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POLITICAL ECONOMY OF STRUCTURAL ADJUSTMENTS: INDONESIA'S CASE

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The political processes of all nations are wider and deeper than the formal institutions designed to regulate them; some of the most critical decisions concerning of public life are not made in parliaments and presidiums: they are made in the unformalized realm of what Durkheim called "the collective conscience".....But in Indonesia the pattern of official life and the framework of popular sentiment within which it sits have become so disjoined that the activities of government, though centrally important, seem nevertheless almost beside the point, mere routinisms convulsed again and again by sudden irruptions..........Clifford Geertz [1]

1. Introduction

Indonesia is, Ulf Sundhaussen argues, rarely included in comparative surveys because, among others, "the subdiscipline of Indonesia watching had been extraordinarily politicized, making it quite unsuitable for cross-national research."[2] However, the recent changes appear to make Indonesia's political economy no longer unique. Her rapid economic development buttressed by the price hike of primary products including oil in the 1970's has brought about the deepening linkage between Indonesian economy and the external markets. Her economy has to be looked at in a global context. It also put an end to the "extraordinarily politicized" interpretations of her economy. There have emerged a number of social changes including the widening rich-poor gap, the decline of environmental conditions and so on, the changes of which could be found elsewhere. Structural by nature, these problems demand a new set of solutions. In short, Indonesia needs to be included in comparative surveys.

The case in point is the fact that Indonesia has undergone the process of "structural adjustments" in much the similar way in which most of developing nations were forced to transform their political economies. Different in range and scope of such a transformation, however, the process in Indonesia, too, includes such measures as the price control of exporting commodities, fighting against inflation, the acceleration of "export-oriented" industrialization, the so-called "deregulation" of administrative guidances, "privatization" of state owned or state controlled corporations, and so on.

Inspired by IMF, World Bank and other international agencies, however, Indonesia has taken such steps on her own initiative. The reasons for this are multifold. First of all, the "structural adjustments" were a response to the burgeoning demands of her own economy. Undoubtedly it was economic adjustment. Secondly, it was an attempt by the government to redistribute the benefit of economic development to the rapidly widening gap between the rich and the poor. Therefore it was an social adjustment as well. And thirdly, it was a political process in which the aging political regime wished to reestablish its legitimacy in the face of increasing demands for democracy.

From the above, it is safe to suggest that such a complex process constituted the "structural adjustments" of Indonesia. Then, how it went? And was it successful? If so, what would be the outcomes of the process? In the following, I shall make some attempts, first of all, to put the "structural adjustments" of the 1980's in the historial perspective of Indonesia's political economy. And then secondly, I shall divide the process into three stages, each stage of which will be looked into more in detail. And finally I will touch briefly on the problems as well as prospects which the whole process of the "structural adjustments" was impinged upon by the very fact of deepening global linkages.

2. Pillars of Indonesia: "Active Neutrality"

Since Indonesia achieved her full independence in 1949, the pillar of her external relations has been an "active neutrality", or what the first vice-President as well as the then Prime Minister, Mohammad Hatta, called as "independent and active" foreign policy. At its onset, it was true to say that such an ideal orientation of her external relations was inspired by a concern to "fend off left-wing demands for the Republic to align itself with the Soviet Union and, correspondingly, to avoid provoking the Dutch and also alienating the United States."[3] Yet it became more than an immediate means to secure her newly won independence. It has become Indonesia's "international outlook", too.

Its main aim is to assure the equal status as an independent state in the family of nations. To this end, it seeks to dissociate herself as distant as possible from the reality of international politics, viz. power politics. Indeed it does share a number of common features with the traditional neutrality practiced by European nations, however, it differs from them in some crucial points.

Due to the deep suspicion of external forces rooted in the centuries long colonial experience, first of all, it tends to regard international relations as an arena of competition, rather than that of cooperation. Secondly, as her self-image of "a virgin girl surrounded by wolves"[4] reveals, the competition on equal footing is out of question for Indonesia. In turn, the so-called protective measures are *sine qua non* for the weak. Thirdly, this politicized view tends to see even non-political interactions as one between friends and enemies, and more often than not, endorses narrowly defined nationalism, if not xenophobia. Finally, it places paramount importance upon the allegiance to internal unity in a society whose diversity is extremely wide-ranged. In other words, the conduct of foreign relations is a means to achieve "unity in diversity", the *raison d'être* of the Republic.

From these, Indonesian relations to the external world might appear to be in deep dilemma between a search of passive harmony and the outright resistance against foreign intervension, or in F.B. Weinstein's phrase "the dilemma of interdependence".[5] Such a dilemma has become more deepened especially in the field of her economic relations with the external world since the late 1960's. Correspondingly, the hitherto exclusively parochial urge for national interest has begun to be impinged upon by the increasingly forceful demand for accommodating Indonesia, if not in the global economy, in an emerging regional economic order namely Asia and the Pacific growth region. Coupled with the change of regime from Sukarno to Suharto, indeed Indonesia has gone through drastic changes socially, economically, and even culturally, which R. Robison characterizes as "capitalist revolution".[6] In such a historical context, Indonisia underwent the process of adjustments in the 1980's.

3. Settings for Adjustments

Since the emergence of *Orde Baru*, or the New Order regime of Suharto, Indonesia underwent a 180 degree change in her foreign policy, especially in its economic field. Sukarno's life-long effort for *Indonesianisasi* , or Indonesianization, was soon replaced with *Modernisasi* , or Modernization. The policy of nationalization of foreign capaital was abandoned, and instead adopted was the promotion of foreign investments. Foreign capitals became to be seen as an indispensable component of her own national economic development, rather than an economic arm for the enemies to dominate the Republic. The huge public spendings which hitherto had brought about a hyper inflation, over 600 percent in 1965, were quickly replaced by the combination of austerity policy with tight monetary control, which has become the hallmark of the Suharto regime's economic policy. By the time the first 5 year plan (*Repelita I*) was commenced in 1969, the annual rate of inflation went down below one digit, a balanced budget was achieved, a 2.4 US $ billion debt left by the previous government settled through the international consortium, IGGI, and above all the fresh foreign capital investments began to find their inroad to Indonesia due mainly to "Foreign Capital Promotion Act" of 1967. From 1968 to 1973, for example, the Japanese investments alone marked a 30 times jump, even though starting from the small amount.[7]

Had there not been a quadruple hike in oil prices in 1973-74, Indonesia might have gone through a fairly slow and gradual process of economic growth in much the same way as many other non-oil producing developing economies, say, like Thailand. The 1973-4 oil price hike, however, did change the course of Indonesian economic development almost totally within overnight.

First of all, Indonesian economy in general and the government policy in particular has become overwhelmingly dependent upon the export of natural resources, *inter alia*, oil. Throughout the 1970's and the early 1980's, over 75 percent of the national revenue, almost constantly, came from oil and gas export.

Secondly, the bonanza of primary products exports brought a huge financial resource for the "acceleration of modernization" (a former presidential adviser Lt. Gen. Ali Moertopo), albeit the strictly balanced budget policy.[8] A large number of public corporations were established with less qualified managements mainly recruited from the armed forces. Consequently, GNP grew rapidly but so did corruption.

Thirdly, this ostensibly state-led economic development gave birth to instant indigenous capitalists. But in reality they were the mere product of extremely complicated state legislations, presidential as well as ministerial decrees, and administrative guidances, licensings and so on, all of which were to serve for the interest of *pribumi* , the indigenous Indonesisans. The real driving force of economic development, however, was a "triple alliance" between foreign, state and local capital, in which crucial were the foreign multinational companies and the local, mainly Indonesian Chinese capital.[9]

Despite these structural weaknesses, Indonesian economy marked the unprecedented rapid growth during the 1970's, especially in the manufacturing sector. However, the second oil price hike of 1979-80 did not bring about the similar effect upon Indonesian economy. Quite contrary, it led to a serious crisis. Notwithstanding the higher oil price, foreign investments in Indonesia declined sharply mainly because of the severe recession in developed economies. In addition, by 1983 oil price began to fall. Furthermore, the less competitive Indonesian manufactured goods had little hope to wedge into those increasingly protective markets in developed economies. The crisis was multifold when the trade balance marked the lowest surplus in a decade (US $ 963 million) and her current account balance the largest deficit ever (US $ 6, 442 million), both in 1983.[10] Indeed difficult was to reduce the increasing imports, especially of capital goods needed to her indusrialization. Urgently required was a structural adjustment of the overall Indonesian economy.

4. Strategy for Non-Oil Export

As of 1982, the export of oil, oil products and gas combined occupied 82.4 percent of the total export. However, mainly due to the price fall, especially the sharpest fall in 1986, the share fell to 51.7 percent in 1987, and for the first time in decades it went below 50 percent of the total in 1988. This phenomenal decline of oil revenue was the bitterest blow to the oil dependent economy of Indonesia. Along with the fall of oil revenue, foreign investments also declined. In 1983 (FY), Indonesia approved US $ 1.3 billion foreign investment. But in 1985, the amount was less than a half, US $ 625 million, the lowest in the decade. Due to her low saving, Indonesia has been dependent upon the trade surplus and foreign investment for capital. The double low in oil revenue and foreign investment, therefore, severely hit the economy. The GDP growth rate fell from 6.0 percent in

1984 to 3.2 percent in 1986.

Under such circumstances, the chosen government policy was to boost the non-oil and gas exports, especially timber, textile and rubber. There were basically two supportive micro economic measures and a macro economic adjustment taken to facilitate the above policy.

One was to increase the value of exports by almost totally prohibiting the export of raw materials and semi-processed products and to encourage the development of downstream processing with higher value added. The plywood industry is a successful example which became the second largest export earner after oil and gas, more than US $ 2 billion in 1988. The up and coming is the rattan industry again with the prohibition of semi-fineshed rattan.

The second measure was to promote foreign investments in such strategic industries as those above in order to make them more competitive in the world market. Such an export-oriented industrialization certainly needed the injection of advanced technology from outside which was unavailable from within on one hand, and demanded the relocation of such industries from the industrialized to Indonesia. Thus, it was not totally free from a head-on conflict, such as the conflict between Indonesia and Japan regarding the former's plywood export to the latter.

A macro economic adjustment was a devaluation of the currency, rupiah. Under the extremely tight control of monetary and fiscal policies, the currency continued to be devalued against US $, for example 1 US $ was 661.42 rupiah in 1982, 909.26 in 1983, and then precisely when most of Asian currencies became upvalued after the "Praza Accord" of 1985, the Indonesian currency continued to slide in terms of US $, 1,282.56 in 1986, 1,643.8 in 1987. This monetary policy was not directly aimed at the promotion of export-oriented industrization. But it undeniablly had such an effect as giving a price competitiveness in the world market.[11]

5. Debts and Investments

The over-extended investments in the 1970's and the early 1980's turned to be one of the main reasons for the largest debt in Asia, which reached US $ 50 billion at the end of 1988. Another reason for the rapid rise of Indonesia's debt, as indicated by a massive increase during the 1986-88 period from US $ 38 billion, was the appreciation of the yen, since Japan had been the largest donor. With such an increase, the debt service ratio also jumped to nearly 40 percent in 1988.

However, Indonesia did not take such a conventional measures as seeking of debt reschedule or debt reduction so common with respect to Latin American nations. Instead, she chose to maintain a favourable credit rating by paying on time. The only exception was an attempt to ease the grossly appreciated payment to Japan. This attempt of a debt relief vis-a-vis Japan did not bear fruit.

With debt service ratio that was three times higher than the conventional upper limit of 20 percent, however, Indonesia's choice was to attract more favourable aid and investments. Indeed, this choice did bring one of the largest foreign aid in 1988 amounting over US $ 4 billion, in that salient is the sharp increase of Japanese aid in the form of concessionary loans, US $ 1.4 billion. In addition, it was awarded US

$ 1.2 billion by the World Bank, US $ 550 million by the Asian Development Bank in the same year. This rapid rise of aid to Indonesia may be interpreted as "foreign vote of confidence" in Indonesian government's handling of her economy.[12)]

Another important result from the above choice was the rapid increase of investment not only by the European, the American and the Japanese investments in Indonesia. It was also by Asian NIES as well as other ASEAN members. For instance, in 1988 Taiwan invested in Indonesia US $ 914.1 million, or 22.7 percent of the total which Indonesia received in that year. The hitherto largest invester, Japan, was the third after the US, only little bit more than that by Hongkong. The combined amount of investments by the 4 Asian NIES, Korea, Taiwan, Hongkong, and Singapore, reached US $ 1.4 billion, nearly 6 times larger than that by Japan, and took more than one third of the total.

In addition, the type of investment by these economies shows an enhanced effort to combine and coordinate each one's industrial policy and its structure. This is a sign of not only the emergence of an intra-regional division of labor, but also an intra-industrial division of labor. The latter is clearly seen in the enhanced division of labor in electronic industry. Indonesia, in turn, began to incorporate her industrial policy into a far more complex regional economic transactions.

6. Social Changes

The gradual and at the same time fundamental change of Indonesian economy since the inception of economic adjustments was not certainly a separate phenonenon from non-economic changes. It was, one might argue, a result of the rapid growth but also was the main cause of tremendous social changes. Apart from a variety of issues on such changes, one issue is extremely imortant in relation to the topic here, the "structural adjustments". It is none other than the problem of emplyoment.

It appears to be a fairly common experience that once the process of industrialization begins, the inter-personal relation shifts from that of a whole-embrasing community or *Gemainschaft* to that of a partially committing society or *Gesellschaft*. The decline of traditional village is inevitable. Secondly, the search of a maximum opportunity to obtain power, wealth, and honor would become the order of the day. Thirdly, such a search as in the above will increase people's horizontal movements and consequently their virtical mobility. This is particularly the case in Indonesia during the latter part of the 1980's. Urbanization became the common phenomenon throughout the Indonesian archipelagos. A huge number of transmigration from village to town, and town to city, city to metropole could not fail to demand the creation of a massive new jobs.

Officially, the unemployment rate is often reported to be 2 to 3 percent. There are a number of good grounds to doubt about the figure, and some estimates are even as high as 30 percent. Whether or not, and even if one takes it at its face value, there is another breathtaking problem, namely the creation of enough jobs for the new comers to Indonesia's labor market. As of 1988, the work force is, according to government statistics, estimated at 75 million. And, it is growing by 3 percent per year, or approximately 2.2 million people every year. In order to solve the unemployment problem or at least to keep unemployment from growing, some suggests, the economy must continue to grow more rapidly than 5 percent a year in order to sustain the growth of employment by 3 percent a year. As the government statistics reveal, no one single year marked an overall economic growth by 5 percent since 1986. In fact, they were 3.2 percent in 1986, 3.7 percent in 1987, approximately 4 percent in 1988. From this, one can easily imagine that GNP per capita grew, at best, by a mere 1 to 2 percent per year. As the World Bank reported, due to the currency slide in dollar terms, Indonesia's per capita declined, namely US $ 530 in 1985, US $ 500 in 1986, and US $ 450 in 1987.(13)

The stagnation of per capita income with a possible growth of unemployment became one of the major concerns of the government. With the recognition of unemployment as a threat to the economic stability in the days to come, the fifth 5 year plan set the official target of economic growth by 5 percent. Yet, even with another oil price hike, it would be exceedingly difficult to fulfill the burgeoning demand for jobs, as long as the on-going adjustment is set for the enhancement of competitiveness in the world market rather than the improvement of domestic living standards.

In this regard, one should not overlook the most recent trend in which unemployment among the educated is growing. Traditionally the government or government affiliated public institutions have offered enough jobs for those highly educated. However, since the fall of oil price and the subsequent implementation of severe austerity by cutting jobs in public sector, the unemployment rate in this category of work force seems to be growing. Taking it into consideration that precisely this group of people has played a crucial role in bringing about political change, if not just political turmoil.

7. Prospects of Adjustments - Conclusion

Indonesia's experience of economic adjustments in the 1980's, as seen in the above, unequivocally conveys the following messages. First of all, the adjustments were necessary to put an upper limit to the overextended state involvement in economic development on one hand, and to reduce Indonesia's overdependence upon the international economy, especially the markets and capitals of the developed economies, on the other. The adjustment policies produced some satisfactory result such as the increase in exports, more fresh investments, inflation under control, and so on. At the same time, however, the very process gave birth to the less controllable problems, including a further dependence upon the international and regional economies, increased gap of competitiveness with the rising Asian economies, trade conflicts in specific industries with large market economies, and above all, serious social dislocations and explosive problems of unemployment.

Secondly, in order to escape such a dilemma and at the same time to refrain from the superimposition of further state control over the already heavily controlled economy, a newly found policy was so-called deregulation. Indonesian government started a number of measures for this purpose since the very beginning of adjustment process. But it became far more serious after seeing more troubles than solutions from the too tight control of economy. In 1988 it began to transfer some important public monopolies into private sectors. This "privatization" policy has yet to produce a real reform to the much regulated economy in which dominant are still public corporations.

Thirdly, since the top management of those public corporations has been almost totally monopolized by the armed forces, especially the officer corps or the retired, the reform of economy can not be separated from political reforms. Indeed, in this regard, rising are the demands for a more equal distribution of the outcomes of economic development on one hand and on the other for a more participation by non-military personnel in policy-making process as well as their implementation processes. Recently, one can not overlook that these demands are expressed by not only the mass of those in the process of povertization, but also the highly educated who have been increasingly frustrated by the inertia and inherent conservatism of the regime.[14] However, due to the formidable power still firmly in the hands of the armed forces, the political reform does not appear to proceed in the speed expected, nor with the magnitude required by the rapidly changing economy.

In view of the above conditions, Indonesia's "structural adjustments" would be a far longer and gradual process, which has just begun, so that it would take a little bit more time to come to the point where such fundamental questions as dependency, state monopoly, administrative intervension, more equal distribution of benefit, and so on, would become the central issue of political democratization.

Notes

1) Clifford Geertz, "The Politics of Meaning", in his, *The Interpretation of Cultures*, Hutchinson & Co., London, 1975, p.316
2) Ulf Sundhaussen, "Indonesia: Past and Present Encounters with Democracy", in Larry Diamond, Juan J. Lintz, and Seymour Martin Lipset eds., *Democracy in Developing Countries, Vol.3 Asia* , Lynne Rienner Publishers, Boulder, Colorado, 1989, p.423
3) Micheal Leifer, *Indonesia's Foreign Policy*, George Allen & Unwin, London, 1983, xvii
4) Franklin B. Weinstein, *Indonesian Foreign Policy and the Dilemma of Interdependence*, Cornell University Press, Ithacs, New York, 1976, pp.42-44
5) *Ibid*, pp.19-41
6) Richard Robison, "Toward a Class Analysis of the Indonesian Military Bureaucratic State". *Indonesia* , vol.25(1978), pp.18-23
7) Yuji Suzuki, *Tounan Ajia no Kiki no Kouzou* (The Structure of Crisis in Southeast Asia), Keisou Shobou, Tokyo, 1982, p.70
8) Ali Moertopo, *Some Basic Thoughts on the Acceleration and Modernization of 25 Years' Development*, Center for Strategic and International Studies, Jakarta, 1973, pp.83-85
9) The concept of a "triple alliance" of multinational, state, and local capital is borrowed from Peter Evans, *Dependent Development: The Alliance of Multinational, State, and Local Capital in Brazil* , Princeton University Press, Princeton, 1979

10) The figures are taken from The Institute of Developing Economies ed., *Ajia Doukou Nenkan* (Annals of Asia), IDE Press, Tokyo, 1988, p.480
11) Jon Halldorsson, "A Higher Profile for Indonesia", *Southeast Asian Affairs 1989*, Institute of Southeast Asian Studies, Singapore, 1989, p.140
12) *Ibid.*
13) See The World Bank, *World Development Report 1987, 1988, 1989* .
14) On the conservatism of the regime, see Karl D. Jackson, "The Political Implications of Structure and Culture in Indonesia", in his and Lucian W. Pye eds., *Political Power and Communications in Indonesia* , University of California Press, Berkeley, 1978, pp.23-42