Indonesia's Economic Performance under Soeharto's New Order

Thee Kian Wie *

This paper describes the rapid and sustained economic growth which Indonesia achieved during the three decades of President Soeharto's New Order rule. Rapid economic growth was accompanied by rapid social development and a steep reduction in absolute poverty. From being the 'chronic underperformer' in Southeast Asia in the early 1960s, Indonesia by the early 1990s had become one of the high-performing Asian economies (HPAEs). However, by the late 1980s the New Order's political legitimacy had eroded as the regime became more blatantly corrupt and self-serving. In economic policy this was reflected by an erosion in fiscal discipline as off-budget expenditures outside the control of the Department of Finance were spent on ambitious development projects the economic viability of which were questionable. The New Order collapsed when it was unable to deal effectively with the Asian economic crisis.

Keywords: Rapid and sustained growth, Absolute poverty, Relative inequality, Erosion of political legitimacy

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I. Introduction

After experiencing hyperinflation and economic decline during the final years of President Sukarno in the early 1960s, Indonesia experienced rapid and sustained economic growth for three decades

* Senior Economist, Economic Research Centre, Indonesian Institute of Sciences (P2E-LIPI), Widya Graha 5*th* floor, Jalan Gatot Subroto 10, Jakarta 12190, Indonesia, (E-mail) theekw@cbn.net.id. This paper is a revised version of a chapter published in: Yasuba Yasukichi (ed.). *Socio-Economic Development in Southeast Asia, 1970-2000*. Tokyo: Keiso Shobo, 2005. (in Japanese)
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under the New Order government of President Soeharto. Rapid and sustained economic growth was accompanied by a steep reduction in the incidence of absolute poverty from 40% of the population in 1976 to 11% in 1996.

However, focusing only on the New Order's economic achievements, while disregarding its failings gives a biased view of the era. Given the general view in Indonesia after the Asian economic crisis that the New Order brought economic ruin to the country, this paper attempts to present a more balanced account of both the economic and social achievements as well as failings of the New Order.

II. From 'Asian Miracle' to 'Asian Crisis'

After the New Order government had restored monetary stability after the hyperinflation left by the Sukarno government and rehabilitated the dilapidated productive apparatus and infrastructure, the Indonesian economy since the late 1960s experienced an unprecedented rapid and sustained growth for the next three decades. Rapid and sustained economic growth during the New Order transformed Indonesia from Southeast Asia's 'chronic underperformer' in the early 196Os into a 'high-performing Asian economy' (HPAE) in the early 1990s. During this period rapid industrial growth also transformed Indonesia from an agrarian economy into a 'newly-industrialising economy' (NIE) along with Malaysia and Thailand (World Bank 1993, p. 1).

Like the other HPAEs, Indonesia's rapid growth was underpinned by high rates of capital investment, including investment in human capital, and high rates of TFP (total factor productivity) growth (World Bank 1993, pp. 28-9, 40-8).

Indonesia's rapid economic growth during the New Order was accompanied by rapid social development, as reflected by a steady decline in absolute poverty, steady growth in private consumption *per capita*, steady rise in life expectancy at birth, and steady decline in the adult illiteracy rate. Moreover, unlike in most other developing countries, Indonesia's rapid economic growth was not accompanied by worsening income distribution.

However, by July 1997, only two months after the release of a fairly upbeat World Bank report on the medium-term prospects for the Indonesian economy, market sentiments about the Southeast

Asian economies, including the Indonesian economy, suddenly changed for the worse. As a result, the currency markets in these countries came under pressure, causing the currencies, including the Indonesian *rupiah*, to depreciate rapidly, as foreign and domestic investors scrambled to purchase U.S. dollars to reduce their exposure to these countries, including Indonesia.

In late October 1997 the Indonesian government turned to the International Monetary Fund (IMF) for a standby arrangement to restore market confidence, and thus contain the currency crisis. The government hoped that with the availability of a large IMF standby loan, backed by a credible economic reform program to be implemented by the Indonesian government and sanctioned by the IMF, market confidence in the *rupiah* could be restored (Sadli 1999, p. 17). This was the second time that the New Order government had turned to the IMF, since at the beginning of its reign in 1966 IMF assistance was sought to combat hyperinflation (Booth 1998, p. 178).

However, IMF's involvement failed to restore market confidence because of political uncertainty about President Soeharto's health and serious doubts about the President's commitment to faithfully implement the economic reform program. As the *rupiah* continued to depreciate by 80 per cent in January 1998, inflation rose to 60 per cent, while the economy contracted sharply. Absolute poverty, which had declined steadily during the New Order era, began to rise again. To aggravate matters, Indonesia was also hit by the severe El Nino drought which damaged the rice harvests, and by falling oil prices which reduced the government's oil revenues and export revenues.

Within less than a year Indonesia was transformed from a 'miracle economy', extolled by the international aid community and many foreign economists as a development model worthy of emulation by other developing countries, into a 'melted down economy' dependent on the charity of the international aid community to prevent an economic breakdown. The worsening economic crisis caused the economy to contract by almost -13.1% in 1998, far worse than the -3.0% economic contraction in 1963 (World Bank 1998, p. 2.1). The economic distress, caused by the inability of the Indonesian government to contain the economic crisis, led to a serious political crisis which forced President Soeharto to resign in disgrace after holding power for 32 years. Thus Soeharto's New Order regime, which had emerged triumphantly in 1966 in the wake of a serious economic and political crisis caused by President Sukarno's government, ended ignominiously in another serious economic and political crisis.

III. Indonesia's Economic and Social Development in Regional Perspective, 1965-97

A. Economic Development

Rapid and sustained economic growth under the New Order enabled Indonesia to graduate from the rank of 'low income countries' into the 'lower middle income countries' by the early 199Os as its *per capita* income rose from U.S.$ 100 to U.S.$ 1,000 during this period. With the economy growing at an average annual rate of 7.0 per cent during the period 1965-97, Indonesia's real GNP roughly doubled every 10 years. Due to a successful family planning program introduced by the government in the early 1970s, population growth over the period 1965-97 slowed down to an average annual rate of less than 2.0 per cent, one of the lowest among developing countries. With average economic growth exceeding average population growth by almost 5.0 per cent, Indonesia experienced a rapid increase in *per capita* GNP (Gross National Product). This was much higher than most other developing countries, and compared favourably with the other HPAEs. Rapid per capita GNP growth led to rising standards of living, as reflected by the high average growth of private consumption (Table 1).

Indonesia's economic growth was underpinned by rapid and sustained expansion of gross domestic investment, which also compared favourably with the other HPAEs. However, Indonesia's export expansion was not as impressive as that of the other HPAEs. This can be attributed to the fact that Indonesia, unlike other HPEAS, relied largely on primary exports, particularly oil and gas exports during the 1970s. The Indonesian government only made a serious effort to promote manufactured exports after the oil boom had ended in 1982. The resulting surge in manufactured exports, however, was short-lived, since after 1993 manufactured export growth slowed down. Many observers attributed the slowdown to strong international competition and the relatively low international competitiveness of Indonesia's manufacturing sector.

During the New Order era rapid economic growth led to considerable economic and social structural change (Table 2). These

TABLE 1
TRENDS IN LONG-TERM ECONOMIC DEVELOPMENT OF SEVEN HPAEs, 1965-97

Country	Average annual growth of Gross National Product (%)		Average annual growth of population (%)		Average annual growth of value added (%)			Average annual growth of private consumption (%)	Average annual growth of gross domestic investment (%)	Average annual growth of exports of goods and services (%)
	Total	*Per capita*	Total	Labour force	Agriculture	Industry	Services			
NIEs:	1965-97	1965-97	1965-97	1965-97	1965-97	1965-97	1965-97	1965-97	1965-97	1965-97
Indonesia	7.0	4.8	2.0	2.7	3.9	9.1	7.9	7.2	9.2	5.7
Malaysia	6.8	4.1	2.6	3.1	3.7	8.5	7.1	6.1	10.1	9.7
Thailand	7.4	5.1	2.1	2.7	4.0	9.7	7.5	6.3	9.0	11.3
Three 'Tigers'										
South Korea	8.2	6.7	1.5	2.6	2.0	12.3	8.2	7.4	12.4	16.0
Hong Kong	7.6	5.7	1.8	2.6	-	-	-	8.0	7.7	11.9
Singapore	4.4	6.3	1.9	3.1	-1.4	8.6	8.3	6.7	9.6	12.2
Japan	4.4	3.6	0.8	1.1	-0.1	4.5	4.7	4.2	4.7	7.7

Source: World Bank (1999, Table 1.2, pp. 16-9)

structural changes are reflected in the shift of production from agriculture to manufacturing and modern services; the relative decline of the agricultural labour force and the growth of urban centres; the greater role of trade in the economy; the increasing role of the central government in the economy; and the monetization of the economy as a result of stable economic management (World Bank 1999, p. 31).

The data in Table 2 show that among the HPAEs, Indonesia's economic transformation was the most remarkable as the country in 1970 was much more dependent on agriculture than any other HPAE. Compared to the rapid economic transformation, structural change in the occupational distribution of the labour force was much less rapid, as reflected by the fact that the share of the labour force employed in agriculture in 1990 was much higher than the share of agricultural value added in GDP. The reason for this was that labour productivity in the non-agricultural sectors rose faster than in agriculture (Manning, 1998, p. 89).

TABLE 2
INDONESIA'S LONG-TERM STRUCTURAL CHANGE IN REGIONAL PERSPECTIVE, 1970-97

Country	Agriculture value added (% of GDP)		Labour force in agriculture (% of total labour force)		Urban population (% of total population)		Trade (% of GDP)		Central government revenue (% of GDP)		Money and quasi money (% of GDP)[1]	
NIEs	1970	1997	1970	1997	1970	1997	1970	1997	1970	1997	1970	1997
Indonesia	45	16	66	55	17	37	28	56	13	17	8	50
Malaysia	29	12	54	27	34	55	80	187	20	23	31	97
Thailand	26	11	80	64	13	21	34	93	12	18	27	84
Three 'Tigers'												
South Korea	27	6	49	18	41	83	38	77	15	22	29	45
Hong Kong	-	0	4	1	88	95	181	267	-	-	-	206
Singapore	2	0	3	0	100	100	232	358	21	24	62	82
Japan	6	2	20	7	71	78	20	19	11	-	69	112

Note: 1) Money and quasi money comprise the sum of currency outside banks, demand deposits other than those of the central government and the time, saving, and foreign currency deposits of resident sectors other than the central government. This measure of the money supply is called M2.
Source: World Bank (1999, Table 1.5, pp. 28-31)

During this period Indonesia also became a more urbanised society, with more than one third of its population living in urban areas. Foreign trade too became more important to the economy, accounting for more than half of GDP by 1997.

However, the relative size of the central government in the Indonesian economy, as reflected by the ratio of central government revenue to GDP, was less than the two other NIEs due to the relatively weak taxation efforts of the government. Prior to 1983, income tax collection in Indonesia was complicated and weak, allowing for 'tax haggling' between taxpayer and tax collector (Glassburner 1983, p. 30). Although the tax reforms of 1984 following the end of the oil boom era in 1982 were quite successful in raising non-oil taxes, Indonesia's ratio of non-oil tax revenues to

GDP of 17 per cent is relatively low compared to the other HPAEs. This low tax ratio was not only due to the rather narrow tax base, but also because the tax office was and still is inefficient and corrupt, while the political will to increase tax compliance levels was inadequate (Asher and Booth 1992, p. 49).

Although the Indonesian economy in 1997 was much more monetized than in 1970, it was less monetized than the two other NIEs, namely Malaysia and Thailand. The fact that Indonesia's agricultural sector (of which a significant part was not yet commercialised up to the early 1970s) played such an important role in the economy may account for the fact that Indonesia's economy was less monetised than other East Asian countries.

B. Social Development

Rapid economic growth during the Soeharto era was accompanied by rapid social development, as indicated by various social indicators (Table 3).

Per capita consumption levels, an indicator of the effect of economic development on the welfare of individuals (World Bank 1999, p. 19), rose rapidly in Indonesia over the period 1980-97. Although positive growth rates are generally associated with a decline in absolute poverty, the poor may not share or share less from the improvement of welfare if income distribution is highly unequal (World Bank 1999, p. 19). After correcting the rate of growth of private consumption *per capita* for the degree of income inequality, *per capita* consumption growth in Indonesia was still quite high, even higher than the two other Southeast Asian NIEs.

Indonesia made rapid progress in education, as reflected by the increase in net primary enrollment ratios of both male and female students. In 1980 Indonesia's net primary enrollment ratios were already quite high as a result of the government's large investments in the expansion of primary education, particularly in the rural areas. This expansion was made possible by the oil boom windfall gains in the 1970s (Jones 1994, p. 164). The data in Table 3 show that in the 1980s the goal of universal primary education had largely been achieved, assisted by slower growth of the primary school age population due to the successful family planning program.

Indonesia also made rapid progress in the expansion of primary health care, as reflected by the steep decline in infant mortality rates

TABLE 3
INDONESIA'S DEVELOPMENT PROGRESS, 1970-97, IN REGIONAL PERSPECTIVE

Country	Average annual growth private consumption *per capita* 1980-87		Net primary enrollment ratio				Infant mortality rate per 1,000 live births		Safe water % of population with access
	Incorrected	Distribution corrected[1]	Male % of relevant age group		Female % of relevant age group				
NIEs			1980	1996	1980	1996	1970	1997	1996
Indonesia	4.5	3.0	93	99	83	95	118	47	65
Malaysia	3.1	1.6	-	102	-	102	45	11	89
Thailand	5.5	2.9	-	-	-	-	73	33	89
Three 'Tigers'									
South Korea	7.0	-	104	92	105	93	46	9	83
Hong Kong	5.2	-	95	88	96	91	19	5	
Singapore	4.9	-	100	-	99	-	20	4	100
Japan	2.9	-	101	103	101	103	13	4	96

Note: 1) *Distribution corrected growth of private consumption per capita* is 1 minus the Gini index multiplied by the annual rate of growth in private consumption *per capita*.
Source: World Bank (1999, Table 1.2, pp. 16-19)

over the period 1970-97 and the provision of safe water to the population. This progress, however, is less impressive compared to the achievements of the two other NIEs, and much less impressive compared to the achievements of the three Asian 'Tigers', as reflected by Indonesia's much higher infant and maternal mortality rates. The percentage of Indonesia's population having access to safe water is also much less than in the two other NIEs and the Asian 'Tigers'. The data in Table 3 show that Indonesia's achievements in social development, while considerable, were less impressive than the achievements of the two other NIEs and the Asian 'Tigers' (Hill 1996, p. 7).

TABLE 4
THE DECLINE IN ABSOLUTE POVERTY IN INDONESIA, 1976-96
(% OF PEOPLE UNDER OFFICIAL POVERTY LINE)

Year	Percentage of people under poverty line		Total
	Urban	Rural areas	
1976	38.8	40.4	40.1
1978	30.8	33.3	33.3
1980	29.0	28.4	28.6
1981	28.1	26.5	26.9
1984	23.1	21.2	21.6
1987	20.1	16.1	17.4
1990	16.8	14.3	15.1
1993	13.5	13.8	13.7
1996	9.7	12.3	11.3

Source: For period 1976-1996, see: Badan Pusat Statistik: *Statistical Year Book of Indonesia*, 1998, Jakarta, June 1999, Table 12.1, p. 576.

IV. Absolute Poverty and Relative Inequality

A. Absolute Poverty

One of the remarkable achievements of the New Order government was its success in combining rapid growth with a steady reduction in the incidence of absolute poverty, while maintaining a moderate relative inequality (distribution of income). Estimates by Indonesia's Central Bureau of Statistics (*Badan Pusat Statistik, BPS*) indicated that the incidence of absolute poverty steadily declined from 40 per cent of the population in 1976 to 11 per cent in 1996. This steady decline in poverty took place in both urban and rural areas (Table 4).

The corresponding number of people in poverty fell from around 54 million people in 1976 to 23 million people in 1996 (Badan Pusat Statistik 1999, p. 576). This steep reduction in absolute poverty was quite remarkable, as reflected by a comparative World Bank study on poverty alleviation in several developing countries. This study found that over the period 1970-87 the average annual reduction in absolute poverty in Indonesia was much higher than in the other developing countries (World Bank 1990, p. 45).

In the 1970s this remarkable achievement was caused by the successful stabilisation of food prices which, particularly in Java, meant that the poor experienced a lower rate of inflation than the rich. The growth in agricultural production during the 1970s and early 1980s was made possible by the government's commitment to broad-based rural development, as reflected by the successful dissemination of new production technologies in the food crop (particularly rice) sector, which generated new employment opportunities in production, processing, and marketing. The oil booms of the 1970s also spurred rapid growth of the non-tradable sectors, including construction and trade, which created new employment opportunities for the large number of unskilled workers (Booth 2000, p. 81).

Absolute poverty kept falling even when the government was forced to pursue tight fiscal and monetary policies following the end of the oil boom era in 1982. One reason why the budget cuts after 1982 did not prevent a further decline in poverty was that the cuts were made in the capital-intensive sectors, including energy, and in the transmigration program and the subsidies to state-owned enterprises (SOEs), which did not much affect employment (Booth 2000, p. 85). After the resumption of rapid growth in the late 1980s, poverty declined at a slower rate than during the immediate post-oil boom period, particularly in the rural areas. This development may be largely due to the fact that during the late 1980s and early 1990s the agricultural sector was relegated to a secondary role as reflected by a falling share of budgetary resources. With greater priority being given to large-scale, capital-intensive manufacturing (including hi-tech projects, such as the aircraft industry), modern services and physical infrastructure, economic policies after 1987 arguably became less pro-poor (Booth 2000, pp. 89-90).

Despite the steady downward trend in absolute poverty during the Suharto era, the poverty estimates based on the official poverty line do understate the actual incidence of absolute poverty. Indonesia's official poverty line is lower than the poverty lines in neighbouring countries, such as the Philippines which has approximately the same level of *per capita* income as Indonesia (Booth 1992b, p. 637). Nevertheless, a higher poverty line would still show a similar downward trend in the incidence of absolute poverty, although it would naturally show a higher absolute poverty level than under the official poverty line. The steady decline in absolute poverty according to the official poverty line may also have made the Indonesian government complacent about the poverty problem, since people

TABLE 5
DISTRIBUTION OF INCOME OR CONSUMPTION IN INDONESIA, 1964/65-1995

Year	Gini index
1964/65	0.35
1976	0.34
1987	0.32
1993	0.32
1995	0.34
1996	0.37

Sources: 1) For the period 1964/65-1987: Hill (1996, Table 10.1, p. 193)
2) For the years 1993-95: World Bank (1998, Table 2.8, pp. 69-71)
3) For the year 1996: World Bank (1999, Table 2.8 pp. 70-73)

slightly above the official poverty line were still vulnerable to fall below the poverty line in economically difficult times.

B. Relative Inequality

Another indicator of social welfare is relative inequality, which refers to the degree of inequality in the distribution of income in an economy. This is reflected in the percentage share of either income or consumption accruing to segments of the population ranked by income or consumption levels. The segments ranked lowest by personal income receive the smallest share of total income (World Bank 1999, p. 73). The extent to which the distribution of income (or consumption expenditures) deviates from a perfectly equal distribution can be provided by a summary measure, the Gini index. This indicator reveals that income distribution in Indonesia had remained fairly constant during the New Order era (Table 5).

The World Bank's 'East Asian Miracle' study found that over the period 1965-89, Indonesia was quite successful in combining rapid economic growth with low relative inequality. In fact, over this period Indonesia achieved higher *per capita* GDP growth with lower income inequality than the two other East Asian NIEs, Malaysia, and Thailand (World Bank 1993, p. 31).

Despite the statistical evidence of fairly constant Gini indices, many Indonesians held the view that economic growth, particularly during the late New Order era, had widened inequality. This perception was strengthened by the rise of large conglomerates, many of them owned and controlled by relatives and cronies of former President Suharto, and by the opulent lifestyle of the rich elite.

Insofar as an unequal income distribution reflects an unequal distribution of wealth or productive assets (Ahluwalia and Chenery 1974, p. 43-4), Indonesia's rapid economic growth may indeed have led to greater relative inequality since rising asset concentration could be expected during rapid economic growth. This asset concentration could have included both physical assets (land, ownership of companies, banks, and other economic entities) and non-physical assets (human capital, made possible by access to high quality education, including overseas tertiary education by the privileged groups in society). However, in the absence of reliable data on wealth or asset distribution, the perception of 'unequalizing growth' during the late New Order era may be impressionistic.

C. Regional Income Disparities

Another aspect of relative inequality concerns the disparity in average incomes between the various provinces in Indonesia. Estimates by the World Bank have indicated that *per capita* GPP (gross provincial product) and *per capita* consumption in all Indonesian provinces improved during the period 1983-93, a period for which consistent regional accounts are available. Indicators on social development also confirm this development, as they show improvements, including a steady decline in the incidence of absolute poverty, in all provinces (World Bank 1996, p. 92).

Despite these improvements, by the mid-1990s Indonesia still faced the problem of persistent regional income disparities, although the extent of regional income disparities over the period 1986-96 had become less as the poorest provinces, including West and East Nusa Tenggara, were able to grow rapidly (World Bank 1996, p. 92). For instance, while in 1986 East Kalimantan, the richest province, had a GPP *per capita* 18 times higher than East Nusa Tenggara, the poorest province, by 1996 this regional income disparity had dropped to 11 to 1. These figures still indicate a high disparity, but at least progress had been achieved in ameliorating this disparity (Table 6).

The data in Table 6 show that the degree of disparity in GPP *per capita* between the rich and poor provinces is high by international standards due to the concentration of some of the country's most valuable natural resources, notably oil, natural gas, other minerals

TABLE 6

PER CAPITA GROSS PROVINCIAL PRODUCT (GPP) AND *PER CAPITA* HOUSEHOLD CONSUMPTION EXPENDITURES IN SOME OF THE RICHEST AND POOREST PROVINCES IN INDONESIA, 1986-96 (THOUSANDS OF *RUPIAH*)

Province	*Per capita*	GPP	*Per capita*	Household consumption
	1986	1996	1986	1996
4 richest resource-rich regions				
Aceh	1,364.5	2,913.9	248.4	1,062.7
Riau	2,821.6	4,934.7	276.5	937.2
East Kalimantan	3,324.0	8,274.3	300.4	1,980.6
Riau	584.9	3,462.1	196.6	1,541.4
Two poorest resource-poor provinces				
West Nusa Tenggara	202.9	858.9	131.5	459.0
East Nusa Tenggara	182.9	734.9	128.5	541.2
Jakarta Capital Region	1,239.5	7,146.0	548.8	3,004.1

Note: After the Asian economic crisis the Biro Pusat Statistik, BPS (Central Bureau of Statistics) changed its name into Badan Pusat Statistik, BPS (Central Agency of Statistics).

Sources: 1) BPS: *Regional Income of Provinces by Expenditure, 1983-1990*, Biro Pusat Statistik, Jakarta, February 1993.

2) BPS: *Gross Regional Domestic Product of Provinces in Indonesia by Expenditure, 1994-1997*, Badan Pusat Statistik, Jakarta, November 1998; For Gross Provincial Product (GPP) data: Table 38, p. 8; For household consumption data: Table 39, p. 39.

3) For population data: BPS: *Statistical Pocketbook of Indonesia, 1988*, Jakarta, January 1989, Table 3.1.3, p. 28; BPS: *Statistical Pocketbook of Indonesia, 1999*, Jakarta, June 2000, Table 3.1.3, p. 47.

and timber, in a few sparsely-populated provinces, notably Aceh, Riau, East Kalimantan, and Papua (Booth 1992c, p. 41). The oil and gas operations in these resource-rich provinces are enclaves with little linkages to the local economies. Before the introduction of regional autonomy in early 2001, the revenues from oil and gas exports accrued to the central government which constitutionally owns these resources. This meant that a considerable portion of the Gross Provincial Product (GPP) generated in these resource-rich provinces was transferred to the central government. The central government then redistributed part of the revenues from oil and gas back to these resource-rich provinces through its spending and transfers to the regional governments (World Bank 1996, p. 93).

Part of these revenues were also transferred to the poorer provinces in order to ameliorate regional income disparities. Through these fiscal transfers, supplemented by financial support from the international aid community, social expenditures across the provinces could be sustained (World Bank 1996, p. 92).

The transfer of huge financial resources from the resource-rich provinces, as reflected by their large export surpluses, understandably led to serious discontent, including separatist movements in some provinces, namely Aceh and Papua. The people in these resource-rich provinces were quite aware that, while their provinces were among the richest in terms of *per capita* GPP, their living standards, as reflected by their *per capita* consumption expenditures, were much lower than their *per capita* GPP levels would warrant. They were also aware that living standards in Jakarta, the capital, were much higher than in their own region (Table 6).

After the introduction of regional autonomy in 2001, the resource-rich regions could keep a large part of the resource revenues to finance their own needs. However, with a much greater share of the resource revenues accruing to the local governments of the resource-rich regions, the ability of the central government to ameliorate regional income disparities through fiscal transfers to poor regions, has naturally declined.

V. The Environmental Impact of Economic Growth

During the first decade of the New Order, the Indonesian government put a high priority on rapid economic growth without much regard to the adverse environmental consequences, specifically resource degradation and resource depletion. Resource degradation was very serious in regard to land and water resources as it involved a process of ecological adjustment from an originally stable level to a lower and often less stable level of productivity (Hardjono 1994, p. 179). Resource depletion was not only a problem with non-renewable resources, like minerals, but also with renewable resources, like timber.

Because of the indiscriminate felling of trees and burning of Indonesia's tropical hardwood forests which has persisted until today, one of Indonesia's most valuable natural resources have been seriously depleted. In fact, as early as 1988 the World Bank estimated that the rate of deforestation was nearly 900,000 hectares a year, due to conversion of unsuitable lands to agriculture, poor logging practices and natural and man-made disasters (World Bank 1988, p. 92).

By the late 1970s the adverse environmental impact of rapid industrialisation and greater use of motor vehicles, particularly air and water pollution, became increasingly serious. Air pollution has worsened due to increasing urbanization, motorization and industrialization. In Sumatra and Kalimantan and even in neighbouring Singapore and Malaysia, air pollution has worsened because of forest fires due to large scale land conversion in the former two islands (World Bank 2003, p. 3).

To deal with the adverse environmental consequences of rapid economic growth, President Soeharto in 1978 appointed Emil Salim as Indonesia's first Minister for the Environment. Professor Salim was instructed to find a path of sustainable development in which economic development could be combined with protection of the environment (Salim 1997, p. 62). As a Minister of State, however, Salim was not an executive agent and had to work through other ministers who were mostly concerned with their own sectoral concerns, and therefore indifferent, if not opposed, to Salim's views on environmental protection (Salim 1997, p. 64).

VI. The Erosion of Political Legitimacy of the New Order Government

The New Order government political legitimacy was based on economic performance, particularly on its ability to deliver rising standards of living for the people. This required rapid and sustained economic growth, and the opening up new employment and business opportunities as a means for escaping poverty.

Rapid and sustained economic growth seemed to be assured in the late 1980s following the restoration of macroeconomic stability and the wide-ranging deregulation measures taken in response to the end of the oil boom era in 1982. However, from the late 1980s many observers and academic economists began to voice growing concern about various economic and social issues which in their view threatened to undermine not only long-term growth, but also the cherished national goal of establishing a 'just and prosperous society' (*masyarakat adil dan makmur*). Many of these issues were inter-related and included the massive scale of corruption at all levels of the government bureacracy and the embezzlement of public funds for private gain, collusive relationships between political power holders and their business cronies, many of them Sino-Indonesian tycoons, and the proliferation of policy-generated barriers to domestic competition and trade, which created lucrative, rent-seeking opportunities.

These restrictions on domestic competition were of particular concern to Indonesian economists, as they adversely affected the business environment for bonafide entrepreneurs. Although successive trade reforms since the mid-1980s had steadily reduced the 'anti-export bias' of Indonesia's trade regime, domestic competition and trade faced various restrictive regulations, particularly in the agricultural sector. Restrictions on domestic competition included cartels, price controls, entry and exit controls, exclusive licensing, dominance of state-owned enterprises (SOEs) in certain industries, and ad hoc interventions by the government in favour of specific firms or sectors (Iqbal 1995, p. 14).

These restrictions on domestic competition and trade were often justified on grounds of 'national interest', such as the promotion of domestic value added in processing activities (wheat flour, soymeal), exploitation of Indonesia's markets (plywood), revenue raising for local governments, and the 'essential' nature of certain commodities, the distribution of which was considered too important to be left to the market (cement, fertilizer) (World Bank 1995, p. 46). However, the justifications of these restrictions on domestic competition were mere excuses for blatant 'rent-seeking activities', which yielded huge monopolistic and/or monopsonistic rents to politically well-connected businessmen and their political patrons, both in the central and local governments. Aside from the policy-generated barriers to domestic competition, politically well-connected businessmen also received preferential access to credit provided by state-owned banks, protection against import competition, and tax and duty exemptions.

The corrosive effects of these 'KKN' (*korupsi, kolusi, nepotisme*) practices eroded the legitimacy of the government. 'KKN' practices also gave rise to the widely-held view about the 'widening economic gap' between rich and poor and between non-indigenous (mostly Sino-Indonesians) and indigenous Indonesians, which undermined the social cohesion required for political stability and national development.

Since the early 1990s many economists also expressed growing concern about the erosion of the government's financial discipline. This was reflected by the allocation of off-budget funds outside the control of the Department of Finance to finance controversial and costly projects. These projects included the so-called 'national car' project of the President's youngest son, and the costly 'hi-tech' projects promoted by Dr. Habibie, the powerful State Minister of Research and Technology, particularly the aircraft industry, the economic viability of which were often questionable (Nasution 1995, pp. 4-5).

In the end, the abuses by the increasingly corrupt and oppressive New Order regime eroded its political legitimacy, as overt criticism led to ruthless suppression, by violence if necessary, and ultimately led to its infamous downfall when the regime was unable to deal effectively with the Asian economic crisis. Ironically, President Soeharto's downfall was basically precipitated not so much by a people's revolt, but by the 'invisible market forces' which had caused the steep depreciation of the *rupiah* which Soeharto failed to comprehend and deal with effectively. Thus the New Order regime came to its inglorious end amidst the misery of a seriously damaged economy, which had to rely on large infusions of foreign and domestic loans to prevent an economic breakdown. The costs of this hugely enlarged foreign and domestic debt will continue to be a burden on the Indonesian economy for many years to come.

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