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Why did Indonesia overcome the resource curse?

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Summary

Over the past few decades, developing countries that are rich in natural resources have performed significantly less well in economic terms than those that are resource poor. Indonesia is an exception in this respect. Despite its natural resource wealth, Indonesia performed extremely well in the three decades prior to the onset of the Asian crisis in 1997. In 1965, Indonesia was widely regarded as an economic “basket case” but by the early 1990s, it had been labelled by the World Bank as an East Asian “miracle” economy. How can Indonesia’s economic success compared to other resource-rich countries during this period be explained? This paper suggests that Indonesia’s success stemmed from two factors: the victory of counter-revolutionary forces over communist and radical nationalist forces in Indonesia during the 1960s and the nature of Indonesia’s geo-political and geo-economic environment. The former, it is argued, established the preconditions for a reorientation of economic policy during the late 1960s and, through this, the country’s reintegration into the global capitalist economy. The latter meant that this reintegration occurred on terms favourable to the country. The two combined meant that when international oil prices rose sharply during the 1970s, Indonesia’s “New Order” government had a strong incentive to manage the country’s newfound oil wealth well rather than allow it to be completely squandered through corruption or poor economic management.

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1 Introduction

Over the past few decades, developing countries that are rich in natural resources have performed significantly less well in economic terms than those that are resource poor. After examining the economic growth performance of 97 developing countries between 1970 and 1989, Sachs and Warner (1995) found that countries that had a high ratio of natural resource exports to Gross Domestic Product (GDP) in 1971 had much lower economic growth rates between 1970 and 1989 than those with a relatively low ratio of natural resource exports to GDP. Auty (2001: 5–6) has presented data showing that the per capita incomes of resource-poor countries grew at rates two to three times higher than resource-rich countries between 1960 and 1990. Sala-i-Martin and Subramanian (2003: 13) have estimated that economic growth in countries that are rich in fuel and mineral wealth has been on average lower than in countries that are not rich in these commodities by about 0.36 percent per year. Stijns (2001) has argued that such findings are not robust with regards to differences in the measurement of natural resource abundance. But Auty (2001: 5) and Wood and Berge (1994) have argued otherwise, the former noting that studies assessing the relative economic performance of resource-poor and resource-rich countries have used a number of different measures for natural resource abundance including dependence on primary product exports, per capita land area, and primary sector labour force (2001: 5). In general, then, there appears to be broad agreement among scholars that natural resource wealth is, perhaps contrary to initial expectations, a curse rather than a blessing.

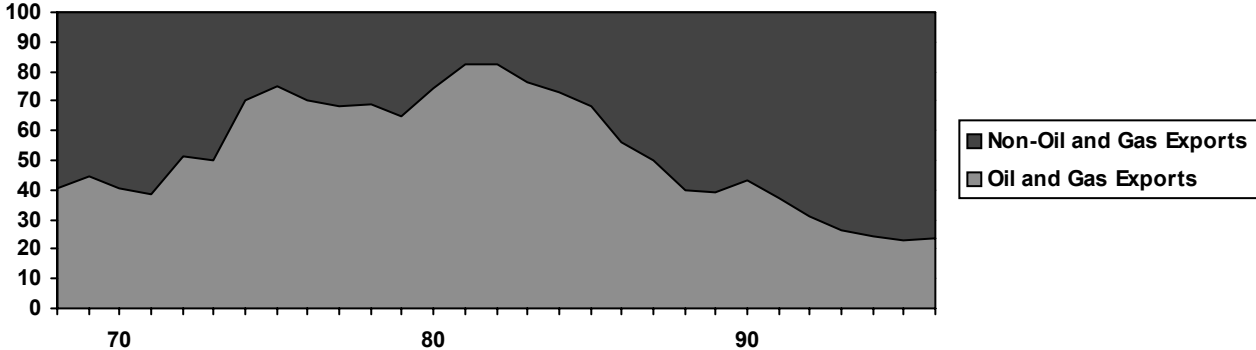
Indonesia is one of the few resource-rich countries that have overcome the resource curse. The country has long been rich in natural resources, most notably oil and gas. As several scholars have pointed out, it is a clear example of a “rentier state” (Tanter 1990; Isham *et al.* 2002). Mahdavy (1970: 428–9) has defined these states as ‘those countries that receive on a regular basis substantial amounts of external rents’ – that is, ‘rentals paid by foreign individuals, concerns or governments to individuals, concerns or governments of a given country’. An important feature of these rentals is that they are unearned – as Mahdavy (1970: 428–9) has put it, they are like ‘a free gift from nature or . . . a grant from foreign sources’. As Figures 1.1 and 1.2 show, Indonesia has been a large recipient of such unearned rentals, particularly from the oil and gas sector.

Despite its natural resource wealth, Indonesia performed extremely well in economic terms in the three decades prior to the onset of the Asian economic crisis in 1997. In 1965, the country was widely regarded as an economic “basket case” but by the early 1990s it had been labelled by the World Bank as an East Asian “miracle” economy (Hill 1996a: 1–2; World Bank 1993). Some sense of the country’s economic achievements can be seen in Figures 1.3, 1.4 and 1.5. Whilst Indonesia clearly did not develop as rapidly as some of its neighbours (e.g. South Korea, Taiwan, Singapore and Hong Kong) during this period and, in this sense, the three decades prior to the crisis represent a “missed opportunity” (Winters 1994; Tanter 1990; Budiman 1991), its economic record is nevertheless good when compared to that of other resource-rich states. When its economy crashed in the late 1990s, this had much less to do with management of its oil wealth than with the political economy of its financial sector, the nature of the

international financial system, and the post-Cold War geo-political context.¹ Not surprisingly, then, Indonesia has been seen as a model for other resource-rich developing countries to follow in managing their resource wealth (Usui 1997).

Figure 1.1 Composition of Indonesia’s exports, 1968–1996

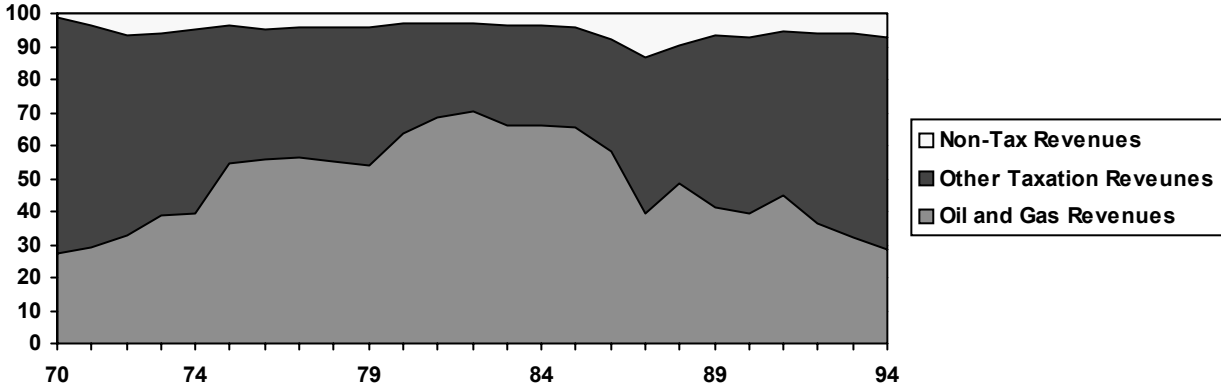
(per cent)



Source: Rosser (2002: 42).

Figure 1.2 Composition of government revenues, 1969–1993

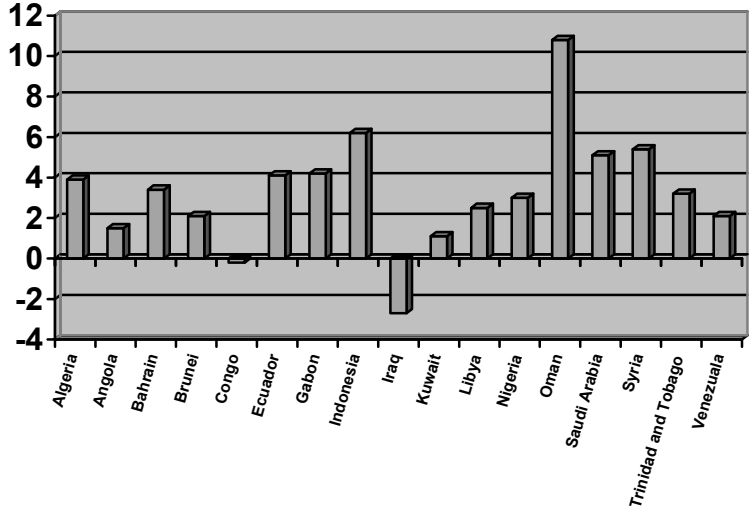
(per cent)



Notes: (i) Years on horizontal axis are financial years, e.g. 70=69/70; (ii) Figure for 93/94 is from APBN.
Source: Rosser (2002: 43).

¹ For analyses of Indonesia’s crisis that emphasise these factors, see Hamilton-Hart (2001), Rosser (forthcoming), Radelet and Sachs (1998), and Winters (2000).

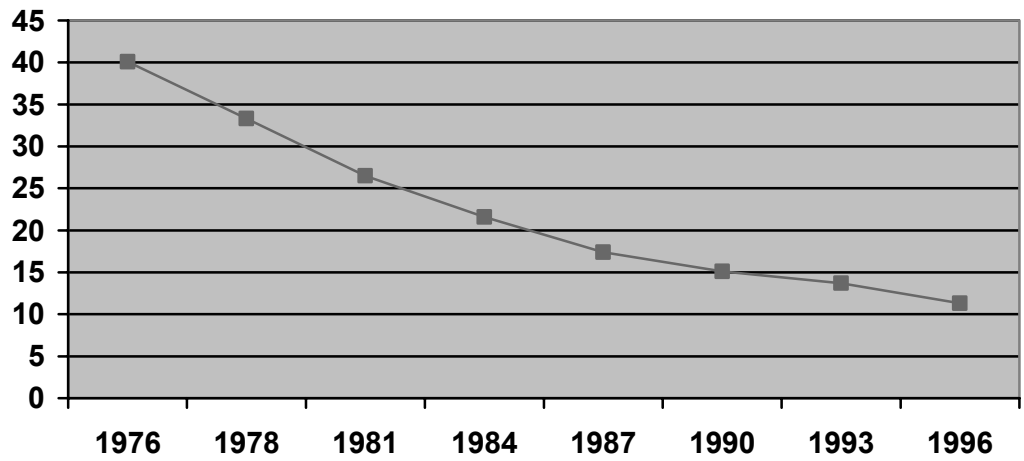
Figure 1.3 Average annual growth rates for 17 oil exporting countries, 1965–2000
(percentage)



Notes:

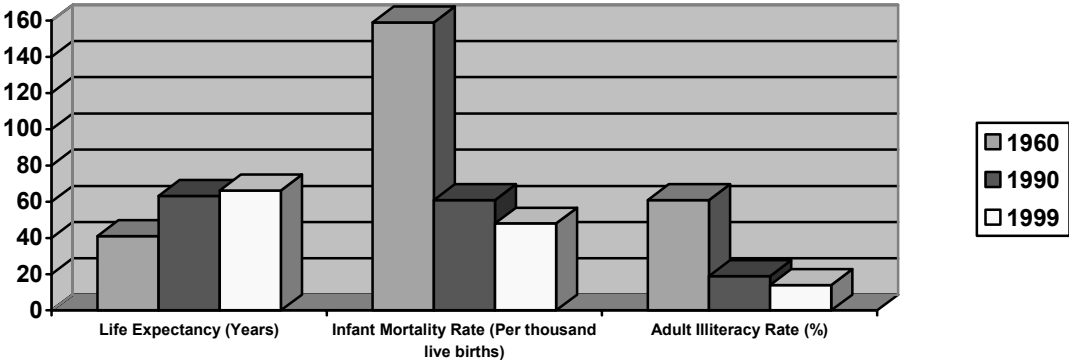
1. The average economic growth rates for several of the countries included in Figure One are for slightly shorter periods than 1965 to 2000 because of gaps in the underlying data set. These countries are Oman (whose rate is based on data for 1965–1995), Libya (1965–1989), Brunei (1973–1998), Bahrain (1981–1999), Angola (1981–2000), Kuwait (1965–1999), Iraq (1965–1991), and Congo (1965–1998).
 2. The countries included in the table are those identified by UNCTAD as “oil exporting countries”.
- Source:* World Bank, *World Development Indicators CD-ROM*. I wish to thank David Evans for his assistance with the underlying calculations.

Figure 1.4 Proportion of population below the poverty line in Indonesia, 1976–1996
(percentage)



Source: Dhanani and Islam (2002: 1215) based on Central Bureau of Statistics figures.

Figure 1.5 Indonesia: human development indicators



Source: Indonesian Central Bureau of Statistics, Bappenas, and UNDP Indonesia, *Toward a New Consensus: Democracy and Human Development in Indonesia*, Indonesia Human Development Report 2001, Jakarta: BPS-Statistics Indonesia, Bappenas, and UNDP Indonesia.

How can Indonesia’s economic success compared to other resource-rich countries be explained? Why did it succeed (at least prior to the Asian crisis) when so many other resource-rich countries failed? What lessons can we draw from the Indonesian experience? In particular, does it suggest a pathway out of the resource curse for other developing countries?

The purpose of this paper is to examine these questions. In doing so, I begin by reviewing the arguments that scholars have put forward to explain the success of particular resource-rich countries that have been able to overcome the resource curse. I argue that none of these adequately explains Indonesia’s experience. In the next section of the paper, I present an alternative explanation of Indonesia’s success. I argue that Indonesia’s success stemmed from two factors: first, the victory of counter-revolutionary forces over communist and radical nationalist forces in Indonesia during the 1960s and, second, the nature of Indonesia’s geo-political and geo-economic environment. The former, it is argued, established the domestic preconditions for a reorientation of economic policy in Indonesia during the late 1960s and, through this, the country’s re-integration into the global capitalist economy. The latter meant that this re-integration occurred on terms favourable to the country. The two combined meant that when international oil prices rose sharply during the 1970s, Indonesia’s “New Order” government had a strong incentive to manage the country’s newfound oil wealth well. Of course, this did not mean that it would necessarily succeed in this task. But it did mean that the circumstances the government faced were such that it was under serious pressure to ensure that its oil wealth was not squandered through corruption or poor economic management, as has occurred in many other resource-rich states.

The conclusion to the paper considers the lessons that can be drawn from the Indonesian experience for other resource-rich countries and, in particular, addresses the question of whether Indonesia provides a model of some kind that can be followed by these countries.

2 Explaining exceptionalism

The scholarly literature on the resource curse has focused overwhelmingly on explaining why resource-rich countries as a whole have performed less well in economic terms than resource-poor countries rather than explaining why some resource-rich countries have been able to break the resource curse. Economists, for instance, have advanced at least four different sets of explanations for the relatively poor performance of resource-rich countries: that resource-rich countries have faced declining terms of trade over time; that instability in international commodity markets can be transferred to the domestic economies of resource-rich countries in turn affecting the reliability of government revenues and foreign exchange supplies and dramatically increasing risks for private investors; that the “enclave” nature of natural resource activities has restricted opportunities in resource-rich countries for the development of backward and forward linkages between these activities and the rest of the economy; and that resource-rich countries are susceptible to the so-called “Dutch disease”, a condition whereby a resource boom leads to appreciation of the real exchange rate and in turn damages manufacturing and other tradable sectors. Political scientists have also advanced a range of explanations for the relatively poor performance of resource-rich countries, all of which centre on the effects of resource booms on the quality of governance. Resource booms are variously seen as producing myopic disorders among policy-makers, making them either complacent and lazy or irrationally exuberant and prone to a “get rich quick” mentality; empowering social groups that favour protectionist and growth-reducing policies; or weakening state institutions by reducing the state’s need to tax local populations and hence respond to societal demands for accountability, transparency, and democratic decision-making structures (Ross 1999).

A small number of scholars, however, *have* sought to explain the success of particular resource-rich countries in breaking the resource curse. The arguments that they put forward to explain the success of these countries fall into three broad groups: those that focus on the nature of these countries’ economic policies; those that focus on the role and interests of these countries’ political leaders; and those that focus on the nature of these countries’ political, bureaucratic, and legal institutions. Below, I review these arguments and evaluate their usefulness in explaining Indonesia’s experience.

2.1 Economic policy-focused arguments

In explaining the success of particular resource rich countries in overcoming the resource curse, many scholars have focused on the nature of economic policies in these countries. In general, these scholars suggest that economically successful resource-rich countries have been able to break the resource curse because they have adopted orthodox economic policies, particularly in the macroeconomic and fiscal realms. Sarraf and Jiwaji (2001: v), for instance, argue that Botswana, a mineral-rich country that at independence was one of the 25 poorest countries in the world and that grew to become an upper middle income country by the late 1990s, was able to break the resource curse because its government adopted ‘sound economic policies and [provided] good management of windfall gains’. More specifically, they argue that its government accumulated foreign reserves, ran budget surpluses to be spent only in leaner periods rather than deficits, and managed the nominal exchange rate in such a way as to avoid real

appreciation of the national currency. By doing these things, they argue, the government ensured that the country avoided external debt, experienced stable rather than volatile economic growth, and developed a diversified economic structure.

It is widely argued that Indonesia's economic success prior to the Asian crisis stemmed from the New Order's adoption of orthodox economic policies. In particular, economists have emphasised the re-orientation of the country's economic policies that occurred following the rise of the New Order in 1965. Whereas Sukarno's Guided Democracy, which ruled Indonesia between 1959 and 1965, pursued a disastrous, ideologically-driven state-led economic development strategy, they argue, the New Order's policy-makers maintained conservative macroeconomic and fiscal policies and established more liberal trade and investment regimes which were effective in stimulating investment (Hill 1994; 1996a; Usui 1997). Faced with severe economic crisis in the mid-1960s, they argue, the New Order quickly stabilised the economy by securing much-needed foreign assistance and implementing a stabilisation programme that had been agreed with the IMF. It then introduced a range of economic rehabilitation measures including the partial liberalisation of the banking system and the introduction of new foreign and domestic investment laws (Arndt 1971). Whilst economists note that the New Order intervened extensively in the industrial sector of the economy during the oil boom years of the 1970s, they argue that this contributed little to the country's development (Hill 1996b). At the same time, they argue that the country avoided serious economic problems by maintaining sensible macroeconomic and fiscal policies during this period. Usui (1997), for instance, has argued that Indonesia avoided the Dutch disease during and after the 1970s oil boom because the government accumulated budget surpluses, spent budget resources on strengthening the production base of the tradable sector, kept a lid on foreign debt from the mid-1970s onwards, and sustained currency devaluation effects by maintaining a conservative fiscal stance. When oil prices collapsed in the mid-1980s, economists have argued, the government responded quickly and prudently by liberalising the country's trade and investment sectors and deregulating the financial sector (Hill 1996a; Cole and Slade 1996).

The problem with these arguments is that they provide at best only a partial explanation of Indonesia's economic success. Although they identify the policies that helped Indonesia overcome the resource curse, they fail to explain why the government adopted these policies in the first place. What is missing from their analysis is an assessment of the way in which political factors shaped the policy-making process in New Order Indonesia and hence determined the possibilities for the adoption of orthodox policies. It is thus only by considering the way in which politics shaped policy-making in New Order Indonesia that one can fully explain its success in overcoming the resource curse.

2.2 A political elite-centred argument

The work of Weinthal and Jones Luong on the effects of the resource curse in five Soviet successor states – Russia, Kazakhstan, Turkmenistan, Uzbekistan, and Azerbaijan – is much more sensitive to the role of political factors in shaping economic outcomes in resource-rich countries than that just examined (Weinthal and Jones Luong 2001; Jones Luong and Weinthal 2001). Like the scholars mentioned above,

Weinthal and Jones Luong emphasise the importance of policy in shaping economic outcomes in resource-rich states, although for them it is privatisation policy rather than macroeconomic and fiscal policy that is the most important determinant of these outcomes. Countries that privatise their resources sectors, they argue, are more likely to avoid the resource curse than those that do not, but only if they sell these sectors to domestic interests. This is because domestic investors have greater bargaining power *vis-à-vis* the state than foreign investors: whereas the bargaining power of foreign investors declines once their capital and costs are sunk, domestic investors maintain their bargaining power *vis-à-vis* the state because 'both need the other in order to survive, enabling them to reach a compromise or find that their interests have converged over time' (Weinthal and Jones Luong 2001: 222). In this connection, they point to the different experiences of Russia and Kazakhstan, which sold their oil sectors to domestic and foreign interests respectively, in developing their taxation systems. Whereas 'domestic oil companies are helping to foster the development of an increasingly viable tax regime in Russia', Kazakhstan's tax regime 'has become increasingly volatile' and overly reliant on foreign businesses (2001: 216).

Importantly, Weinthal and Jones Luong go beyond an analysis of the policy causes of economic success and failure in the five former Soviet states to examine the political dynamics that underlay these policies. The starting point for their analysis in this respect is the assumption that political leaders are rational and self-interested actors whose primary concern is to stay in power. More specifically, they argue that political leaders are primarily concerned about maximising the difference between the resources they possess (R) and the costs they face in gaining support and appeasing or defeating opponents (C). At the same time, they argue that political leaders are constrained in their decision-making by (i) the availability of alternative sources of export revenue besides their natural resource reserves and (ii) the level of political contestation over the basis for dispensing political power and economic patronage. The former, they say, determines the level of resources that political leaders have at their disposal (i.e. R) while the latter determines the level of resources that leaders require to maintain their hold on power (i.e. C). When R decreases relative to C or C increases relative to R, the ability of leaders to pursue their preferred development strategy for the resources sector – deemed to be nationalisation with minimal foreign involvement – will be constrained 'because they must generate additional resources with which to appease or defeat their opponents' (Jones Luong and Weinthal 2001: 374).

In this context, political leaders will be willing to sell their country's resources sector to domestic business only if they have extensive access to alternative sources of export revenue and there is a high level of contestation over the basis for dispensing power and patronage.

Under this scenario, leaders engage in extensive privatisation as a means of maintaining support for their continued rule. By transferring ownership of these resources from the state to private domestic actors, they can bolster dominant patronage networks and appease the emerging rival one. They are able to minimise the role of international actors, however, because they can rely on revenue from

their alternative exports. In fact, excluding foreign investors from the privatisation process enables them to sell off these resources to domestic supporters and/or powerful rivals at below market value.

(Jones Luong and Weinthal 2001: 376)

Weinthal and Jones Luong's claim that privatisation of natural resources is the key to overcoming the resource curse is not very helpful in explaining Indonesia's experience. Indonesia underwent rapid economic development within the context of strong state control over and ownership of the country's oil and gas reserves. As Barnes (1995: 142) has noted, 'a central and constant theme of energy policy since [Indonesia's] independence in 1945 has been the need for the state to own the oil and gas reserves and to exercise full control over their development'. In accordance with this, the production-sharing contracts between the Indonesian government and foreign oil and gas firms that governed the exploitation of Indonesia's oil and gas reserves during the New Order, placed these firms in the role of mere contractors who provided services. Under this system, 'The sovereignty of the country and of its hydrocarbon resources was recognised as sacrosanct' (Barnes 1995: 42). This raises doubts about whether Weinthal and Jones Luong's argument can be extended to the Indonesian context.

At the same time, while Weinthal and Jones Luong are clearly more sensitive to the role of politics in shaping policy-making processes in resource-rich countries, in focusing on the interests and calculations of political leaders, they ignore the way in which social interests shape policy decisions. This may reflect the fact that they examine countries where civil society was severely weakened by decades of totalitarian rule. But this limits the usefulness of the framework in explaining the Indonesian case, given that, as several scholars have pointed out, social interests have exercised considerable influence over policy-making in that country. Scholars who have examined the nature of state-society relations during the post-colonial period in Indonesia have suggested that the pre-New Order period was one in which social forces exercised a much greater influence over policy-making than the state (Anderson 1983). Although these scholars have argued that the New Order constituted the re-emergence of the state as the dominant influence over policy, several others have demonstrated the way in which elements within capital – in particular, controllers of mobile capital and the major domestic business conglomerates – influenced its actions (MacIntyre 1990; Robison 1986; Winters 1996; Rosser 2002). Yet others again have suggested that other social forces, including farmers and the press, have exerted limited influence over policy, although typically through indirect mechanisms (Liddle 1987).

In addition, as Weinthal and Jones Luong themselves acknowledge, they also say little about the way in which possibilities for development in resource-rich countries are shaped by international factors such as the nature of a country's geo-political and geo-economic environment (Jones Luong and Weinthal 2001: 395). Yet, some resource rich countries have clearly benefited more from their location within the global political economy than others. For instance, as several scholars (Stubbs 1994; 1999; Anderson 1998; Winters 2000; Berger 1999) have pointed out, the advent of the Cold War conferred great opportunity for economic progress on countries (both resource rich and poor) within the East Asian region. The Korean War in the 1950s and the Vietnam War in the 1960s and 1970s created demand within the region for a

range of goods and services that neighbouring countries could provide. The fact that the US had keen strategic interests in the region facilitated the flow of generous amounts of foreign aid to several countries within the region. At the same time, the region's proximity and historical connections to Japan – particularly the fact that many countries within the region were former colonies – opened up opportunities for East Asian developing countries to attract investment flows generated by economic restructuring within Japan. By contrast, many developing countries in Africa and Latin America, which lacked the strategic importance and geographical proximity to Japan of their East Asian counterparts, received comparatively little economic benefit from the advent of the Cold War and the process of economic restructuring within Japan. As we will see below, these geo-political and geo-economic factors were very important in opening up economic opportunities for Indonesia during the New Order period.

2.3 Historico-institutionalist arguments

A third group of scholars has sought to explain the exceptional performance of certain resource-rich countries in terms of institutional factors. Rather than trying to identify the policies that contributed to economic success in resource-rich countries such as Botswana and Indonesia and economic failure in many other resource-rich countries, they have focused on the character of bureaucratic, legal and political institutions in these countries and the way in which these have affected their governments' capacities to make rational economic decisions. Atkinson and Hamilton (2003), for instance, have argued that institutional "quality" – which they define in terms of the extent of the rule of law, bureaucratic quality, the level of government corruption, and the risk of investment expropriation and contract repudiation – has had considerable influence on the ability of resource-rich countries to successfully manage their resource wealth. More specifically, they suggest that resource-rich countries with 'good quality institutions' 'have enjoyed greater rates of investment and, to a lesser extent, saving' (2003: 1804).

At the same time, these scholars have generally emphasised the way in which history and political interests have shaped institutional development in resource-rich countries. Acemoglu *et al.* (2003), for instance, suggest that Botswana was able to grow rapidly after independence because a unique combination of political and historical factors made it possible for strong institutions and good policies to emerge in that country. More specifically, they argue that the dominant political elements in Botswana in the post-independence period – chiefs and cattle-owners – developed an interest in the development of strong economic institutions and, in particular, strong protection of property rights because of their involvement in ranching and other economic activities during that time. At the same time, pre-colonial tribal institutions 'that encouraged broad-based participation and placed constraints on elites' survived the colonial period because Botswana was peripheral to the British Empire and hence had a relatively limited impact there. When the country later began to exploit its mineral wealth, they argue, it had already started to build democratic and efficient institutional structures and, consequently, its new mineral wealth "likely reinforced" these structures (105) rather than served to undermine them. Not entirely rejecting agency as a factor in shaping institutional outcomes, they add that Botswana's institutions also reflected sensible and far-sighted decisions on the part of post-independence political leaders.

Karl (1997) and Eifert *et al.* (2002) have used historico-institutionalist approaches to explain Indonesia's success in overcoming the resource curse. Karl argues that, by the time the oil boom occurred in the mid-1970s, Indonesia was on a different institutional trajectory from other petro-states. Whereas the formation of other petro-states coincided with oil's domination of the economy, she argues, oil only came to dominate the Indonesian economy from the mid-1970s. Yet the distinctive features of the Indonesian state were constructed years prior to this. This, she argues, meant that by the time of the oil boom, the Indonesian state was different from other petro-states in at least two significant ways. First, 'President Suharto granted unusual prominence to an internationally oriented economic team who became the functional equivalent of an autonomous civil service and whose long tenure provided a continuity in economic policy that has rarely been matched' (210). Second, the government 'adopted agriculture, and especially rice self-sufficiency as a principal objective, thus counteracting much of the bias of oil-led development' (210). The first of these features, she argues, reflected the devastating economic legacy left by the Sukarno regime that had ruled Indonesia prior to the New Order's rise in the mid-1960s. The second, she suggests, reflected the interests of 'powerful vested interests in agriculture' (212).

Eifert *et al.* argue that Indonesia's success prior to the Asian crisis reflected the nature of its political regime. Among oil exporters, they argue, certain types of political regime have performed better at managing oil rents than other types of political regime. More specifically, mature democracies such as Norway have performed better in managing oil rents than autocracies or factional democracies, because their higher levels of transparency and accountability, lower levels of corruption, and stronger protection of civil and political rights have translated into a higher capacity for long-term decision-making and more stable economic policies. The only exceptions in this respect, they say, have been "reformist autocracies" such as New Order Indonesia. These regimes, they argue, have proven capable of overcoming the resource curse because they have been able to 'sustain long decision horizons and implement developmental policies' (2002: 26). This in turn, they say, reflects the fact that reformist autocracies have autonomous, competent, and politically insulated technocratic elites and rely for their legitimacy on their ability to promote development. New Order Indonesia, they argue, exhibited both these features of a reformist autocracy.

Of the three approaches reviewed here, historico-institutionalist approaches provide the most persuasive and comprehensive account of Indonesia's success in overcoming the resource curse. However, perhaps because Karl and Eifert *et al.* examine Indonesia as part of broader studies that focus on other countries and consequently deal with the Indonesian case rather briefly, neither draws out fully the way in which political interests and history have shaped Indonesia's policy and institutional trajectory. First, like all of the approaches examined here, they give scant attention to the way in which Indonesia's geo-political and geo-economic context has shaped the possibilities for development in that country. Second, whilst Karl is right to judge that the reorientation of Indonesia's economic policies under the New Order reflected the economic chaos of the Sukarno years, it also needs to be understood in terms of a political struggle between counter-revolutionary forces, on the one hand, and communist and radical nationalist forces, on the other. In short, the reorientation of economic policy under the New Order did not simply

reflect the greater economic rationality of the technocrats but also the political victory of one section of society over another. Finally, Karl's claim that the New Order's emphasis on the achievement of rice self-sufficiency reflected 'powerful vested interests in agriculture' is off beam. The problem here is that agricultural interests – in particular, landlords and the peasantry – were not a strong force under the New Order (Mackie 1990). As we will see below, a better explanation of the New Order's rice policies lies in a consideration of geo-political dynamics and the political and economic opportunities that these opened up for the New Order.

3 An alternative explanation of Indonesia's economic success

I argue that Indonesia's economic success in overcoming the resource curse during the New Order period reflected shifts in the structure of power and interest within Indonesia during the 1960s as well as the country's location in the global political economy. In specific terms, our argument consists of three main propositions. The first is that the shift away from economic nationalism and left-wing radicalism and towards a more liberal economic policy agenda that occurred following the rise of the New Order reflected the victory of counter-revolutionary forces over communist and radical nationalist forces in Indonesia in the mid-1960s. The second is that Indonesia faced highly favourable geo-political and geo-economic conditions between the mid-1960s and the early 1990s that opened up a range of economic opportunities for the country and political opportunities for the New Order government. These included flows of aid, investment, and access to new technology. The third is that there were strong political reasons for the New Order government to manage its newfound oil wealth well and invest in developmental activities during the oil boom period rather than allow its new wealth to be squandered through corruption or economic mismanagement.

3.1 The victory of counter-revolutionary forces and the reorientation of economic policy under the "New Order"

The reorientation of economic policy that occurred under the New Order reflected the outcome of a struggle between counter-revolutionary forces and communist and radical nationalist forces for political dominance following independence. At one level, this was a struggle between particular organisations, with the army being the most politically important organisation on the counter-revolutionary side, and the Indonesian Communist Party (PKI) being the most politically important organisation on the communist and radical nationalist side. At another level, however, it was also a struggle between particular class interests. Ever since its formation during the war for independence in the mid-1940s, the Indonesian army has been involved in business activities, either on its own or in conjunction with private ethnic Chinese entrepreneurs. This has meant that army officials, particularly at senior levels, have had an interest in the maintenance of policy and institutional arrangements that facilitate capitalist development. At the same time, as we will see below, the army was supported in its struggle against communist and radical nationalist forces by propertied elements within the countryside, particularly at the time of the PKI's land reform

campaign in the early 1960s. On the other side, the PKI drew considerable support from the Javanese peasantry and the labour movement (Wertheim 1969; Hadiz 1997), although it by no means had a monopoly on the support of these elements and, as Mortimer (1982: 61) has pointed out, it also had some support within the Indonesian elite.

Prior to the rise of the New Order, the Indonesian army and the Indonesian Communist Party (PKI) had emerged as fierce political rivals. The origins of this rivalry go back at least as far as 1948, when, as the Indonesian nationalists were still engaged in a war of independence against the Dutch, pro-PKI soldiers unsuccessfully attempted to seize power at Madiun, a town on the island of Java, and were decimated by army units loyal to the republican government. But the rivalry was to continue into the 1950s and 1960s as the two organisations competed for power and influence. Despite the disaster at Madiun, the PKI recovered well during the years of parliamentary democracy following independence. By the mid-1950s, it had become one of the largest and most popular political parties in Indonesia, securing roughly 16 per cent of the vote in the 1955 national parliamentary elections. This result put it in fourth place behind the Indonesian Nationalist Party and two Islamic parties, Masyumi and Nahdatul Ulama. In the 1957 provincial council elections, the PKI did even better, gaining 34 per cent of the vote, a result that made it the most popular party in electoral terms (Ricklefs 1981: 236–8, 248). At the same time, the army leadership consolidated its position, promoting greater professionalism and corporate cohesion within the army, building its own elite strike force, acquiring with Soviet assistance a sizable navy and air force, and suppressing a series of violent regional rebellions in the late 1950s that threatened the unity of the Indonesian republic (Anderson 1983: 483).

The rivalry between the two organisations grew stronger under “Guided Democracy”, the regime that emerged following the collapse of parliamentary democracy and the reintroduction of the presidential 1945 Constitution in 1959. Guided Democracy was characterised by an uneasy balance of power between President Sukarno, the army leadership and the PKI (Legge 1980; Crouch 1988). While Sukarno was responsible for initially floating the idea of “Guided Democracy” and for reintroducing the 1945 Constitution by presidential decree, it was not a personalistic regime. It was rather a regime in which Sukarno was forced to balance the interests of the army leadership with those of communist and radical nationalist forces, of which the most important was the PKI.

In the early stages of Guided Democracy, the dominant political elements were the army leadership and Sukarno. Sukarno had a strong incentive to work together with the army leadership because as the heads of the only nationwide organisation capable of using force, they had enormous political power. In particular, he recognised that the army was the only organisation that had the means to overcome the regional rebellions that erupted in the late 1950s and maintain national integrity. At the same time, the army’s leaders recognised that they needed to cooperate with the president because, as the leader of Indonesia’s nationalist movement, his leadership gave the regime a legitimacy it would not otherwise have had; he had strong support among the political parties, most of which saw him as the main bulwark against greater army power; and he had strong support from significant sections of the officer corps, meaning that their loyalties were in many cases divided (Crouch 1988: 46; Anderson 1983: 484).

During the latter stages of the regime, however, the pendulum of power and influence began to swing increasingly in favour of the PKI. The initiation of “Confrontation” with Malaysia, a policy of opposition to the proposed federation of Malaysia, provided an opportunity for the PKI to expand its influence in government by mobilising mass support for the policy. As Crouch (1988: 62) has noted, the PKI’s role in promoting Confrontation made it very difficult for the army leadership to move against the PKI because it ‘could not afford to appear lacking in dedication to the national cause by hitting at the cause’s most ardent supporter’ (see also Legge 1980: 162–4). The PKI also continued to receive protection and encouragement from Sukarno who felt that his own position was under threat from the rising power of the army and the strong links that had developed between the army leadership and the US government. In this context, the PKI was able to promote in alliance with Sukarno and his supporters an anti-American campaign that became centred on opposition to American films and attacks on American property, and finally resulted in Sukarno’s decision to tell the US government to ‘go to hell’ with its aid. As Anderson (1983: 485–6) has noted, the anti-American campaign was clearly aimed at weakening the position of the army: ‘Both the President and his political supporters were well aware of the enormous importance of the “American connection” (training, funds, weapons, intelligence, etc.) to the army leaders and saw in a sustained campaign for national political and economic autonomy a subtle, but effective, way of manoeuvring toward the breaking of that connection’. In addition, the PKI took steps aimed at weakening the army leadership’s monopoly on the use of violence. On the one hand, it supported Sukarno’s calls for the establishment of a so-called “fifth force” (in addition to the army, navy, air force and police) consisting of armed civilians. On the other hand, it sought to increase civilian control over the armed forces by promoting the establishment of advisory teams to the army consisting of nationalist, religious and communist elements (Anderson 1983: 485). These initiatives threatened to increase civilian control over military affairs and thereby dramatically reduce the army leadership’s power.

The Guided Democracy years also saw the class dimensions of the struggle between counter-revolutionary and communist and radical nationalist forces become more pronounced. In the late 1950s, PKI-led trade unions took over a large number of Dutch enterprises as a form of retribution for the Dutch government’s opposition to Indonesia’s attempts to secure control over West Irian, eventually ceding control over these enterprises to the army. In 1964–65, the PKI’s trade unions launched a new wave of takeovers, this time of British and American enterprises as part of the campaign against Malaysia. Again the army stepped in to take over their management. Gaining control of most of the country’s major enterprises placed the army in a directly antagonistic, class-based, relationship with the peasants and workers who worked in these enterprises, many of whom were members of the PKI or PKI-led organisations (Anderson 1983: 485). During this period, the PKI also tried to push forward a land reform agenda, calling for the full implementation of agrarian laws that had been passed in the early 1960s. Early attempts to implement these laws had foundered because of opposition from landholders who dominated the local boards responsible for land reform and were able to use their positions and close relationships with local government and military officials to prevent redistribution of their lands. In 1963, the Indonesian Peasant Front (BTI), a peasants’ organisation aligned with the PKI, began encouraging

peasants to unilaterally seize and redistribute land. These actions threatened the interests of the numerous military officials who owned land in Indonesia as well as those of other landowners (Crouch 1988: 63–4; Robison 1993).

It is in this connection that the New Order constituted a counter-revolutionary regime *vis-à-vis* communism and radical nationalism (Robison 1981: 23). When the army seized power in 1965–66, it immediately set about halting the agendas that communist and radical nationalist elements had promoted as well as emasculating the organisations and individuals that had represented these elements. Over the next few years, it outlawed the PKI, jailed and executed many of its leaders, sidelined Sukarno and his supporters in the military and bureaucracy, and oversaw and encouraged the murder of perhaps hundreds of thousands of suspected communists. It also returned to their original owners many of the foreign assets seized during the late 1950s and 1960s by trade unions and then surrendered by them to the army, facilitated the re-entry of foreign capital into Indonesia through the introduction of liberal foreign investment and other economic laws, re-gearred Indonesia's foreign policies towards a closer relationship with the US and other Western countries, and brought an end to Confrontation with Malaysia. At the same time, it also increased protection of propertied elements within Indonesia by removing the threat of land redistribution and other communist and radical nationalist-inspired wealth redistribution measures. In short, it completely overthrew the anti-imperialism and radicalism that had characterised Indonesia's economic and foreign policies under Guided Democracy and replaced them with a greater emphasis on openness to the global economy and political alignment with the US and Western Europe. From an economic programme characterised by autarky and the redistribution of wealth, Indonesia was to embark under the New Order on a new economic programme characterised by capitalist development based on foreign investment, the return of ethnic Chinese capital (which had fled as the economy declined under Guided Democracy), and access to foreign aid and markets.

3.2 Indonesia's geo-political and geo-economic environment and economic opportunities

These internal developments intersected with developments in Indonesia's external circumstances that opened up a range of economic opportunities for the country over the next three decades. The first of these was the intensification of the Cold War between the US and its allies and the Soviet Union and its extension, in geographic terms, to Southeast Asia. The New Order gained power at a time when the Vietnam War was just beginning and there was widespread fear within the US and other Western countries that communism would spread, domino-like, throughout Southeast Asia. As Anderson (1998) has noted, the result of this fear was a series of initiatives by the US aimed at incorporating Southeast Asian countries within its sphere of influence. Generally, these involved 'creat[ing] loyal, capitalistically prosperous, authoritarian anti-Communist regimes – typically, but not invariably, dominated by the military'. The US government had been very concerned about the growing strength and influence of the PKI in Indonesia during the early 1960s and was worried that it might at some point take power (Ricklefs 1981: 259–69). When the New Order seized power in 1965, it thus moved quickly, in conjunction with

other Western governments and international organisations, to offer it financial support and assist its attempts to consolidate its rule.

The economic benefits of this situation for Indonesia were immense. Driven by a concern to keep Indonesia on-side, Western governments pumped large sums of aid into the country through the Inter-governmental Group on Indonesia (IGGI), a donor forum established in 1966. Between 1967 and 1971, IGGI committed over \$US2 billion in aid to Indonesia, significantly aiding the country's economic recovery (Woo *et al.* 1994: 193). The Indonesian government also received generous assistance during the late 1960s from the International Monetary Fund (IMF). In conjunction with Indonesia's economic ministers, the IMF played a key role in formulating the country's successful economic stabilisation and restructuring programme. Over the remaining years of the New Order, IGGI, along with the World Bank and the Asian Development Bank, the ownership structures of which were dominated by the major Western governments, continued to provide generous amounts of aid as well as, particularly in the case of the multilateral banks, policy advice.

As Western governments re-engaged Indonesia, mobile capital followed. The success of Western governments and multilateral organisations in helping the New Order consolidate its rule and stabilise the economy signalled to foreign investors that Indonesia was now a relatively secure place to invest. In addition to a concerted attempt by Indonesia's economic ministers to woo foreign capital through policy changes, of which the most important was the introduction of a new foreign investment law in 1967 (Winters 1996: 54, 76), this led to a wave of new foreign investments during the late 1960s and early 1970s (see Table 3.1). Initially these investments focused on exploitation of Indonesia's natural resources, particularly in the oil and gas, mining and forestry sectors. But they became increasingly focused on manufacturing activities as the government embarked on a state-led import-substitution industrialisation drive during the oil boom years of the 1970s and early 1980s. In 1980, the US government granted Indonesia privileges under its Generalised System of Preferences (GSP), a mechanism to encourage trade between the US and developing countries. These privileges became particularly important in helping Indonesia shift away from an import-substitution industrialisation strategy towards an export-oriented one following the collapse of international oil prices in the mid-1980s. As such, they also helped Indonesia avoid one aspect of the Dutch disease – a decline in manufacturing activity.

The Cold War also opened up opportunities for the New Order in the agricultural sector. As Perkins (1997) has pointed out, the US was concerned that the spread of communism would be precipitated by food scarcity and population growth in developing countries and consequently invested heavily in the development of high-yielding crop varieties and provided generous aid to developing countries to assist with agricultural development. The Rockefeller and Ford Foundations were central to these efforts, running a range of agricultural programmes to fund the development of high-yielding crop varieties. For instance, the two foundations established the International Rice Research Institute (IRRI) in 1960 to produce high-yielding varieties of rice (International Rice Research Institute nd: 3). IRRI's success in producing these varieties of rice provided an opportunity for the New Order government to achieve something that Indonesian governments had been trying to do since independence: make Indonesia self-

sufficient in rice. It was an opportunity that the New Order had good reason to take. Achieving rice self-sufficiency would help the country save scarce foreign exchange by reducing the country's need to import rice; help the New Order achieve political stability by increasing the chances that affordable supplies of rice reached urban areas; and clearly demonstrate the New Order's ability to promote economic development, something that was particularly important given the developmentalist ideology promoted by the regime. Not surprisingly, the New Order made achieving rice self-sufficiency a key policy goal especially during the first two decades of its rule, and continued to pursue this goal despite the serious problems encountered during its early rice intensification programmes (on these programmes, see Hansen 1978).

Table 3.1 Foreign investment in Indonesia, 1967–1995

(\$US millions)

	1967– 1975	% of Total	1976– 1985	% of Total	1986– 1995	% of Total	1967– 1995	% of Total
USA	491.7	12.4	770.3	7.4	5971.7	4.7	7233.7	5.1
Japan	953.4	24.0	2429.9	23.5	16419.5	12.9	19802.8	14.0
NICs Total	543.4	13.7	1027.7	9.9	39228.6	30.8	40799.7	28.8
Hong Kong	336.3	8.5	842.1	8.1	12214.0	9.6	13392.4	9.5
Singapore	95.0	2.4	39.1	0.4	13051.4	10.3	13185.5	9.3
South Korea	94.4	2.4	70.8	0.7	6203.9	4.9	6369.1	4.5
Taiwan	17.7	0.4	75.7	0.7	7759.3	6.1	7852.7	5.5
UK	35.9	0.9	228.1	2.2	11940.7	9.4	12204.7	8.6
Netherlands	157.1	4.0	253.3	2.4	3065.2	2.4	3475.6	2.5
Total	3970.5	100.0	10349.8	100.0	127204.5	100.0	141524.8	100.0

Notes: (i) Figures are cumulative totals and are in millions of \$US; (ii) Figures for 1967–1975 are to February 1975 rather than December as is the case for the figures for 1976–1985 and 1986–1995.

Source: *Indonesian Financial Statistics*, various editions.

The second major development in Indonesia's external circumstances that created economic opportunities for the country relates to the geo-economic interests of Japan and the East Asian NICs. In the late 1960s, the Japanese government removed controls on the export of capital, precipitating a large wave of foreign investment into East Asia, a significant chunk of which, as we have seen, went into Indonesia's natural resource sectors. Another wave of Japanese investment flowed to Indonesia following the signing of the Plaza Accord in 1985, as Japanese manufacturers sought cheaper bases from which to export to the US. As the currencies of the East Asian NICs began to appreciate during the late 1980s and their privileges under the GSP came under threat, large amounts of manufacturing investment also flowed from these countries to Indonesia. These investment flows were particularly important for the Indonesian economy following the collapse of international oil prices in the mid-1980s. When oil prices fell, the New Order

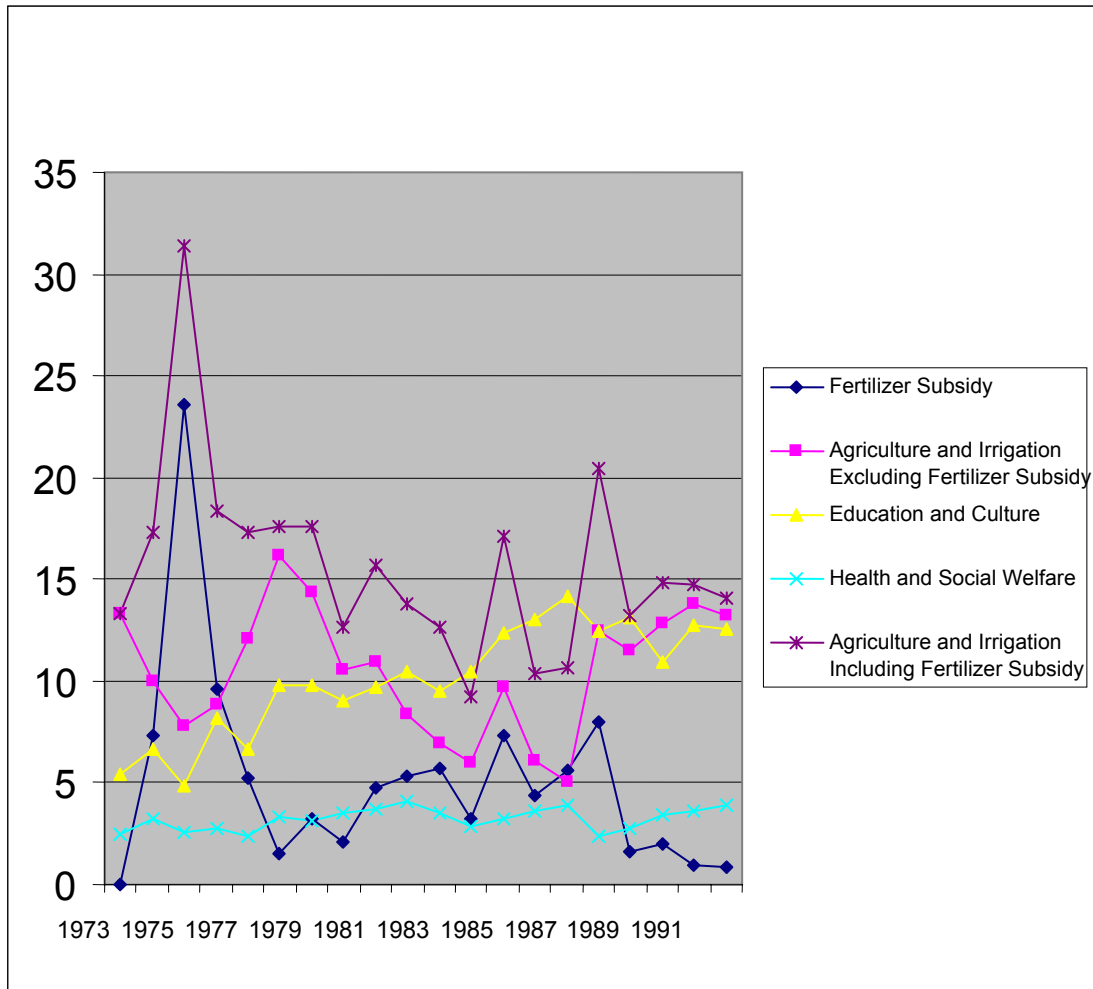
was forced to attract alternative sources of investment to drive economic growth. This relocated investment served to provide the required stimulus (Steven 1988; Beeson 2001; Rosser 2002: 128; Stubbs 1994, 1999).

3.3 Managing Indonesia's oil wealth

It is widely argued that Indonesia managed the massive increase in its oil wealth well during the oil boom years and consequently avoided the economic difficulties experienced by many other oil-exporting countries as a result of this boom (Eifert *et al.* 2002; Booth 1992). As noted above, Usui (1997), for instance, has argued that Indonesia was able to avoid the Dutch disease-related problems that afflicted Mexico and so many other oil exporting states at this time by adopting sensible macroeconomic and fiscal policies. Similarly, Booth (1992: 327) has argued that, in contrast to governments in many other developing countries, the New Order placed 'longer-run considerations of the national interest' above the interests of political and business clients and, as a result, was able to ensure that the oil boom did not have a negative impact on poverty and inequality levels. It is also clear that, whilst the government wasted a good proportion of Indonesia's newfound oil wealth on unproductive and inefficient hi-technology and capital intensive industrial projects (Hill 1996b), it also used much of this wealth for developmental purposes. As Figure 3.1 illustrates, government spending on agricultural development (particularly fertiliser subsidies for rice production) and education increased significantly during the oil boom period.

At the same time, whilst Suharto and his cronies were able to enrich themselves during this period, the country's newfound oil wealth does not appear to have been completely squandered through corruption. Nor, did corruption expand to the point where it deterred private investment. As MacIntyre (2003) has argued, President Suharto had both a strong incentive to ensure that arbitrary and corrupt behaviour was contained within tolerable limits and the ability to monitor and take action against such behaviour. The incentive stemmed from the fact that containing arbitrary and corrupt behaviour served to provide greater security and predictability to investors and, hence generate investment. Suharto's ability to monitor and take action against arbitrary and corrupt behaviour stemmed from the fact that power was centralised in his hands; there were a variety of mechanisms in place (such as the appointment of former military officials to Inspector-General positions within government departments) by which such behaviour could be detected and reported to higher authorities; all major political players owed their positions to him; and he had a range of policy instruments at his disposal to punish those whom he thought had been excessively corrupt. By making selective use of these instruments, MacIntyre argues, Suharto was able to 'ensure that corruption was conducted in an orderly fashion that was within the limits of what the market would bear' (2003: 14) (See also McLeod 2000).

Figure 3.1 Government expenditure on agriculture, health and education
(percentage of total development expenditure)



Source: Woo *et al.* (1994).

Why did Indonesia manage its oil wealth well and invest a significant proportion of this wealth in developmental activities rather than simply squander it through mismanagement and corruption? Our answer is that the (internal and external) developments examined above created a political climate in which there were strong incentives for New Order policy-makers to manage the economy, and in particular its new oil wealth, well. The point here is that by the time the oil boom began in 1973, the New Order had already embarked on a capitalist programme of development involving integration into the global economic system, and, notwithstanding its membership of the Non-Aligned Movement, effective alignment with the US and Western Europe in the Cold War struggle. In short, it was a capitalist state geared towards providing an environment conducive to private capital accumulation. The coalition of interests that underpinned the New Order included, as we have seen, local and international propertied classes which had a strong interest in seeing Indonesia continue to pursue capitalist development. To have adopted policies which limited the potential for private capital accumulation would thus have threatened the very existence of the New Order by undermining the coalition of interests that supported it. This acted as a powerful incentive for the New Order to limit the extent to which oil wealth was used

unproductively or allowed to contribute to economic instability through, for instance, Dutch disease effects or irresponsible borrowing on international financial markets. Why the New Order thus became a reformist rather than predatory autocracy and constrained the spread of corruption thus becomes clear. To have allowed state officials to squander the country's oil wealth would have undermined Suharto's government and threatened its ability (as well as his own personal ability) to hold on to power. Of course, this is not to say that there was anything predetermined about Indonesia's success in managing its oil wealth. Policy-makers could have made technical errors in managing the economy – i.e. chosen the wrong policies. Suharto could have misjudged the extent to which his survival as leader depended on the economic success of his regime – that is, he could have made an error of political judgement (Liddle 1991). But the point is that the nature of the state provided strong incentives for political leaders to take a long-term view and manage the economy well.

At the same time, there was a strong political logic driving a number of the government's development policies. The political logic underpinning the government's rice policies has already been discussed. One can also see a strong political logic underlying the New Order's education policies. On the one hand, key New Order figures such as Ali Moertopo saw expansion of the education system as an essential prerequisite for economic development. Economic development, they argued, would be impossible without improvements in the country's human resources (Moertopo 1981: 68–76). On the other hand, expansion of the education system also provided a mechanism for the New Order to promote its political ideology and pursue nation-building objectives. Particularly important in this respect were the fact that students at all levels were required to study courses in Pancasila, the state ideology, and use the national language, *Bahasa Indonesia*, rather than their respective regional languages, in the classroom. Seen from this perspective, it is possible to understand why the New Order invested so much more heavily in education than health (see Figure 3.1). Whereas investment in the education system offered a range of political benefits to the New Order, investment in health offered virtually nothing in this respect. As Januar Achmad (1999: 138) has argued, New Order policy-makers saw health outcomes as having very little relevance to the maintenance of internal security and control.

4 Conclusion

I have argued here that Indonesia's success in overcoming the resource curse stemmed, not just from the policies and institutional arrangements that characterised the New Order's rule, but also from the political and social conditions that made these possible. Most important in this respect, I have suggested, were the victory of counter-revolutionary forces over radical and nationalist economic forces in Indonesia during the 1960s and the nature of Indonesia's geo-political and geo-economic environment. The former, I have argued, provided the political and social basis for Indonesia's reintegration into the global capitalist system and the adoption of the economic policies that facilitated this. The latter meant that Indonesia gained a range of economic opportunities as a result of this reintegration, opportunities not available to many other resource-rich countries. The two combined created a strong incentive for the New Order government to

manage the country's newfound oil wealth well and ensure that this was not squandered through corruption or poor economic management.

This explanation of Indonesia's success suggests that Indonesia does not provide much of a model for other resource-rich developing countries to follow. The primary lessons of Indonesia's experience are that the nature of political and social coalitions within a country, the balance of power between them, and a country's geo-political and geo-economic context play a significant role in determining a country's ability to successfully manage its natural resource wealth and overcome the resource curse. These variables are, of course, extraordinarily difficult to change and so are not replicable in other country contexts. But this analysis does at least offer a little more hope for resource-rich countries than most analyses of the resource curse which, as Jones Luong (2003: 2) has pointed out, are rather deterministic and virtually deny the possibility of a pathway out of the resource curse. In contrast, the analysis here suggests that whilst the resource curse is serious and real, it is, to paraphrase Auty (1994: 24), less an iron law, than a strong tendency that can be overcome given the right conditions.

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