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INDONESIA

Background: The Central Issues in Indonesia's Development

Indonesia has been gradually emerging for a generation from extraordinary divisions and extraordinarily primitive conditions. Superimposed on a map of Europe, Indonesia's 15,000 islands would stretch from Britain to Morocco and from Britain to Leningrad. Sukarno created a nation out of this tribal archipelago at the cost of economic policies which led in 1966 to the world's then-largest rescheduling. Since then, Suharto, with the advice of a group of Western-trained technocrats, has employed sound, pragmatic economic policies to create a national economic and administrative infrastructure and to institutionalize a secular, moderate, Western-oriented state.

The oil boom has funded most of Indonesia's development program and enabled the country to build its infrastructure while pursuing a development program focused on heavy industry and rice. The country has steel, petrochemical, shipping, and even aircraft industries, while light manufacturing has been largely bypassed. Because of the oil subsidy, the country has been able to sustain these hugely inefficient industries, protecting them and most of the rest of the economy behind a huge wall of tariff and non-tariff barriers. It has also been able to absorb the inefficiency implied by a system of pervasive import monopolies, export monopolies and production monopolies.

The focus on heavy industry has worsened Indonesia's key social problems: some of the world's worst unemployment, poverty, and inequality, and heavy concentration of trade, management, and ownership in the hands of a vigorous minority (three percent of the population) which is of Chinese background. This minority is smaller, more essential to the continued health of the Indonesian economy, and more feared and resented than its counterparts elsewhere in Asia. The (indigenous) political leadership takes its political and economic advice primarily from ethnic Chinese; permits the continued dominance of the economy by ethnic Chinese; pursues an economic strategy in which superior Chinese capital, skills, and networks of contacts confer a particularly great advantage; and places its personal wealth in the hands of a small number of favored Chinese businessmen.

This social situation has generated the primary threats to the regime. Initially, poverty and inequality, and the absence of a credible moderate strategy for overcoming them fuelled the emergence under Sukarno of the Communist Party, which became the third largest in the world and nearly took over the country in the mid-1960s. Its bid for power triggered a bloodbath in which 300,000 to 500,000 people were killed. The Suharto government's firm measures, and its policy of ensuring the availability of cheap rice, have effectively suppressed Indonesian communism for most of a generation since then.

The other threat to the regime has come from the right, from a fundamentalist Islamic movement whose strength and strategies respond to the same social problems. Violent fundamentalist Islam is everywhere a social reaction to poverty, inequality, and a sense of social humiliation. Muslim movements in Indonesia have their historical origins in reactions against the

infringement of Chinese traders on the markets of indigenous Indonesian traders. In the 1930s Darul Islam, a radical fundamentalist Islamic guerrilla movement, was founded with the goal of imposing an Islamic state. Sukarno and his colleagues suppressed Darul Islam, but Islamic fundamentalism has proved somewhat more resilient than communism. Every few years there have been important riots, invariably directed against Chinese targets but with clear anti-government thrusts. In the Suharto period these have never threatened the state. Moderate Islamic organizations have flourished in recent years, often in a semi-antagonistic relationship with the government, and fundamentalist organizations have periodically emerged.

The Early 1980s Crisis

In the early 1980s, Indonesia has faced a combination of problems which could have proved fatal for the regime. Oil prices began to decline, Islamic organizations increasingly challenged government policy, serious anti-Chinese riots broke out in nearly a dozen major cities in 1980-'81, and the regime faced a generational change as the "Generation of 1945," which has held power ever since the independence struggle, aged and weakened. Suharto responded in 1983 with firmness and tactical genius:

- He introduced austerity, devaluation, and various financial reforms in a timely and effective manner that averted the financial tragedies of such OPEC brethren as Nigeria.
- He retired the entire senior leadership of the military, appealing to their patriotism and giving them lucrative industrial jobs.
- He appeased the Muslims, softening the government's reaction to Muslim criticism and giving them funds to build mosques all over the country.
- He appointed an honest, non-threatening, unexciting vice president who could serve as an interim figure while the military debated the real succession.
- He renewed his team of technocrats and created an even more unified group of able economic advisors.

In short, Suharto was strong enough to implement reforms. He had the decisiveness to act, on both succession and austerity, before a crisis occurred. He was willing to take painful decisions, even when it hurt him politically and caused great cutbacks in expenditures that his family and friends were counting on. He was pragmatic and willing to compromise. His evident patriotism gave force to his requests that others make patriotic sacrifices. These qualities, and one other, shape the difference between Indonesia's situation and those of Nigeria and the Philippines.

The other crucial quality is Suharto's determination to build enduring institutions, rather than to undermine institutions to protect his personal power. Indonesia once lagged far behind India and the Philippines in building military, business, administrative, and political institutions that were not mere personal fiefdoms, but Suharto has moved ahead while Marcos and Indira Gandhi have moved backward. The Indonesian army, the banking system, the governing political party Golkar, and many others testify to Suharto's success.

The Tactics of 1984

In 1984 Suharto sought to move ahead decisively to institutionalize the central aspect of Indonesian politics: the creation of a moderate, secular, humanitarian state. These principles were the core of Sukarno's national ideology, Pancasila, and, for all his other differences with his predecessor, Suharto has been determined to institutionalize Pancasila. To do this, he insisted that all political parties and all social organizations formally accept Pancasila as their organizing principle. In practice, this demand had a strong impact only on the Muslim political party, PPP, and on Muslim social organizations. In pursuit of a noble, indeed vital strategic objective, Suharto sacrificed a malleable linkage to Muslim political groups.

The coincidence of this political initiative, the passing of the wave of good feeling associated with all the deals made prior to the 1983 election, and the accumulating although gradual effects of austerity measures, triggered a new period of Muslim-government and pribumi-Chinese tensions, with the following critical developments:

(1) After considerable struggle, the Muslim party PPP accepted Pancasila principles of organization, effectively secularizing the party. This deprived the PPP of a *raison d'etre*, and the new leader of the country's largest and most important Muslim group, Nahdatul Ulama (NU), announced that NU would no longer officially support the party. Politics, the new leader declared, is a game the government understands and always wins, and the NU intends to play a social game, which it understands and intends to win. The NU, however, remains moderate and does not seek a Muslim state or the overthrow of Suharto.

(2) A wave of violent incidents reminiscent of past periods of disturbance began in September, when riots in the Tanjung Priok port district followed an evening of inciting lectures at nearby mosques. A major ammunition dump mysteriously exploded. In October, two banks and a commercial center were burned, and two weeks later the Super Mie noodle factory also burned; these incidents and others hit mainly the property of Chinese tycoon Liem Sioe Leong. Further bombings occurred in November. In January, discontented local people blew up parts of Indonesia's most famous temple, Borobodur and a sophisticated fragmentation bomb was used against a police car. Other incidents include political assassinations in distant parts of Java that have not been publicly reported.

(3) Following the Tanjung Priok incident, Suharto backed away from demands that the NU follow Pancasila principles. He failed to respond to NU's withdrawal of official support from the PPP.

(4) A new radical Muslim student group, NDI, formed, and is positioning itself as the successor to Darul Islam. The initials stand for Indonesian words meaning "True Principles of Islam," but also are deliberately chosen so that they could also stand for "New Darul Islam." So far, the group is small, but this kind of organization could rapidly take advantage of a deteriorating situation.

(5) Chinese from major Chinese groups began to complain bitterly about the greed of Liem Sioe Leong, who is the wealthiest Chinese businessman/banker and the greatest repository of the president's family financial interests.

(6) There is a widespread, amorphous sense of cultural oppression which is more intense than in the past, resulting from the struggle with the Muslims over Pancasila principles and from the successful fragmentation or elimination of social groups of all kinds (e.g., campus student organizations) which had potential political influence. This will have few immediate consequences but also could become important in time.

On balance, all of these tactical issues are manageable and are likely to be brilliantly managed so long as Suharto remains healthy. But they could become the basis of serious difficulties if he should weaken or get into serious economic trouble.

There is one tactical issue which needs to be watched: since Indonesia implemented a major tax reform, it has been unable to sign any new production sharing agreements with oil companies. The problem is largely an accounting issue, not one of substance; everyone agrees on an 85-15 revenue split, but the Ministry of Finance and Pertamina haven't been able to agree how to arrive at that result. There are minor substantive disputes over the deductibility of various oil company expenses. In all probability, this will be amicably resolved.

Addressing the Central Strategic Issues

Suharto's tactical genius is a given. He faced all the potential problems of both Nigeria and the Philippines and, by the tactics noted above, avoided the political pitfalls and financial crises of both. These tactics have followed a 25-year strategy, laid out by Ali Murtopo, for building a modern economic infrastructure and creating the basic institutions of a moderate secular state. It is not surprising that tensions and risks remain; they always will.

The Ali Murtopo strategy does not, however, address the two central strategic issues of Indonesia's post-infrastructure phase:

(1) As oil prices inexorably decline, Indonesia must replace oil revenues with non-oil export revenues.

(2) Indonesia already has some of the worst unemployment and inequality in the world, and it will have 1.9 million new jobseekers maturing in the next five years.

Both of these problems can only be addressed through light manufacturing and agricultural development. Ultimately, if such a program is successfully implemented, the tactical genius of Suharto in managing Indonesia's frightening tensions would no longer be necessary. If no such program is implemented, eventually no amount of tactical genius will rescue the regime and its finances. Such a program could have many variations, but all the variations would share a common core:

- investments would have to be diverted from heavy industry to light industry and agro-industry;
- light industry would have to be relieved of the burden of using indigenous overpriced steel, over-priced ships, over-priced aircraft, and over-priced intermediate goods.
- the bureaucratic/regulatory system, which for instance currently requires some 3,000 permissions, and a small bribe with each permission, to move goods from one part of Indonesia to another, would have to be overhauled.

Given such reforms, Indonesia clearly has the resources and the institutions to avoid major crises. Few countries have such diverse resources. Moreover, there are hopeful signs: From 1983 to 1984 Indonesia's textile exports to the U.S. went from 85 million yards to 220 million, and Indonesia has become the world's largest manufacturer of plywood.

Auspiciously, Indonesian officials are now acutely aware of the two central strategic issues. In the past, such officials seldom raised these issues. In early 1985, nearly all took the initiative to address jobs and non-oil exports. Many said that these issues were the government's top priority.

The difficulty is that the reforms are very painful indeed. The government wants to promote jobs and non-oil exports, but it does not want to give up other high priority goals in order to attain these.

Indonesia does not want to sacrifice its heavy industry, existing and planned, on the altar of these strategic priorities. It does not want to write off its billion-dollar-plus investment in Krakatau's overpriced steel, nor to give up its indigenous auto industry (14 assemblers producing 150,000 units per year, with heavy domestic content requirements), or to give up its budding aircraft industry, shipping industry, or jetfoil boat manufacturing. It wants to start a microcomputer industry. It recently restarted a planned billion dollar refinery project which had been deferred by the austerity program.

Likewise, Indonesia's elite feels that its protectionism is an issue of nationalism, not of technical economics. And its system of designated importers and designated monopolists of certain sectors is perceived (quite incorrectly) as emulating the successful Korean-Japanese system of powerful

conglomerates. (Japanese and Korean conglomerates compete fiercely, whereas Indonesian ones do not.)

There are proposals to let certain new industries import lower-priced foreign inputs, or to subsidize the new industries in order to offset the cost of inefficiently produced domestic inputs, but so far even these temporizing measures (which depend on a flow of money that may not be indefinitely available) have not been seriously considered.

There is much talk of bureaucratic reform, but concrete steps have been extremely limited. Reform will amount to a mini-cultural revolution if it occurs. The Indonesian bureaucracy was designed by fearful Dutch colonizers, on the principle that local people should not be allowed to do anything unless they had explicit permission -- exactly the opposite of the Western view that anything is permitted unless explicitly forbidden. Sukarno feared imperialist multinational corporations and extended to them the Dutch regulatory philosophy -- with a vengeance. In addition, Indonesian culture has long made a virtue of dividing scarce work. In the traditional village, harvesting could only be done with a fingernail knife, so that everyone would get a share of the work. The modern version of this is that customs clearance requires 35 signatures and 35 small bribes. Clearing a traffic violation requires 38 signatures and small bribes.

The biggest obstacles to reform are social and political. Opening up the economy more, and reforming its overregulation, would give a free hand to the Chinese, in the view of most Indonesians, and thus worsen anti-Chinese sentiments and exacerbate the income maldistribution. Somewhat contradictorily, they might also undermine some of the Chinese monopolists whose support the president needs.

Thus, it is heartening that government officials are aware of the central strategic issues and beginning to formulate theories, and to take small steps, to resolve them. But movement is quite slow. The record indicates that, in a pinch, Suharto will take difficult decisions when forced to do so. But there is a danger that response to oil price declines could lag behind financial necessity. There is a danger that the social issues could become critical at a time when Suharto is beginning to slow down.

Indonesia's story is one of heroic figures succeeding against great odds, a nation succeeding when far smaller problems have tripped its counterparts elsewhere. This justifies substantial confidence for the next one to three years. It gives ground for strong optimistic hopes over a five year period. But it does not fully assure one that everything will go smoothly when age ossifies Suharto's tactical genius. One cannot be sure that Suharto's brilliance in implementing his 25-year strategy will translate into an ability to define and implement a very different strategy for the coming decade. So there is considerable uncertainty toward the end of the 1980s. Indonesia could squeak through. But it could also find itself in a massive crisis of succession, lack of foreign exchange, unemployment, Muslim fundamentalism, and anti-Chinese outbreaks.