BASIC NEEDS IN INDONESIA

Economics, Politics and Public Policy

Sjahrir

INSTITUTE OF SOUTHEAST ASIAN STUDIES

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Center for Policy Studies

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Foreword

This book on *Basic Needs in Indonesia* is a revision of Dr Sjahrir's dissertation submitted to Harvard University for a Ph.D. degree in Political Economy and Government. This is a somewhat old-fashioned degree. It harks back to the very origins of economics as a discipline and reflects a Ricardian concern for the application of the tools of economic analysis to the problems of the body politic. To do this usefully, the scholar must understand not only economics as an analytical science but also government as a collective process of decision making. Hence the degree is in political economy and government. A candidate's dissertation is meant to demonstrate skills in both dimensions and a keen awareness of links between them.

There is no better topic than basic needs to provide a stage for such a demonstration.

At its simplest, a basic needs development strategy argues for high priorities on increasing the poor's consumption of a package of essential goods and services — food, health care, education, housing, clothing, water and sanitation, and so on. Just what to include in this package of basic needs has been a constant source of argument, with radical strategists calling for political liberation, freedom of speech, and other human rights, while development economists tended to focus on key economic factors more amenable to incrementalist approaches. Of these, food and education programmes leading to literacy, and basic primary health care have come to be seen as most important because of their combined effects on improving welfare in the short run and potential payoff in the long run as return on investment in human capital.

It is these three sectors that Sjahrir examines in an Indonesian context. This context needs no explanation from a Western scholar to readers of the Bahasa Indonesia version, but readers of an English edition may not have similar detailed knowledge of modern Indonesian history. For Indonesian readers, there are also comparative perspectives that might be illuminating indeed, and the following comments are offered to both sets of readers.

To the Western world, Indonesia is the least well known or understood society relative to its size. Despite being the world's fifth most populous country, a diverse and rich culture that spans two millennia, and one of the most astonishing development records in modern economic history, Indonesia remains a mystery to most Americans and Europeans. The reasons are no doubt complex, but at least part of the reason must be the relative paucity of Indonesian scholars writing for an international community of scholars. For whatever reason, most Indonesian scholars, and especially the economists, have stayed at home and worked on the problem of their own society, for the benefit of their society. Important as this is to the success of the development process itself, the result has been an incomplete and spotty analysis of the Indonesian record accessible to outsiders. Sjahrir's thesis stands as a welcome addition to this literature.

What is so unusual about the Indonesian story? Firstly, the record spotlights the crucial interplay between political stability and economic growth. No one can come away from Sjahrir's discussion of the 1950s and 1960s without sensing a house of cards about to tumble, as political ideology pushed aside economic reality. But the political concept of Indonesia as a nation was cemented in these two decades despite all the economic costs. Without this concept as reality, none of modern Indonesia's economic achievements would have been possible. By the same token, political integration could very easily have been sacrificed if economic reality had not been asserted in time. Perhaps only countries that have stepped to the very edge of economic chaos are prepared to make the long-term political commitments needed to set the process of economic development firmly in place. How else can we explain the strikingly different development paths of Asian countries compared with Africa and Latin America?

Sjahrir's overview of Indonesian economic and political development weaves these themes together very persuasively. The contrast between the political orientation of the pre-New Order government and the economic orientation of the New Order highlights the enormity of the basic needs tasks confronting development strategists in 1967 when Sjahrir's story really begins. Here, the government's concern for growth and rehabilitation was paramount, with meeting basic needs well back in priority. As Emil Salim put it in 1970, "there is little point in dividing up evenly such a tiny pie."

For many governments around the world, in Brazil or the Philippines, for example, the pie never seems to become large enough for concerns about equity to be acted upon. Why is Indonesia different? Despite all the remaining problems of poverty and the inadequacies of implementing programmes that Sjahrir correctly notes, why is the Indonesian record on alleviation of poverty and improvement in basic needs so dramatic? Once again, the answer lies in the realm of politics and economics. It is a story that is particularly fascinating in Sjahrir's telling because he was one of the key actors who helped bridge a widespread political concern for more equitable results of the development process in the early 1970s with a revised economic strategy that responded to that challenge.

Sjahrir's analysis shows clearly how this integration came about, and no single part of the story can give a complete picture. The economic analysis in Chapter II, for example, demonstrates quite conclusively the dramatic progress achieved during the 1970s in increased food intake, primary schooling, and access to rural clinics where family planning facilities were available. No matter whether micro-economic surveys, sectoral patterns, or macro-economic results are used to measure progress in achieving basic needs, progress is very impressive even if not complete. It is fair to say that the degree of progress surprised even Sjahrir himself, and the next chapter to be written is a search for explanations beyond just the economic policies themselves.

The public policy perspective of Chapter III will probably not fully make sense to readers who have not seen how the story unfolds up to that point. In this chapter Sjahrir is asking why — given the economic and political history in Chapter I and the achievements cited in Chapter II — the results are so successful and the remaining failures so troubling. His analysis in depth of the implementation of three key programmes — BIMAS rice intensification, INPRES SD (primary school), and family planning — from the perspective of policy functions and decision order reaches some important conclusions. Economic benefits are the key to participation in government programmes. Better incentives and less directiveness increase the efficiency of programmes. And basic needs can be provided only through progressive alleviation of poverty. For the latter, a healthy rural economy is essential, and with this lesson Sjahrir's analysis comes full circle. In his concluding chapter Sjahrir rightly emphasizes Hirschman's concepts of entrepreneurial and reform functions of government, with a key task being how to redress a perpetual bias on the part of most élite-based governments towards urban-oriented development strategies.

Indonesia has escaped much of the worst of this bias, which is the ultimate explanation for her success in meeting basic needs. Sjahrir's analysis of this success, when read as an integrated whole which links the economic strategies with the political context, provides the best understanding yet as to why Indonesia is so different.

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Preface

I have been motivated to undertake this study because of my deep concern for socio-economic equity and democracy in Indonesia. This in turn came from my experience as a student activist in Indonesia. The discussions with several friends from that period to the present day shaped many of the ideas behind this study. It is to these friends that I owe my gratitude.

This study would not have been possible but for the constant encouragement, help, guidance, and constructive criticism given to me by my advisors C. Peter Timmer and John D. Montgomery. As the primary advisor, C. Peter Timmer has proved that the word "guru" has a universal meaning. Throughout this long period of study he was as generous with his patience, understanding and help as he was in demanding high quality academic work. I had the pleasure of working as a teaching assistant to my other advisor, John D. Montgomery, and this valuable experience contributed greatly to my understanding of the relevance of the study of public policy.

This study is the result of academic work in the most splendid academic setting that I have ever experienced at Harvard University.

The Ford Foundation funded my tuition and living expenses for nearly five years and I thank them for their generosity. In particular, I thank Theodore Smith, Tom G. Kessinger, and John Newmann.

The advice, help and criticism of Soedjatmoko gave me a better insight on trying to combine functions as an academic and social critic.

My study and stay in Cambridge could not have been productive without the care of Gustav F. Papanek and Hanna Papanek.

The Rector of the Universitas Indonesia, Mahar Mardjono, encouraged me to go to Harvard University for higher studies in 1978. I am grateful to him for his confidence in me.

David O. Dapice, and S. Malcolm Gillis improved my knowledge and methodological skills to undertake this study. The important role played by the former is particularly evident in the work.

I must acknowledge the invaluable help that I received from Paul Streeten of Boston University and Allan Strout of MIT.

My fellow graduate students, Richard Monteverde and Rama Subba Rao helped me significantly, particularly in the final stages of this study. Janet Hoskins helped me in the early stages of the study. Amy Rodriguez and Nalini Subba Rao helped with the typing of the draft as well as the final thesis. I am thankful to Widigdo Sukarman for generously lending his word processor to prepare the final thesis.

My mother-in-law, Mrs B. Pandjaitan showed patience and care throughout the entire period of my study and my deep gratitude for her help.

It is a matter of personal grief that by the time I completed this study both my father, Maamoen Al Rasjid and my father-in-law Bonar Pandjaitan passed away.

This work could not have come to the successful end but for the loving and understanding family that I am fortunate to have. My wife Kartini never hesitated to sacrifice in every possible way to support my study. My son Pandu and daughter Gita, both in their own way gave me the pleasure of being a father and the inspiration for this study.

This book is dedicated to my late mother, Rusma Malik, who sacrificed the most throughout the period of my life until she passed away in August 1984.

For the publication in the present book form by the Institute of Southeast Asian Studies, I wish to thank Professor K. S. Sandhu for the research fellowship which gave me time to revise and update my original work. The assistance and help from Dr Sharon Siddique, Mrs Triena Ong and Mrs Betty Kwan helped my work considerably. Of course, the responsibility for the views in this publication is my own.

Sjahrir

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INTRODUCTION

Since Indonesia proclaimed its independence on 17 August 1945 and gained its sovereignty from the Dutch in December 1949, tremendous changes have taken place in nearly every aspect of the economic and political life of this new state. And yet, some constants loom large for the people of Indonesia. David Dapice, an astute observer of Indonesia put it this way: ''watching Indonesia is like watching a race between the possible and the inevitable''.[1] What he meant by ''possible'' is using the natural and human resources for the benefit of its population and by ''inevitable'', the population increase and labour surplus that endangers the ''survival'' of Indonesia itself.

The Indonesian population in 1984 exceeded 161 million[2] making it the fifth most populous nation in the world. There are two factors that make population pressure in Indonesia even more serious. The first is the population distribution. The islands of Java and Madura which have only 6.89 per cent of the total arable land absorb 61.9 per cent of the total population. In 1982, Java and Madura had 718 persons per sq km[3] which makes them two of the most densely populated areas in the world. The second problem is that Indonesia's population is very young. In 1980, 40.9 per cent of the total population was in the 0–14 age group. This implies a large dependence ratio for the people in the work-force and pressure to increase employment in the immediate future as well as pressure for more education. Yet the World Bank, in its *World Development Report, 1982*,[4] has promoted Indonesia from the category of low income countries to that of middle income countries with a Gross National Product (GNP) per capita of US$430 in 1980 and recorded increased well being in many social indicators, as well as high food production. In 1984 Indonesian Gross Domestic Product stood at US$560 per capita.

An overview[5] of Indonesian economic and political development will give us the chance to see to what extent the possibilities have been exhausted as well as missed. It covers the period 1950–59 called the parliamentary democracy period which saw eight cabinets and the so-called Guided Democracy era (1959–66) under President Soekarno for the Old

Order or pre-New Order. The New Order began with the abortive coup on 30 September 1965 which saw the end of Soekarno and the entry of General Soeharto who became president in 1967.

Much emphasis will be placed on the New Order, instituted in 1966, since not only are the data to be scrutinized for basic needs research from the New Order era, but also from the fact that it was only during the New Order era that growth and stability exist in Indonesian history. The characteristics of the New Order will be compared with those of the preceding era which will be called the pre-New Order era.

The path of post-independence Indonesian economy over time is characterized by both continuity and change. Continuity persisted mostly for the twenty years of independence and in some way too, for the last fifteen years. Change occurred mostly within the last fifteen years. The continuities are: increase in population, underemployment, poverty, and inequity as a result of low purchasing power and low access to public utilities and public facilities, inefficiency in the bureaucracy, corruption, and the low level of economic growth with a high level of inflation especially from 1957 to 1966. Since the New Order took power some of these continuities are still in existence such as bureaucratic inefficiency and corruption, but changes have taken place in many other sectors such as changes in the economic structure. And for the last fifteen years, there has been continuous high level of economic growth and a lower level of inflation. But since 1982, the Indonesian economy has been affected by the world recession and the growth in 1982 was a mere 2.2 per cent and in 1983 4.2 per cent, both based on 1973 constant price. One other aspect of the economy during the New Order era that requires attention is the increased role of market forces in the economic system, which is complicated by the strong existence of the state's involvement in the economy.[6]

In order to understand the continuity and changes as well as some of the roots of the economic conditions of both eras (pre-New Order and the New Order) the following reviews of the economy of each era will be divided into two parts, namely, planning and economic policy, and income, production, and structural dimension.

The Pre-New Order Era

The pre-New Order era saw great changes in the government as well as the political system, but it was also an era in which there were many negative continuities in the economy. Some New Order proponents might argue that the low standard of living was a result of the political instability then.[7] But to a large extent the low level of economic development in post-independence Indonesia was the heritage of the colonial economy.[8]

However, it is also true though that some of the problems of the economy were results of missed opportunities, particularly during the period of parliamentary democracy (1950 to 1958–59) and the pre-occupation with politics during the so-called Guided Democracy and "guided economy" era (1958–59 to 1965–66) where the predominant political actor was President Soekarno who was not interested to say the least, in the technicalities and intricacies of the economic affairs of the state.

Planning and Economic Policy

The discussion on the state's role in this period will be further divided into two periods that have different political systems; the period of parliamentary democracy (from 1950 to 1957–58) and the Guided Democracy and guided economy period (1957–58 to 1965–66). The difference in the political system resulted in differences in the perception of the state's role in the economy as well as differences in the society's responses, especially the private sector, towards the declared policy of the state. The interaction between the state and society with regard to economic policy and planning is hence very significant. It has a strategic effect on real economic conditions.

Planning: Economic Urgency Plan 1951, Five-Year Plan (1955–60), Eight-Year Plan (1961–69)

Although Indonesia proclaimed independence in 1945, the transfer of sovereignty occurred only in December 1949 and in the interim even though there was an economic plan committee headed by Vice President Hatta, the whole programme of the Indonesian Government was political diplomacy and war with the Dutch who attempted to regain their former colony. For this reason and as there are no statistics for the period 1945–50,[9] this study begins in 1950–51.

However, in the period of parliamentary democracy and Guided Democracy there were many changes in the government. From the Hatta Cabinet (when Indonesia was a federal republic) to the Djuanda Cabinet (the last cabinet in which parliamentary democracy was in operation) there existed eight cabinets over a span of less than ten years. What is amazing is the preoccupation of the successive cabinets with planning and not surprisingly and to be discussed later, the utter failure in the implementation of their plans.

Since independence, Indonesia has had a formal development plan in every period. Chronologically, they are the Committee for Strategic Development in 1947[10] (organized during the bitter fight against the Dutch that made it impossible to carry out economic planning); the

1951[11] Economic Urgency Plan (Rencana Urgensi Perekonomian) continued in 1956[12] with an economically rational five-year plan made by a planning agency; in 1961[13] this was replaced by the National Comprehensive Development Plan for the next eight years; and finally, to the successive REPELITAs I, II and III and the present REPELITA IV which will end on 31 March 1989. This means that from 1947 until the present Indonesia always had a development plan supposedly in effect. The 1951 Economic Urgency Plan, the 1955 five-year plan and finally the 1961 eight-year plan will be discussed here.

Economic Urgency Plan and its Economic Policy

When the plan was made in 1951, the per capita income of Indonesia was 28.3 guilders which was even lower than the per capita income of the Dutch East Indies in the worst year of depression in 1933, at 30 guilders.[14] This level of living existed within an economic structure which was essentially still a colonial economy, albeit, under a different government political structure, namely, an independent Indonesian Government. The logical step for a new independent country was to increase the standard of living of its population and to change the economic structure to reflect its political independence. Unfortunately increasing the well-being of the Indonesian population and building a national economic structure was a zero sum game at that time. This dilemma was reflected in the Economic Urgency Plan (EUP) which was a stronger form of indicative planning compared to the subsequent two plans in the pre-New Order era. The EUP consisted of programmes which were nationalistic in nature, "developing small national (indigenous) industry to produce import substitutes in the hope of reducing dependence on foreign trade; by means of capital assistance to indigenous sellers, including specific import licences for indigenous importers".[15] The EUP also called the Sumitro Plan, after the then Minister of Trade and Industry, Dr Sumitro Djojokadikusomo — gave a direction which clearly assumed a greater role for the state in the economy. For example, in the EUP there is a "provision that the government would control new 'key industries' including defence plants, basic chemical industries, cement plants, power plants, water works and transport enterprises".[16]

The EUP was preceded by the Benteng programme (fortress programme) aimed at creating indigenous Indonesian entrepreneurs by credit-backing decree legislation.[17] The Benteng programme influenced the EUP in its change of direction from the colonial economic structure to the national economic structure.

The EUP and Benteng programme were implemented at a time when the standard of living of most of the population was low as was the level of expertise that could implement and monitor the plan bureaucratically thus creating a serious problem by trying to do more than they could. Part of the problem came from the fact that the economic structure was still a colonial structure "that was dominated by export oriented foreign enterprises in the modern sector and peasant agriculture in the traditional sector".[18] The Central Bank was not yet nationalized in 1951[19] and public transportation such as the Sea Transportation Company, KPM (Koningklyke Paketvaart Maatschappy) was still owned by the Dutch. In this situation it was difficult to radically alter economic power. Although successive cabinets pronounced "socialist" slogans, it is clear that throughout the parliamentary democracy period, the changes in the economic structure were painfully slower than the decrees or slogans might suggest. The only option available in economic policy for the governments practising parliamentary democracy was whether to enhance the state's power through increased build-up and strengthening the public corporations or indigenous enterprises (as opposed to Chinese Indonesian or non-Indonesian Chinese) through the implementation of the Benteng programme.

The lack of real options may explain why the EUP as well as the Benteng programme seemed politically bound to the preceding cabinet. In theory, each consecutive cabinet has a new mandate and this should give them power to build a new economic policy. The fact of the matter is that every cabinet from the Hatta Cabinet to the first Ali Cabinet (that is, from December 1949 to July 1955) announced and implemented an economic policy that was an implementation of the EUP and the Benteng programme.

The policies implemented were: monetary tightening, budget tightening to control inflation, manipulation of exchange rates and trade policies to direct and control foreign exchange through differential exchange rates, import tightening, export certificate system and other regulations. Indigenization in the private sector was mostly through credit facilities and decrees allowing specific indigenous companies the privilege of importing certain material.

In the public sector the national banking system was started during the Natsir Cabinet (1950–51) and Sukiman Cabinet (1952) with the creation of the Commercial State Bank and nationalization of the Central Bank from the Javasche Bank to Bank Indonesia.[20]

Looking at the agricultural sector the importance of rice in the economy and the need for a clear government policy concerning it was another legacy of the colonial period. Timmer stated in 1975

> Looking back with a thirty-year perspective reveals how thoroughly the Dutch actions of the 1930s laid the path for what was to follow. The physical apparatus in the form of the Stichting Het Voedings middel en fonds (VMF) and regulations carefully organizing all aspects

> of trade in rice were put in place. In addition, and perhaps more importantly a philosophy was established. It argued that rice was too important to be left alone and that the proper government response was direct intervention in the market place, frequently with trade barriers, price ceilings and floors and an ultimate reliance on cheap foreign imports to maintain stability.[21]

The quote above stresses the continuing importance of rice in the economy which will be discussed under the New Order era as BULOG (Logistics Board or Badan Urusan Logistik) still greatly influences the rice economy even now.[22] Rice rations were distributed in 1950–51 to civil servants and continued through the post-independence period to the present. The colonial institution that intervened in the rice market called VMF was renamed BAMA (Jajasan Bahan Makanan or Foundation for Food) in the pre-New Order era in 1950 and subsequently changed to JUBM (Jajasan Urusan Bahan Makanan) in 1952.

What happened throughout the EUP and the Benteng programme was that socialist decrees although repeatedly proclaimed were not implemented in the modern sector. The Benteng programme which was supposed to produce strong indigenous enterprise failed to do so because favouritism (by decree with special licences as well as soft credit loans that were given without clear business criteria) produced only corruption at the government level and the so-called Ali-Baba enterprises (''Ali'' is the nominal Indonesian and ''Baba'' the Chinese Indonesian).[23] But to say that the national economy was more of a private sector economy would be inaccurate if we take into consideration the state's influence on the functioning of the rice market through many policy instruments as well as the increased role of the state's Commercial Bank and public enterprises.

What caused the failure of the EUP as well as the Benteng programme was that the Dutch influence in the economy was still strong until December 1957, when existing Dutch firms were taken over by the Indonesian Government.[24] The existence of Dutch enterprises hindered the effort to produce a national economy since it conflicted with their own interests. However, the takeover of the Dutch firms also produced a situation in which the national economy became more an economy in which the state had increased influence as opposed to the private sector. This became apparent in the five-year and eight-year plans.

First Five-Year Plan (1955–56 to 1960–61)

The first five-year plan which was supposed to be implemented from 1955 to 1960 was completed and ratified as a national plan only during the Ali Sastroamidjojo Cabinet (April 1956), although technically Ali Sastroamidjojo did not play a part in the planning and was under no obligation to