day was to deregulate the economy.
Unlike the early years of the New Order, the technocrats in the mid 1980s were no longer alone. This time they had an effective and articulate partner: the country’s growing liberal epistemic community. It was this group of people who made the case for economic deregulation persuasive. They brought to the public an understanding that the country’s major economic problems could not be solved with more dirigist policies. They criticized the dirigist intellectuals, the bureaucrat-nationalists and the engineers. By doing so, they laid the intellectual groundwork for the acceptance of the deregulation programs initiated by the technocrats. It was through their effort that ideas, as I argued in Chapter 1, became the bridges which connected the problems of the day with their possible solutions.

The high tide of liberalization policy occurred in 1986-1989. During this period the liberal “coalition” was triumphant and their policy initiatives were launched package by package. The consequence was a boost in the country’s economy that helped the New Order government to strengthen its legitimacy once again.

There were some limits to their effort, though. Suharto and a large number of elite members inside the government did not want to liberalize some of the major sectors, i.e., those
related to the state-owned enterprises, because Suharto and other elite members were the beneficiaries of existing practices. Besides this, the technocrats and the members of the liberal community were not quite certain whether privatization programs in those areas were necessary. They did not have the intellectual will to press their effort further because they were worried that the Sino-Indonesians might become more dominant in the country's business realm. So here ideas, instead of becoming a force for change, played a role as constraining factor, blocking the possibility for the government to reach the ultimate conclusion of its liberalizing policy.

In 1990, as described in Chapter 6, the anti-deregulation coalition regained its strength. Its spokespersons were quite successful in disseminating their belief that the Widjojo policy had exacerbated existing socioeconomic inequality and produced new monsters, the conglomerates, most of whom were Sino-Indonesian. Unfortunately, the liberal coalition failed to meet this rising intellectual challenge resolutely. Their consensus weakened and they failed to come up with a new explanation to answer their foes' legitimate questions.

Furthermore, Suharto in the early 1990s had started to play his own politics to remain in power as long as possible and to protect his children -- who by then had grown very rich and
powerful -- from criticism. In achieving his ends, Suharto, among others, courted the Muslim majority and supported the increasing role of ICMI, whose chairman and leading members were among the fiercest critics of the Widjojo group.

As the result of all that, the process of liberalization started to weaken. It was not stopped, but it did not progress as fast and far-reaching as it should have either. The process of policy making became more complicated and uncertain. In some areas, the policies of control, regulation and protection flourished once again, and the technocrats could only watch them from the sidelines.

7.1 Further Research

This study argues, on the basis of Indonesian data, that ideas and the actors who fight for them are important in the public arena. The implication is that further studies to understand the process of policy maintenance and change will not be complete without understanding how ideas and epistemic communities play their part.

Studies conducted by Peter Hall (1986) on the process of policy change in France and Britain, by Kathryn Sikkink (1991) in Brazil and Argentine, and by Sheri Berman (1998) in pre-War Germany and Sweden are some of the good examples which can be
pointed to as models of research to capture more of the dynamics of policy change. All of these studies take the role of ideas and epistemic communities seriously, without dismissing the importance of other variables as well, depending on the context and complexity of the country concerned.

For the future, the scope of such research might be enlarged by focusing on broad processes of political, social and cultural change. The sociologist Robert Wuthnow (1989), for instance, in understanding great historical events in history, such as the Protestant Reformation, the Enlightenment, and the rise of socialism in Europe, emphasizes the important role played by "historical" individuals like Luther, Voltaire and Marx and the persuasiveness of their ideas in the context of their time.

Wuthnow is not an "idealist." But, as his excellent Community of Discourse explains, the great events in history would not have happened, or at least would not have happened the way they did, without the ideas and visions of the thinkers, writers and ideologues who convinced their societies that the causes for which they fought were right, true, and necessary for the good of all.

There are many more great or historical events that we can study, in the past and in the present, using the approach sug-
gested in this study. In the 20th Century, for instance, the rise of communism in Russia and China cannot be comprehended fully without understanding the role played by such actors as Lenin and Mao and the importance of communism as a new, inspiring idea to solve the perceived failures of the old society in both countries. Likewise, the downfall of the Soviet Union and the "capitalist" reform in China cannot be seen simply as consequences of structural necessities (i.e., globalization of the world, economic inefficiencies and economic failures, the rise of new technologies, the emergence of a new, professional class, etc.) To a certain degree, these two major transformations of the late century showed how inspiring ideas in one period of history had become rigid, dead dogmas in another period, which could no longer satisfy their constituencies.

So by studying how ideas evolve and how the leading actors create their new vision, while rejecting the old one, in their effort to persuade their society to "move" with them, our understanding of the great historical events will be enriched.
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