ECONOMIC CHANGE IN MODERN INDONESIA

Colonial and Post-colonial Comparisons

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SOAS, University of London

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Economic Change in Modern Indonesia

Indonesia is often viewed as a country with substantial natural resources, which has achieved solid economic growth since the 1960s, but which still faces serious economic challenges. In 2010, its per capita GDP was only 19 per cent of that of the Netherlands, and 22 per cent of that of Japan. In recent decades, per capita GDP has fallen behind neighbouring countries such as Malaysia and Thailand and behind China. In this accessible but thorough new study, Anne Booth explains the long-term factors that have influenced Indonesian economic performance, taking into account the Dutch colonial legacy and the reaction to it after the transfer of power in 1949. The first part of the book offers a chronological study of economic development from the late nineteenth to the early twenty-first century, while the second part explores topics including the persistence of economic nationalism and the ongoing tensions between Indonesia's diverse regions.

Anne Booth is Emeritus Professor of Economics in the Department of Economics at SOAS, University of London. Her chief area of interest has been Southeast Asia with a particular interest in Indonesian economic history in the twentieth century.

Acknowledgements

In the 1960s, the literature on the Indonesian economy was sparse and pessimistic in tone. Despite the improvement in economic performance after 1965, the economic future of the largest country in Southeast Asia was, for at least two decades, still considered uncertain, and very dependent on a few key commodities, especially oil. Much has changed since the 1980s, and anyone, in the early twenty-first century, attempting a survey of Indonesian economic performance in both the colonial and post-colonial eras must deal with a large body of literature from a range of sources. At the very least such a survey should try to convey both the achievements and the failures of successive governments from the early 1900s until the fall of Suharto in 1998. It should also try to engage with the more recent literature which examines the implications for the Indonesian economy of the post-Suharto political changes, most of which came as a considerable surprise to economists, both Indonesian and foreign, who had worked in the country over the decades from the late 1960s to the late 1990s.

In writing this book, I have drawn on my own work in Indonesia, which began when I first went to Indonesia as a student in the early 1970s. Since then I have benefited enormously from interaction with many scholars from various parts of the world including Australia, the Netherlands, the United States and Japan, all of whom find Indonesia as fascinating as I do. I am most grateful for their willingness to share their research with me. In particular I am especially grateful to Thomas Lindblad and his colleagues at Leiden University who have invited me to several important seminars over the years, especially the one held in Leiden in October 2008 on the Indonesian economy in the 1950s, which resulted in a special issue of the journal *Itinerario* in 2010. The editors have allowed me to draw on an article originally published in this journal in Chapter 3 of this book.

I have also benefited from teaching courses on the economic development of Southeast Asia at the School of Oriental and African Studies in London since the early 1990s, as well as giving lectures and seminars on Indonesia and Southeast Asia in various locations around the world, from the United States, Australia and Germany to Tokyo and Beijing. Different audiences raise different questions about Indonesian economic development, but in all cases they have forced me to rethink some cherished opinions and re-examine my ideas on the achievements and failures of Indonesian economic development, both in the colonial era and subsequently.

I also owe an enormous debt to the many Indonesians who over the years have helped me come to a better understanding of their remarkable country. I am especially grateful to those institutions which have invited me to give lectures and participate in seminars, including the Indonesian Institute of Sciences (LIPI) and the Centre for Strategic and International Studies (CSIS) in Jakarta, the Bogor Agricultural Institute and Gadjah Mada University in Yogyakarta. I must also thank the Central Board of Statistics in Jakarta, who over the years have helped me, along with many other scholars, to access and evaluate a range of statistical data. Their invaluable website has allowed me to complete this book over the last year without having to leave my study in London. Such are the marvels of modern technology! I am also grateful to the Indonesian Regional Science Association (IRSA), which invited me to give a keynote lecture to their conference in Makassar in 2014, and to interact with many scholars both Indonesian and foreign who have been working on aspects of regional policy in Indonesia in recent years. I do not expect that all Indonesians will agree with the views expressed in this book, but I hope that my ideas will serve to stimulate further discussion about the economic future of this important country.

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1 Introduction

Indonesia's three watersheds

Indonesia's three watersheds

Many countries have had, at some point in their history, watershed moments when the opportunity seems to arise to wipe the slate clean and make a new beginning. Such moments often arise after wars or after revolutions or some other political upheaval which lead to a regime change, and the chance to start afresh. Typically at such times, new policies are introduced which seek to bring about political, economic, constitutional, administrative or social change, or some combination of all these. Not infrequently, reforms which most observers would have thought impossible under the old regime are implemented with surprising rapidity and apparently with little opposition. In many parts of Asia and Africa, such a watershed moment occurred with the granting of political independence. Beginning with the decision by the American government to grant the Philippines full independence in 1946, all the major states of Asia had achieved either self-government or full political independence by 1960.

The Indonesian struggle for independence began in the immediate aftermath of the Japanese capitulation to the Allied powers in August 1945. Two key leaders of the independence struggle, Sukarno and Hatta, under considerable pressure from younger, more radical activists, declared Indonesia's independence on 17 August 1945, a date that has been enshrined as Indonesia's national independence day ever since.[1] But in the aftermath of this declaration, the transfer of power to an independent government in Indonesia did not take place smoothly. The Dutch officials who had fled to Australia when the Japanese armed forces swept through the archipelago in 1942 returned in the wake of the British army in the latter part of 1945.[2] Even the more progressive among them were

[1] There are many studies of this period in Indonesian history; a good overview of the literature can be found in Ricklefs (2001: 247–86).

[2] Accounts of the British occupation and the return of the Dutch can be found in van der Post (1996), McMillan (2005) and Bayly and Harper (2007: 158–89).

determined to re-establish Dutch control over the entire archipelago and regarded the leaders of the independence movement, especially Sukarno and Hatta, as little more than lackeys of the Japanese who had no support among the Indonesian masses. These opinions were supported by almost the entire population of the Netherlands who feared that 'the loss of the Indies' would spell ruin for the Dutch economy, already severely weakened by the German occupation. It took more than four years of armed struggle and negotiations brokered by foreign powers and the infant United Nations before the Dutch finally recognised that they could no longer withstand the winds of change sweeping across Asia.

The final transfer of power to the Republic of the United States of Indonesia took place on 27 December 1949. This is not a date that Indonesians celebrate, but it should be regarded as the first of the great watersheds in Indonesia's post-independence history. At last Indonesia was an independent nation, taking its place among other sovereign powers in the international community. In international forums such as the United Nations and the Non-Aligned Movement (which Indonesia helped to create) the new republic played a prominent role. But at home, economic and social problems mounted, and the next two decades were far from easy for the infant republic. Many of these problems had been inherited from the Dutch era, but after 1949 they had to be tackled by successive governments which often appeared weak and divided. Debates between what might be termed the economic rationalists and the economic nationalists erupted shortly after independence. These debates reflected deeper divisions about what to do with the remaining Dutch presence in plantations, mining, industry, banking and commerce, and about how to deal with the Chinese minority which dominated domestic private business and the professions.

To most Indonesians who had participated in the struggle for independence, it was taken for granted that in the colonial era the profits from exploiting the country's natural wealth had accrued either to the colonial government or to foreign-owned companies. In neither case, it was argued, did indigenous Indonesians benefit much, if at all. In common with many newly independent nations, the leaders of the Indonesian struggle for independence envisaged a major role for government in implementing an economic development strategy which would use the country's resource wealth to improve the living standards of the Indonesian people. But in the years after 1949, this proved an elusive goal.

In real per capita terms, government expenditures fell from the mid-1950s onwards, and increasingly they were diverted to military goals including the liberation of West New Guinea, which had remained under Dutch control after 1949, and the confrontation with Malaysia, a federation formed in 1963 from the territories in Southeast Asia controlled by the British. Accelerating inflation in Indonesia was accompanied by economic stagnation and mass poverty. As the economy deteriorated, the political situation became more fraught. An attempted coup in September 1965, during which six senior generals were killed, triggered mass killings of people affiliated to the Indonesian Communist Party. By early 1966 it was clear that power now lay with the army.

The struggle between Sukarno and the army, which was backed by urban student groups and some leading non-communist civilians, including the Sultan of Yogyakarta and Adam Malik, came to a head in March 1966.[3] On March 11, Sukarno and his cabinet fled from Jakarta to the presidential palace in Bogor. They were pursued by a trio of senior army officers who forced a reluctant Sukarno to hand over power to a group led by a little-known officer, Suharto. Although it was probably not obvious at the time, 11 March 1966 turned out to be the second great watershed in Indonesia's post-independence history. Suharto had escaped the slaughter of senior generals on 30 September 1965 and was not at first seen as much more than a transitional figure, likely to be shunted aside in further power struggles within the military. But matters turned out otherwise. The New Order initiated by Suharto, together with his military and civilian supporters, was to last until his resignation in May 1998.

During his thirty-two years in power, Suharto presided over a transformation of the Indonesian economy. Per capita GDP, which in 1960 was lower than in many other Asian and African economies, had risen more than fourfold by 1997 (Table 1.1). Indonesia also made considerable progress in human development. Educational enrolments increased at all levels, and there were sharp falls in infant and child mortality from the very high levels which prevailed in the early 1960s. Increasingly Indonesia was viewed internationally as a leading Asian success story. Along with Taiwan, South Korea, Thailand, Singapore and Malaysia, Indonesia was included in the 'Asian Miracle' report which the World Bank published in 1993. According to this report, it was an example of a high-performing economy, which in the words of one World Bank official seemed to have done almost everything right (Bruno 1994: 10).

[3] The Sultan of Yogyakarta had inherited his position as traditional leader of Yogyakarta from his father just before the Japanese occupation. After 1945, he supported the nationalist movement, and Yogyakarta became the capital of the new republic during the struggle against the Dutch. He remained a highly respected figure in independent Indonesia, and served for a term as vice president under Suharto. Adam Malik, a Sumatran, was foreign minister under Sukarno, but was considered to be anti-communist and served in several posts under Suharto.

Table 1.1 *Per capita GDP in 1960, 1997, 2004 and 2010: ASEAN countries and selected Asian and African countries (2005 international dollars)*

Country	1960	1997	2004	2010
ASEAN countries				
Singapore	4,398	34,900	39,879	55,839
Brunei	NA	49,386	50,713	44,543
Malaysia	1,453	9,477	10,173	11,962
Thailand	962	6,066	6,734	8,066
Indonesia	665	3,143	3,079	3,966
Philippines	1,466	2,561	2,715	3,194
Vietnam	NA	1,371	1,912	2,779
Laos	NA	1,290	1,605	2,620
Cambodia	NA	859	1,338	1,890
Other Asian and African countries				
Korea	1,670	17,365	21,807	26,614
China (V.1)	772	2,276	3,915	7,746
India	724	1,679	2,317	3,477
Ghana	1,289	1,348	1,592	2,093
Nigeria	1,558	1,126	1,559	1,693
Ivory Coast	959	1,481	1,297	1,283
DR Congo	691	242	196	240

Note: Data refer to per capita GDP, at 2005 prices, derived from growth rates of c, g and i. No data are available for Myanmar (Burma).
Source: Heston, Summers and Aten (2012).

When the Thai authorities were forced to float the baht in early July 1997, few observers expected that there would be much impact on neighbouring economies where economic fundamentals were thought to be sound. But it soon became clear that Indonesia was more vulnerable to the regional turbulence than had been anticipated. By early 1998, capital outflow was accelerating and the rupiah had plunged to a low of around 17,000 to the dollar, compared to 2,500 in June 1997. Debates continue about how to apportion the blame for the economic turmoil of late 1997 and early 1998, but by May 1998, the political consequences were clear. After serious riots broke out in Jakarta and several other cities, Suharto lost the confidence of his cabinet, let alone the wider nation, and on 21 May he resigned in favour of his vice president, B.J. Habibie. He went into retirement and died a decade later, in January 2008.

It was immediately clear that 21 May 1998 represented a further watershed in Indonesia's post-independence history. Not only did the country's second and longest-serving president leave office, but there was a wave of demands from many civil society organisations for radical political, economic and constitutional change. Economic collapse and mounting inflation in 1998 were accompanied by increasingly sweeping demands for reform. The new president was well aware of the shifts which had occurred in public opinion and tried to accommodate them with a series of legislative changes. But he too was swept from office a year later, in the wake of the violence in East Timor and in other parts of the country. The president who took office following elections in 1999, Abdurrahman Wahid, was a widely respected politician who had come to prominence through his leadership of *Nahdlatul Ulama*, one of the largest Islamic organisations in Indonesia.

But Wahid, who was in poor health, had difficulty controlling an increasingly restive parliament and a country which seemed at times determined to fulfil the dire predictions of many external observers that Indonesia was on the verge of breaking up. In July 2001, he was replaced by the leader of the party which had won the largest number of seats in the 1999 elections, Megawati Sukarnoputri, the daughter of the first president. But she also was a rather weak and indecisive leader who seemed to be increasingly under the influence of elements within the armed forces. When Indonesia held its first direct vote for a president in 2004, she was defeated by Susilo Bambang Yudhoyono, a retired military officer who had risen through the ranks under Suharto, but who presented himself, with considerable success, as a reforming candidate who would set Indonesia on a new economic and political trajectory.

Yudhoyono's first five years in power did achieve some progress on both the political and economic fronts. Regional violence was brought under control and economic growth accelerated. He was re-elected to office for a further term in 2009, at least partly as a result of his apparent success in protecting the economy from the global economic crisis which had erupted in 2008. Unlike several neighbouring economies in Southeast Asia, let alone the United States and Western Europe, Indonesia recorded positive economic growth in 2009, and after sixty years of independent nationhood, seemed once again to be on a stable growth trajectory. Official poverty estimates showed a decline in numbers below the poverty line. Demographic and social indicators were improving. Indonesia's membership of the G-20, along with India and China, appeared to accord the country recognition as an important rising power in the global economy.

In spite of the achievements in the years after 2004, there was still discontent with Indonesia's economic performance at the end of the first decade of the twenty-first century. Much of this discontent was fuelled by growing evidence that the pace of economic change in

Indonesia was slower than in countries such as China, India and Vietnam which twenty years previously had been well behind Indonesia. In terms of both per capita GDP and non-economic indicators such as life expectancy, educational enrolments and maternal mortality rates, Indonesia's progress seemed disappointing. Per capita GDP only returned to the 1997 level in 2004, by which time China had surged well ahead (Table 1.1). In addition the government seemed unable to deal with chronic bottlenecks in infrastructure. In Java, roads and railways built in the colonial era needed modernisation. A trans-Java highway was mooted in the 1970s, but progress was slow, and it remained uncompleted in 2014. Logistics experts argued that the country needed several new container ports to ease the chronic congestion in existing facilities. Outside Java, the road network was still undeveloped, and many people in rural areas were still not connected to markets and other facilities. Fifteen years after Suharto's departure from office, there were many critics of government performance.

What is this book about?

While it might, with the wisdom of hindsight, be easy to detect the principal watersheds in Indonesia's post-independence history, it is much more difficult to determine the extent to which the slate really was wiped clean, and the new regimes able to strike out in new directions. Can any society, especially one as large and complex as Indonesia, really jettison the past and start afresh? The main purpose of this book is to argue that, in spite of the progress which has occurred in Indonesia since 1950, a number of economic problems still persist. These problems can be viewed as legacies from the Dutch colonial era, but successive governments have not been able to resolve them, and at times have exacerbated them.

To develop this argument, it is essential to examine the economic legacy of the Dutch colonial era, and especially the legacy of the first four decades of the twentieth century, often called the 'ethical' era. As in many other former colonies, the view that the Dutch colonial state was exploitative and predatory, and prevented the economic advance of the indigenous population, was widely held among many Indonesians who participated in the struggle for national independence, and who assumed senior positions in the government after 1949. In Indonesia, as in many other former colonies, it became part of the ideology of post-independence nationalism, on which most of the key political leaders based their legitimacy, that colonialism was the main reason for the country's economic backwardness and widespread poverty. But was this really the case?

The economic legacy that the Dutch bequeathed to an independent Indonesia was, and remains, a contested issue. On the one hand, many nationalists stressed the negative aspects, including the exploitation of the country's national resources and the remittance of its profits abroad and the failure to invest in the education and health of the indigenous populations. The harsh terms of the economic and financial agreement reached before the Dutch finally conceded sovereignty in 1949 have also been stressed. But, on the other hand, the Dutch could point to an impressive amount of infrastructure, especially in Java, which was handed over to the new nation. In addition by 1942 the Dutch had created an integrated national economy stretching across much of the vast archipelago. Per capita GDP was around 22 per cent of that in the Netherlands in 1900, and there was little change over the next four decades, in spite of the impact of the global depression (Table 1.2). Chapter 2 of this study will try to assess both the benefits and costs of the Dutch legacy for the new republic.

It is often taken as self-evident that, in the years between 1949 and 1966, independent Indonesia failed to build on the positive legacies of the Dutch or remedy the negative aspects of the colonial legacy. Indeed most economists have tended to view these years as characterised by increasing economic turmoil, culminating in hyperinflation and mass poverty in the mid-1960s. In Chapter 3, it is argued that, while the conventional view is broadly correct, there were achievements which have often been overlooked, especially in sectors such as health and education. These early

Table 1.2 *Per capita GDP in Indonesia as a percentage of Netherlands, China, Japan and the United States, 1900–2010*

Year	Netherlands	China	Japan	USA
1900	22	135	62	18
1920	21	na	53	16
1930	19	191	59	17
1938	20	188	43	17
1950	14	182	43	9
1960	12	153	25	9
1970	10	158	13	8
1980	13	179	14	10
1990	15	134	13	11
2000	15	94	16	11
2010	19	59	22	15

Source: The Maddison Project data, downloaded from http://www.ggdc/maddison/maddison-project/home.htm, 2013 version.