Social capability and resilience to economic shrinking: The case of accountability and autonomy in the transformation of Indonesia

Martin Andersson, Tobias Axelsson [1] and Andrés Palacio[2]

Preliminary draft

Abstract

Economic shrinking has been neglected from the discussion on the long determinants of development. The paper studies the role of social capability as a historical influence in the resilience to shrinking of Indonesia. In general, the social capability thesis holds that the potential for rapid growth could be realized if the economy is "technologically backward but socially advanced" (Abramovitz, 1986). In this line, we see social capability as a set of national characteristics that are important for resilience to shrinking, and by implication for the dynamics of growth. Indonesia, once one of the poorest countries in the world, shows a dramatic progress in fortune. In order to reveal the capabilities needed to exploit that advantage, the literature welcomes no consensus, and we present a formal approach to social capability by defining five theory-grounded and empirically transparent and interactive processes, rather than outcomes: transformation, inclusion, social stability, autonomy and accountability.

We find that shrinking over the last four decades has been avoided in Indonesia. A country ruled by a military regime, a large agrarian economy, food shortages, high prices, and high mortality, was able to develop a set of capabilities that opened the road to material success. We focus on two capabilities: autonomy, which is here operationalised as the capability to install institutional arrangements to keep vested interests at bay in both central bank and fiscal policies. And accountability, defined here as redistributive capacity, as measured by food security and industrial policies to encourage the rise of small and medium sized enterprises. We argue that these two capabilities were fundamental elements for explaining why Indonesia has become resilient to economic shrinking.

Keywords: Indonesia, capabilities, shrinking, catching up

Introduction

In the second half of the 20th century we saw the economic rise of Asia. Rather than the gloomy outlook predicted by leading economists of the time (most notably Myrdal´s Asian Drama 1968), Japan and the "four tigers" (Taiwan, South Korea, Hong Kong and Singapore) caught up with the rich world (Bank, 1993). The second tier of Asian countries, i.e. Malaysia, Indonesia, Thailand, and the

[1] Affiliated at Department of Economic History, Lund University, Sweden
[2] Affiliated at Department of Economic History, Lund University, Sweden, and Faculty of Finance, Government and International Affairs, University Externado de Colombia

Philippines, joined the path to convergence in the early 1980s, followed by China, India and Vietnam, among others. All these economies have shown a sustained growth record with very few years of shrinking. While the dynamics of growth is a well-researched field, the resilience to shrinking is largely unknown (Broadberry and Wallis, 2017). If we were to compare Asia -without Japan - against African or Latin American countries during the last three decades, the frequency of shrinking in Asia has been a third of that in Latin America or Africa[3].

The aim of the paper is to study the role of social capability as a historical influence in the resilience to shrinking of Indonesia. In general, the social capability thesis holds that the potential for rapid growth could be realized if the economy is "technologically backward but socially advanced" (Abramovitz, 1986). In this line, we see social capability[4] as a set of national characteristics that were important for the dynamics of growth, and by implication for resilience to shrinking. Indonesia is a case in point for the dramatic change in fortune that we have witnessed in Asia. The first 15 odd years of independence were marred by political and economic turmoil with at least 7 spells of shrinking. In 1965, the country was arguably in many respects a lost cause. The GDP per capita was at a level below many African countries and one of the lowest in Asia (Booth 2016). The Malthusian trap was about to slam shut (Bresnan 1993) and the level of industrialisation accounted for only 10 per cent of GDP (Hill 2000). Furthermore, the level of social and political tension led to a failed coup in 1965 and the army gaining full control through an authoritarian regime under the rule of Suharto. Despite the repressive nature of the state, and its crony capitalism largely based on resource extraction, Indonesia since then experienced only 3 spells of shrinking[5], and income per capita grew by a factor of 6 to 11.262 USD in 2015 (TED, 2018), making Indonesia emerging into one of the world´s largest democracies and, since 2008, a member of the G-20. In this study we investigate the reasons behind this transformation. We highlight the fact that Indonesia in comparison with other countries at a similar per capita level was exceptional in its ability to build resilience to economic shrinking. Our research question is as follows: what are the key factors involved in the build up of this resilience? We argue that a capability approach provides a reasonable and plausible way to analyse this issue and we show that Indonesia developed certain key capabilities that strengthened its resilience to economic shrinking.

Although the literature welcomes no consensus, the potential metrics for social capability include educational levels and skills, experience with large-scale enterprises, quality of institutions, state capacity or social cohesion, adaptation to foreign technologies, among others (Abramovitz, 1994,

[3] The average of shrinking over the last fifty years is 11 years. The countries in the Asian sample are Bangladesh, Cambodia, China, Hong Kong, India, Indonesia, Japan, Malaysia, Myanmar, Pakistan, Philippines, Singapore, South Korea, Sri Lanka, Taiwan, Thailand and Vietnam.

[4] The term "social capability" was coined by … to explain the rapid industrial recovery of Japan after the Second World War OHKAWA, K. & ROSOVSKY, H. 1973. *Japanese economic growth,* Stanford, CA, Stanford University Press..

Rodrik, 2011). Andersson (2019) has developed a formal approach to social capability. Andersson defines five theory-grounded and empirically transparent and interactive processes, rather than outcomes, namely transformation (capability to diversify the economy), inclusion (capability to benefit from the transformation process), social stability (arrangements for conflict resolution), autonomy (capability to manage distributional conflicts by keeping group interest at bay) and accountability (capability to provide public goods to all). The contribution of this paper is to empirically delve deeper in two of these, autonomy and accountability, by examining the Indonesian development process since independence.

We find that shrinking has been successfully limited in Indonesia. Even though its rate of shrinking is the Asian average, 7 out of the 11 shrinking years occurred in the 1950s and 1960s, when the country was one of the poorest in the world and was facing a political transition from colonialism into a republic. That period left the country with a large agrarian economy, food shortages, high prices, and high mortality. The arrival to power of the military regime did in fact promote the two capabilities discussed in the paper, and they leave on after the transition into democracy. The long term "Transformation" of the economy was not halted by the reliance of oil revenues in the first decade of the Suharto regime. It was instead used to pursue the modernization of agriculture and industry simultaneously. By mid 1980s, self-sufficiency in food had been reached and industry contributed with 40% of GDP. Inflation was under control and a major tax reform was under way. However, the population employed in agriculture still accounted for almost half of the population, and industrial policy had been focused on heavy industry and the benefits from the tax reform seemed only temporary. While industrial policy changed towards labour intensive industries and SMEs in the late 1980s, much as a response to the changing division of labour in the region, renewed efforts for tax reforms did not happen until after the financial crisis.

This paper is divided as follows. The first section is a brief overview of the growth record of Indonesia between 1950 and 2015. The second section introduces the concept of social capability and makes an attempt to connect it to economic shrinking. The third section discusses the historical influence of autonomy and accountability in the resilience to shrinking. The paper concludes with some general observations and the road forward.

1. The Growth Record

This section is a brief overview of the growth record of Indonesia from 1950 until 2015. The new nation emerged under the leadership of president Sukarno, who came to power with a nationalist platform to develop the economy and society. The 1950s was a politically tumultuous decade with an

increasing conflict between the Army and the Communist Party (PKI), which found an ally in President Sukarno. Despite the general elections of 1955 democracy was not introduced. Instead, Sukarno established an authoritarian regime under the concepts of "Guided Democracy" and "Guided Economy"[6]. Sukarno asked himself why Indonesia with all its riches still had a population living in such poverty. Indonesia was then one of the poorest countries in Asia. Based on data from the 2016 Total Conference Board, the average income per capita in Indonesia after independence was 30% below that of Asia and 10% below that of Africa. Figure 1 shows that it underwent 7 spells of shrinking during the period, and the average growth was close to 0%. The main source of growth was agriculture, which contributed 60% of GDP and employed over 80% of the labour force. However, food shortages and malnutrition were common. The spells of positive growth rates came with three digit rates of inflation between 1962 and 1968 pulling away the rug from under the feet of the poor and vulnerable.

Figure 1.

Source: Total Economy Database, 2016

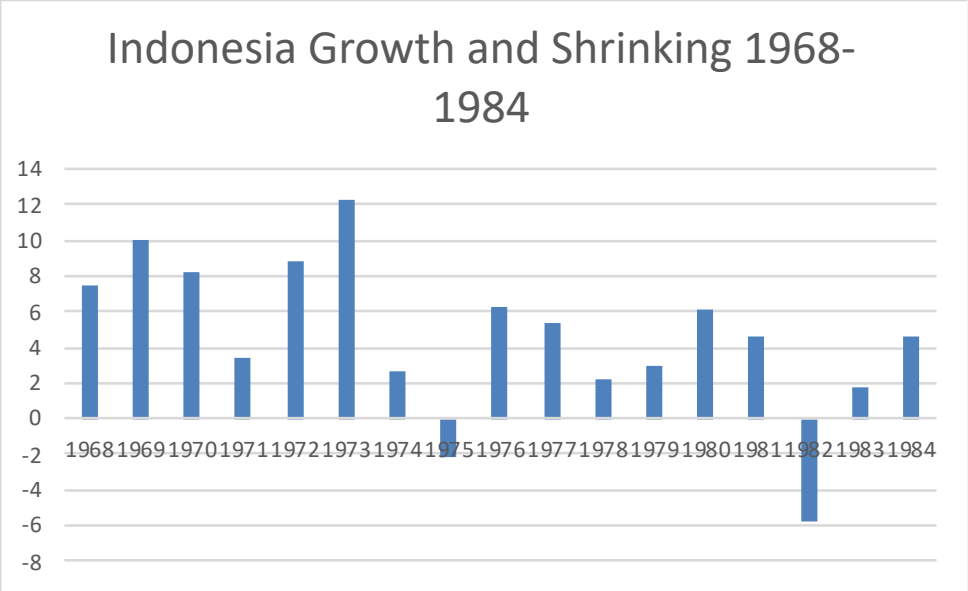
The Sukarno regime came to a violent end in October 1965. The long escalating conflict between the Army and the Communist Party ended with a military regime in power with Suharto at the helm for the next three decades. The ousting of Sukarno did not just signify a change of leadership but also a marked political and economic redirection. It was dubbed the New Order to contrast with the old Sukarno regime. Politically Suharto turned away from the socialist block and ended the conflict with Malaysia. Also in terms of economic strategy, the new order meant a redirection. Suharto surrounded himself with Indonesian economists trained in the US, and his first achievement was to stabilise the economy and to control inflation. Controlling inflation gave meaning to prices, and food shortages

[6] The Guided Democracy was …. And the Guided Economy

became less frequent. Oil was an important source of revenue and growth in the economy, with close to 5% of GDP (Hill, 2000). Between 1968 and 1975, income per capita growth was over 5%, with only one spell of shrinking of -2 % in 1975. In 1975, Pertamina, the state-owned oil company, collapsed and the state stepped in to cover the mounting debts. While the crisis had serious repercussions it also threatened the budget and brought to light the need for greater checks and balances on the big state-owned companies (Glassburner 1976)

Between 1976 and 1981, growth rates deaccelerated to an average over 4%. Another spell of shrinking occurred in 1982, at close to - 6 %, and the main cause was the combined effect of a global economic down turn and the plummeting oil prices, which affected Indonesia had given the dominant role of oil in the economy (Yasin 1999). The regime response was to restructure the economy away from oil dependence and the state-owned enterprises. After that, the economy grew with rates over 5% and was able to declare self-sufficiency in rice, the main staple in the economy, in 1985 and was announced as one of the East Asian miracles in the 1993 World Bank Report. In this period, the economy had diversified, with industry accounting for over 40% of GDP. Some excess labour remained in the agricultural sector, with more than 50% of the population. Agricultural GDP contributed with another 20%, and even though the poverty rates had improved, the gap between agricultural employment and GDP provides an idea about the difficulties of the labour market in reallocating people.

Figure 2.

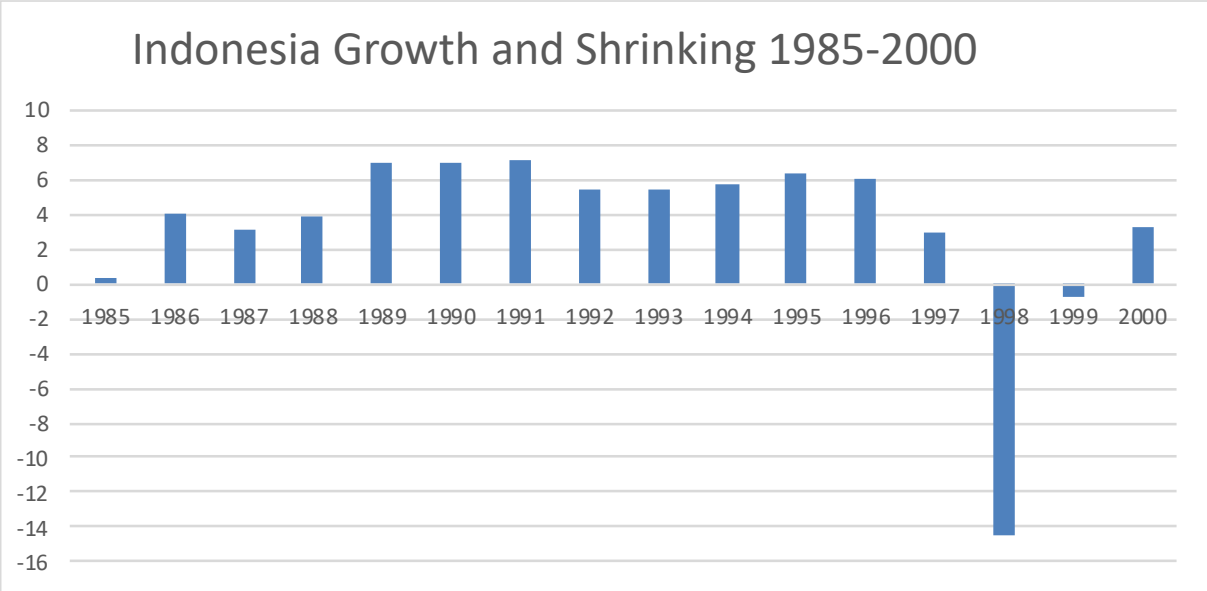


Source: Total Economy Database, 2016

Indonesia was heading towards NIC status. Suharto was firmly in power and the country was arguably one of the most centralised countries in the world controlled by the elite in Jakarta (World Bank 2003).

It was at this time that the Asian crisis hit Indonesia in mid-1997. Although Indonesia had been heralded as the half way miracle of Southeast Asia, the Indonesian economy collapsed in 1998 (World Bank 1993; World Bank 1997). Income per capita contracted by 14% in 1998 and 1% in 1999. However, against all odds, the crisis led to the relatively peaceful ousting of Suharto and the transition towards democracy. Furthermore, the economy recovered in less than a year and positive growth rates over 3% have followed through since then. The average annual growth drops to only 2.8 for this period, much a result of the dramatic two first years. If we exclude the 1998 the average growth is a whole percentage point higher.

Figure 3.



Source: Total Economy Database, 2016

It is evident that the economic stability from the second half of the Suharto kept paying off, in combination with the emergence of a strong democracy with regional autonomy. When Suharto stepped down in 1998, Indonesia embarked on a road towards democratisation. With democratisation demands from regional governments for more power and the discussion on regional autonomy was reignited as the regions pressed for greater autonomy (Usman 2001, World Bank 2003). In 1999, law 22 and law 25 were passed. Two years later decentralisation and regional autonomy was effectuated (World Bank 2003). The 'big bang' of decentralisation meant that the old top down approach to development no longer applies. The new era stemming out of the crisis has therefore led to a changing role of the central State. The process is now in the hands of the provinces, although decentralisation has brought increasing conflicts between local stakeholders. For instance, local governments today exploit their resources to a much larger extent than what they did before. The greater freedom has led

to greater local possibilities with less central intervention (Firman 2009), and the growth path of Indonesia has been rewarded with the G20 membership in 2008.

2. Shrinking and Social capability

In the literature on the nature and causes of economic growth in the developing world in the post-war era, economic shrinking has received limited attention with a few exceptions (Easterly et al, 1993; Rodrik, 1999; Pritchett, 2000; Broadberry and Wallis, 2016). The consensus is however that economic shrinking is a frequent phenomenon in developing countries and that the growth literature is not well equipped to understand it. A production function cannot explain why economies shrink, partly because it makes emphasis on the proximate causes of growth (capital, labour and technology) and fails to capture the fundamentals like geography, culture and institutions (Andersson 2019). Changes in these fundamentals are slow and make up for key characteristics that are part of the explanation of why some economies grow faster than others. We believe that some of these fundamentals produce societal or national characteristics that make some economies resilient to shrinking.

We take the concept of 'social capability' (Ohkawa and Rosovsky 1973; Abramovitz 1986;1995) as a point of departure and relate its evolution to economic shrinking. Our starting point is to decompose the concept of social capability into five empirically operational and interconnected parts. These are: *(i) transformation* captures the completion of the agricultural transformation; *(ii)* i*nclusion* captures fall in poverty, widespread access to productive resources and that the economy is open to entry, implying that the growth process has the potential to be pro-poor and participatory; *(iii)* social stability refers to constructing arrangements for curbing social and political conflict; (iv) *autonomy* which we understand to be the ability of the state to keep vested economic interests at bay, and lastly *(v) accountability* understood as to capture the quality of governance and provision of public goods (cf. Besley and Persson 2013). Analytically the different social capabilities are interconnected and difficult to disentangle into clear-cut elements. In reality they are also subject to cumulative causation and mutual interaction. Nevertheless, we focus in on two distinguished elements that most clearly relate to the capacity of the state to create conditions for broad-based invigoration and stable rules of the economy, captured by the state's autonomy and accountability.

In detail, autonomy refers to the arrangements that limit powerful actors' possibilities to interfere with the credibility of the macroeconomic system with regard to prices stability, deficits, volatility etc. To empirically operationalize autonomy, we focus on the working principles of the Central Bank; arrangements for limiting galloping deficits and policies for strengthening diversification of the

economy. Accountability refers to policies and principles for the use of public resources that serve to increase the productive potential and living standards of a broad cross section of society. Our way of operationalizing this focus on how the Indonesian state promoted food security for the masses and policies to encourage the rise of labour intensive small and medium scale enterprises.

3. Historical influence of Social Capability

3.1 Autonomy of the State – The role of Inflation, balancing the budget and taxation

State autonomy is seen as the ability to keep vested interests at bay through law enforcement and order (Johnson and Koyama, 2017). However, a strong state and a weak civil society might not fit the social and institutional requisites for avoiding shrinking. Indonesia had an authoritarian regime since its independence until the crisis of 1998 and therefore the influence of the Army precluded and channelled the role of private entrepreneurs, politicians, journalists, trade unions and other social organizations. In other words, studies indicate that crony capitalism was entrenched in the regime (Vatikiotis, 1993; World Bank Governance Report, 2017), and senior army officials or army owned private firms were in charge in a range of sectors, such as forestry, automobilies, banking, arilines, hotels and tourism, among others (Robison, 2009). A brief look at the strong growth record and relatively low inflation between 1950 and 2015 appears to confirm the view that markets in Indonesia did not work in an institutional vacuum.

3.1.1 The central bank – vested interests and inflation

In the 1950s the inflation was high but stable (Arndt 1965). As we enter the 1960s this was to take a turn for the worse. In 1962 prices were up by 170 percent. In 1963 the process continued up by another 134 percent which was followed by rampant hyperinflation from 1965 (see various survey of recent development in BIES 1965). The government response was to decrease the money in circulation by a currency reform with a conversion rate of 1000 rupiah to one new rupiah. This did not stem inflation for two reasons. Firstly, the conversion to the new rupiah was a means for the regime to put into circulation rupiah notes that had been printed in the early 1960s but had been made obsolete by the rampant inflation. Furthermore, the regime engaged in inflation driving policies by hiking up wages for state employees and by paying out handsome bonuses. There was during the Sukarno era thus a clear ineptitude to deal with the challenge at hand. Furthermore, the regime was faced with strong pressure from vested interests to maintain subsidies and preferential treatment both in terms of access to foreign exchange and in the distorted value of the rupiah. Perhaps the running of the Central bank is the clearest example of this. The bank was established in 1953. Although based on western

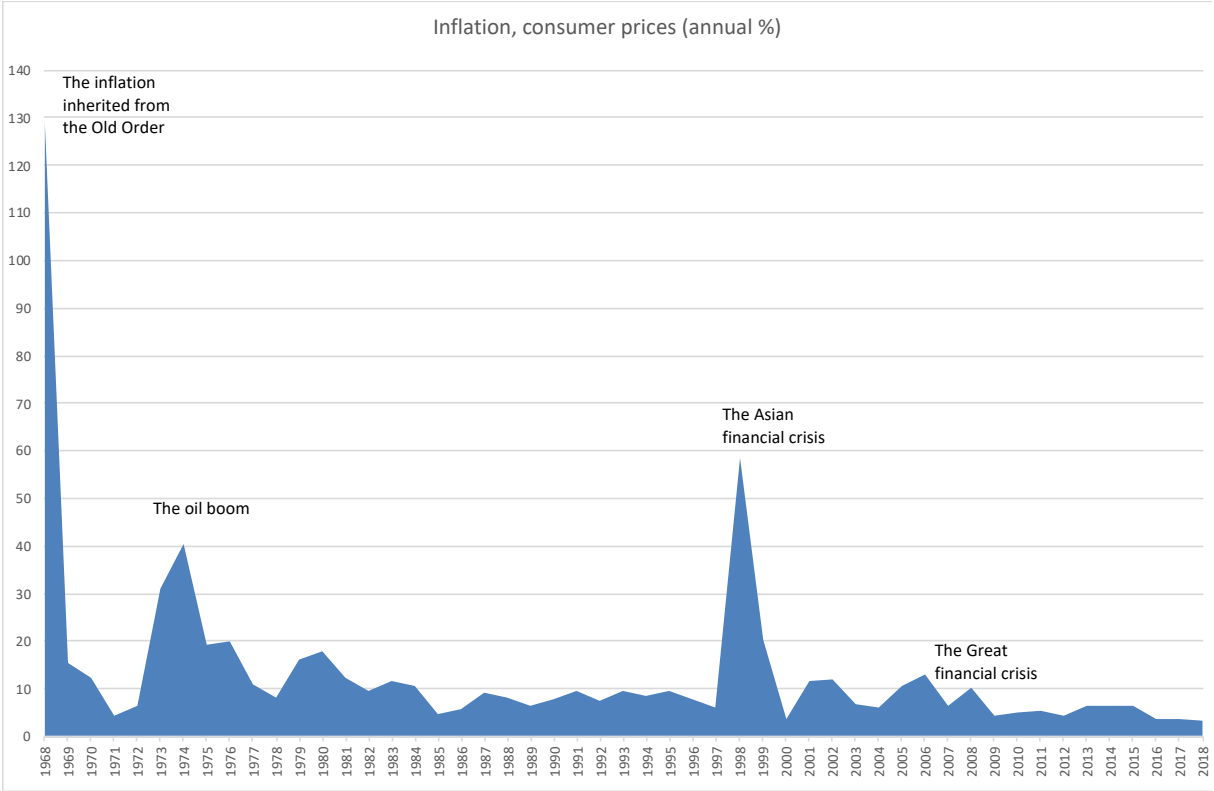
ideals it was in the hands of the government already from the start as two of the three directors came from the government. In 1957-58 regulations on reserve requirements of Indonesian banks were relaxed enabling them to lend more money. At the same time, different ministries within the state apparatus exerted control on other banks and could then bankroll their own projects. In 1961 Jusuf Mudal Dalam became governor at the same time as he was the Minister of banking, completely blurring the line between the government and the Bank (Arndt 1965).

With Suharto in power, there was a change in economic policy as well as management. Trained economists had often been in opposition to Sukarno's more political ambitions already back in the 1950s (Bresnan 1993). After the events of autumn 1965 a significant change occurred. With the banning of the communist party in early 1966 Suharto was given greater opportunities and the country was governed by a trio consisting of Suharto, an avid anti-communist called Adam Malik and the Sultan of Yogyakarta (Steinber et al. 1987). When Suharto was given the de facto powers in March 1966, a group of economists from the University of Indonesia with training from UC Berkeley, often referred to as the Berkeley mafia rose to prominence and influence which would last well into the 1980s (Bresnan 1993). The very same group of economists that throughout the first half of the 1960s had strongly criticised the Sukarno regime in various seminars at the University Indonesia economics faculty. The top priority became a stabilisation programme to get the Indonesian economy on track and reschedule the debts which, with the deficits of the Sukarno era running wild, had skyrocketed to a level where Indonesia could not meet its obligations.

This stabilisation strategy was drawn up with external support from the IMF and the top priority was to battle inflation. This meant a shift away from the socialist and planned economy that had been the principal strategy of the Guided economy from 1959. Instead, the new strategy signalled a turn towards austerity and market forces where both private actors and the state played an important role. It was also a clear shift towards the capitalist western world. In more concrete terms, this meant less involvement from the state with less preferential treatment of state-owned companies. It is important to note that the role of the state was by no means to play a back-seat role in the development process. On the contrary, while private business was important the state played crucial role (BIES Survey 1966 2:5).

In this context, restructure the banking sector and restore the authority of the central bank became paramount. This meant that the central bank regained control over both state and private banks. Also, foreign exchange policy access to foreign reserves came under stricter control. Indonesian state companies could no longer expect preferential treatment, and finally a more realistic exchange rate for the Rupiah was established.

Figure 4.



Source: World Development Indicators, 2019

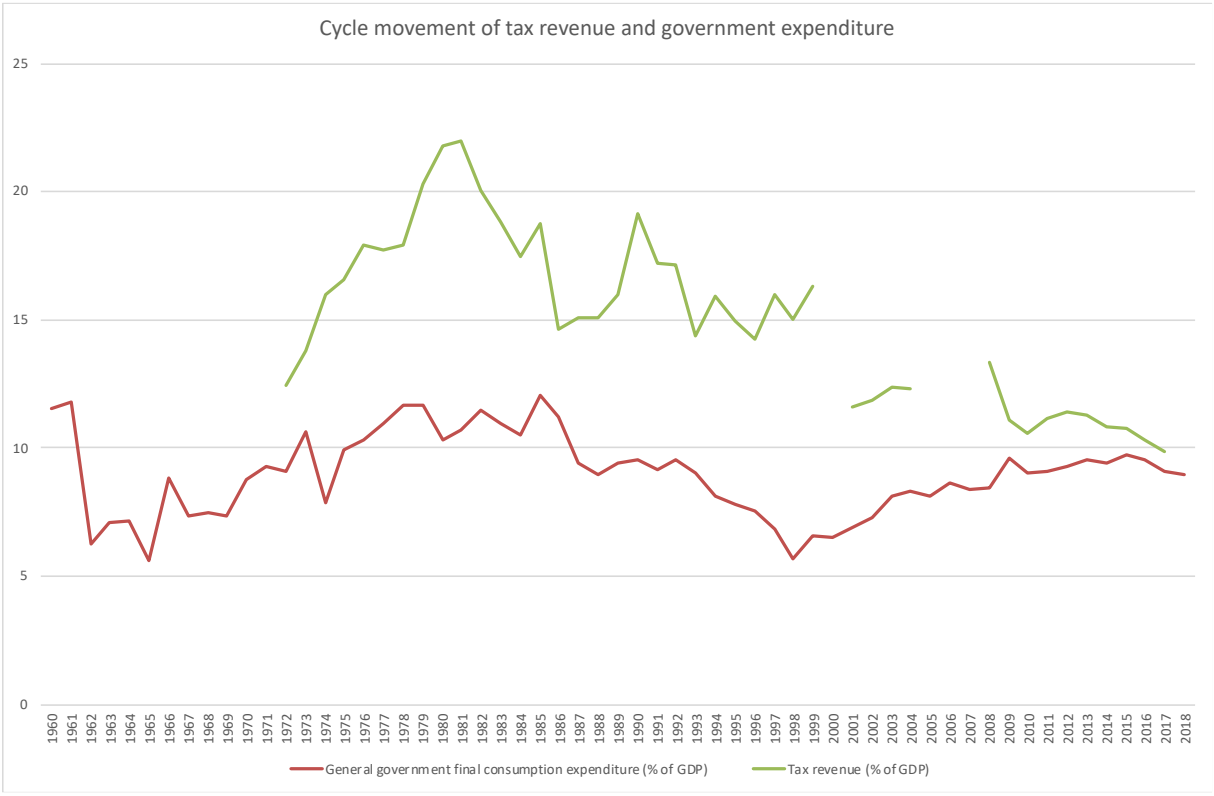
Figure 4 show that the results of the restructuring gave relatively quick results on the level of inflation. Already by 1969, the inflation was down to more manageable levels. This was mostly a result of the Suharto regime getting the budget in order. In the 1970s there are three main spikes in inflation. The first one was related to the rice crisis in 1972. With poor management of the price setting as well as the distribution of inputs from the rice procurement agency BULOG in combination with dry weather and poor harvests in both Indonesian and abroad led to the rice price skyrocketing with a direct impact on the cost of living (Grenville 1973). The two other spikes in the inflation were both related to the oil price hikes of 1973 and 1979. In both hikes Indonesia was faced with a windfall source of revenue which enabled the country to invest in development projects but also increased inflation. While it may be argued that the Suharto regime could have battled inflation more effectively and sterilised the unexpected oil windfall to a larger degree, unlike in the Sukarno regime the government was not the driver of inflation. In other words, before the crisis in 1965 the main drivers were government policy of printing more money and running large deficits. After the crisis, it is driven by commodity prices. It may be argued that the Suharto regime became increasingly apt at tackling the windfall form oil.

3.2 Fiscal prudence,the balanced budget principal and tax-reform

In the last years of the Sukarno regime the deficits were rampant and increasing. Arguably, the budget was out of control. A first step for the Suharto regime and his technocrat advisors was to cut the

expenditures. In terms of expenditures these were lowered by ending the costly armed conflict with Malaysia. Costs were also lowered by ending the above-mentioned support to the state-owned companies. Finally, the development projects, which did not give a quick return, were to be scrapped or postponed (BIES 1966 2:5).

Figure 5.



Source: World Development Indicators, 2019

To address the immediate deficit was of course very important but the fact is that Indonesia, since the crisis at the end of the 1960s, has not seen the same great imbalances in the budgets. Indonesia addressed not only the current problems but also the underlying fundaments of fiscal policy that got the country into trouble in the first place. In other words, government consumption was moving in tandem with tax revenue (see figure 5). In this context, it is important to highlight the balanced budget principal. The idea of the balanced budget principal stems out of the budget deficit running out of control in the last years of the Sukarno regime (Aghevli 1976). The balanced budget rule has been questioned as to how effective it actually was in terms of both avoiding deficits (see for example Hill 2000) and also if it actually helped in avoiding inflation (Glassburner 1986). The point is, however, that it held off the excesses of the Sukarno era. In fact, government representatives including Suharto himself would use the budget balance principle as a fall back when arguing for austerity (Glassburner 1986). The balanced budget principle was in place until the very end of the Suharto regime with moderate inflation (McLeod 1997). Despite the downfall of Suharto, the budget constraints remained

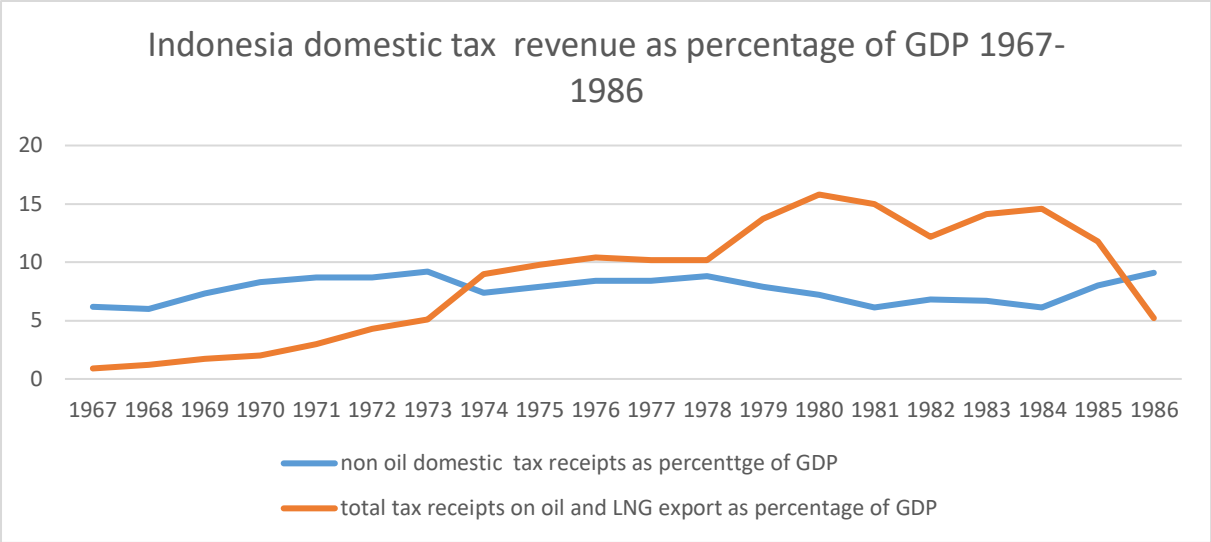
in place with low deficits even at the height of the financial crisis in 1997 and 1998, a result of matching expenditure with the shrinking revenues (Blöndal, Hawkesworth and Choi 2009). Again, the international creditors have played an important role in after the crisis.

The balanced budget principal had may have had an effect on curbing excessive expenditures and promoted sound macroeconomic policies with more austere policies in comparison with the old order. On the other side of the coin is of course the importance of revenues. It has already been touched upon above in regards to the windfall oil revenues but a more careful examination of the Indonesian taxation system is in order. In the Sukarno era it was clear that not only did the expenditures rise but the revenues declined. The young nation inherited an antiquated taxation system from the Dutch. The principal sources of tax revenues came from taxes on foreign trade (Asher and Booth 1995). Apart from the trade taxes there were a number of taxes including a property and sales taxes. The tax system was inefficient, unclear, and open to abuse. Due to unclear definitions and the size of the informal sector tax evasion was rife and levels of taxation often became a negotiation between collectors and payers (Odando 1987). It was therefore of the utmost importance to the regime to improve the taxation system.

The 1970s saw some tax reform with the land tax system being the clearest example. Land revenue was, however a negligible source of income to the state coffers.

With the cash flow from oil running dry in the early 1980s Indonesia was facing a shortfall of revenue and the tax reform became important. The aim being to steer away from the oil dependency while avoiding relying too much on aid (Booth 1995). In order to achieve this the government had a two pronged approach based a) to simplify the tax code and b) to increase the efficiency of tax collection (see for example Kelly 1993; Odande 1987, Asher and Booth 1995). Work on reforming the system began already in 1981 and resulted in a revived income tax in 1984. In 1985 a value added tax was introduced which replaced the old sales tax and in 1986 IPEDA was replaced with a land and building tax. The core change in income tax meant a simplification of the tax brackets from 19 to only three. The new system was built on self-assessment with penalties for evasion. In addition, the VAT tax law was a simplification of the old system moving from ten to only on rate (with the exception of some luxury goods). Finally, the new land and building tax was also a case of simplification, the above-mentioned seven sectors taxed under IPEDA was now replaced with a single property tax.

Figure 6.



Source: Gillis 1989

The more simplified system of course a means to improve efficiency of the taxation system but there was also other methods to achieve this. On the one hand the Indonesian government took measures to educate the tax collectors but there was also a reorganisation of tax collection and possible consequences for tax avoidance. While the tax reform in itself may be seen as standard, from our point of view the most interesting part is how it was carried out. Rather than being a result of an indigenous process, it was the result of a top down process with very little Indonesian involvement. While the ministry of Finance was in charge, the work was carried out by the Harvard Institute for International Development (Heij 2001). Indonesian tax officials were informed rather than consulted. Furthermore, the process of pushing it through the legislative chambers was very opaque in an effort to not include vested interests. Perhaps more importantly it was all done with the explicit support of Suharto (Heij 2001). In short, the tax reform was a result of a very autonomous process.

If we look at the Suharto regime as a whole, it is clear that the tax revenue increased greatly over time (IMF 2018). This trend if we exclude the dramatic effects of the financial crisis of 1998-1999 persists to this day. A closer look, however, reveals some issues that warrant further examination. As can be seen in figure 6, tax efficiency as measured by tax revenue in relation to GDP growth it is clear that the efficiency declines in the mid 1970s. This picture becomes even clearer if we look at the share of taxes to GDP. From1967 to 1980 tax revenues had more than three folded from 7 per cent to 23 per cent of GDP (Gillis 1989). A decomposition of taxes however shows that non-oil and LNG was more or less stable in contrast to a 15 time increase seen in the mineral sector (Gillis 1989). With the steep decline in oil prices, we also see how tax revenue stagnates. It is not until the second half of the 1980s that we see a clear improvement in tax revenues something which then continues to until present day, if we do not include the crisis of 1998. It may thus be argued that with the increasing oil revenues, which came with the oil boom of the 1970s, the pressure for reforming the taxation system was minimal until the steep decline in the oil price in. This also meant that changes that did occur were

often small in character and a comprehensive tax reform did not occur. As a result, non-oil revenues decreased from 60 per cent of all revenues at the start of the Suharto era down to only 25 per cent in 1981 (Odano 1987 Hill 2000).

Turning to the second big tax reform, it is clear that there is a steep decline in conjunction with the financial crisis of 1998 that continues into the new millennium. This was an effect of the economy shrinking but also an effect of the more difficult conditions for tax collections given the social unrest and tensions (Iswahyudi 2017). As noted above, the end of the Suharto era was a watershed in Indonesia, which heralded change in the form of both democratisation and decentralisation. The reforms in post Suharto Indonesia was not only driven by the new political climate but also the need for revenue to get out of the financial difficulties created by the crisis in 1998 (see for example Brondolo et al 2008).

As seen in figure 6, the tax reform coincides with the upswing in revenues. While this is undoubtedly a consequence of the economic recovery the momentum is maintained also after pre-crisis levels where achieved. Worth noting is also that while the tax reform of the mid 1980s had a direct impact. The effect soon wore off and stagnation once again set in. This was very much a result of problems that had been there also before the previous tax reforms. The institutional context was weak which meant poor tax collection and also weak enforcement. Heij (2001) argue that while the process had been set up autonomously, the vested interests, often through Suharto, soon gained influence and preferential treatment. In the aftermath of the financial crisis Indonesia again turned to foreign advisors to improve the tax system. With the tax reforms of 2001, things have shaped up differently. As seen in momentum is maintained if the global crisis in 2008 is excluded. Also indirect taxes has become increasingly important.

3.1.3 Industrial Policy (to be developed)

The period 1968-1984 also saw the expansion of industry[7]. As with agriculture, the opportunity for triggering industrialization came with the oil boom in 1973. The nature of the industrial policy and thereby the outcome was to have great impact on prospects for the structural transformation. Like in many other developing countries of the time, industrialisation was led through state initiatives. The focus was on capital rather than labour -intensive industries (Hill 2000; 1990). This being said, these policies also benefitted the expanding manufacturing industries making the Indonesian industrial sector much more diversified in the middle of the 1980s.

The industrial sector grew in importance and hovered around 40% of GDP while agriculture close to 20%. At first glance this was just a continuation of the oil fed industrialisation strategy of the 1970s.

[7] By industry we mean mining, manufacturing, construction and public utilities.

However, when the collapse in the oil price occurred, Indonesia could no longer sustain an oil fed and inefficient industrial policy (Hill 2000; Bresnan 1993). A shift from this industrial policy was met with resistance from the industrial elites that had benefited from their close ties with Suharto (Vatikiotis, 1993). While there was an internal pressure for change the regional dynamics in Asia had also changed with the Plaza Accord in 1985, which opened up for increased capital flows to feed manufacturing. The result was a shift in the drivers of the industrialisation process away from the oil driven state-led industrialisation project towards an export-oriented manufacturing sector fuelled by foreign direct investment. It is this process that took off in the early 1990s with labour intensive industries (Hill 2000). his shift meant that more people could be absorbed in the industrial sector thus shifting from low productive and low-income activities to ones which lifted them, and Indonesia out of poverty.

4 Accountability a case of food security[8]

In this paper food security is a proxy for accountability. A regime's ability to deliver food security indicates how broad based the development process is. In short, did the increased revenues that growth entailed benefit just the few or a large strata of society? Already from the onset of the Sukarno regime Indonesia was faced with a precarious food shortage. Food security was therefore a pressing issue. Despite this, both funds and a coherent policy was in short supply. The regime promoted the use of chemical fertilisers and new seeds, but the efforts were chronically underfunded and there was no organised efforts of guidance and support for new agricultural technologies. (See for example J. 1965 and Kolf 1971; Penny 1965). The end result was that while food production increased, demand grew faster. In the end Sukarno resorted to campaigns promoting consumption of other food crops than rice (Bresnan 1993).

When Suharto took over Indonesia in 1965/1966, the economy was still dominated by the agricultural sector with more than half of the labour forced in farming. In the first years, however, little resources and effort was invested in the sector. Failing to put food, particularly rice, on the table would have risked Suharto to lose power (Bresnan, 1993). Consequently, ensuring food security was also a matter of political survival. The state agencies entrusted with the task of food procurements was at best not up to the task and even speculated in order to make money on increased food prices.

With severe shortages in 1972 the prices spiked and lack of food resulted in violent protests against the still frail Suharto regime. The development of the agricultural sector was principally entrusted to the Ministry of Agriculture, which worked through a number of agencies in the regions, the most important one being Dinas Pertanian (Mundy 1992:30). The organisation was highly centralised and each region had a number of Dinas offices, each responsible for a particular type of agriculture such as livestock, fishery and food crops (Mundy 1992:28). The provincial Dinas answered to the provincial

[8] This draws on Axelsson 2008

coordination offices Kanwil, which in turn acted on orders from the Ministry of Agriculture in Jakarta. Despite the close connection to Jakarta, they were administratively under the local governor. Below the provincial level there were district offices.

These districts also answered to Jakarta but were at the same time under the jurisdiction of the local district head. This allowed the regime to tie the agencies closer to the central authority, ensuring agricultural policy was carried out according to its plans, but at the same time this order would have increased the risk of conflicts between regional and national policy makers (Mundy 1992:29-30). At the subdistrict level, in the kecamatan, there were rural extension centres, Balai Pertanian Lapangan (BPP) responsible for teaching and guiding the farmers. These centres ensured that information on new technologies was spread to the farmers. The staff at the centres were referred to as Penyuluh Pertanian Lapangan, field training officers (PPL). The officers divided the villages in the kecamatan among themselves. Each officer had to visit the villages once or twice a month to instruct, help and gather information on how the new technologies and techniques work (Dinas 1973; Penny 1968). In addition to distributing information and know-how, the officers were to report upwards on issues such as pest control etc. in order to make these procedures more efficient. It started out as a relatively small, makeshift organisation but gradually grew larger as resources increased (Dinas 1968- 1998). Dinas Pertanian and PPL, in cooperation with the state-owned radio and some journals, eventually became the paramount knowledge resource for the farmers, with a monopoly on information.

In addition, there was the so-called mass guidance, Bimas, programmes. These had been experimented with as early as the 1960s. Bimas was not an independent extension system but rather a programme directly targeted at increasing the productivity of chosen crops through mass guidance. Just like Dinas, Bimas operated on a number of levels. As expected, the programmes were closely connected to Dinas as Kanwil was responsible for the running of it although the provincial governor was officially in command. This sharing of responsibility is mirrored on lower levels. (Mundy 1992:27). The Bimas programmes worked on five principles; improved water control, use of new seeds, use of fertilisers and pesticides, better cultivation methods and, finally, a stronger co-operative structure in the villages (Lokollo 2002:3).

The Bimas programmes were improved in 1970 by the addition of wilayah unit desa, or village units. These units consisted of a field extension worker, a village bank which would provide the farmers with credits and a village unit cooperative which, among other things, dealt with the distribution of inputs and marketing of rice. There were also the village kiosks, often privately run, selling inputs directly to the farmers (Lokollo 2002:4). Alongside Bimas, there were the Inmas programmes. The two programmes worked similarly and the farmers were given a package consisting of seeds, fertilisers and pesticides (UNDP 2001:81). At the beginning, the Bimas provided guidance for rice but

gradually, and on a much smaller scale, other crops, such as maize, were introduced. In the initial years of the New Order, production increased steadily as production figures broke new records.

The programmes failed to produce stable increases and Indonesia's ability to secure a safe level of rice production came into doubt (UNDP 2001). It became clear that the Bimas programmes in their current state were not capable of providing enough food and the goal to achieve self sufficiency was not close. In order to improve and stabilise yields, the central government decided to go one step further in the third development plan (1979-1983). This was done with special intensification programmes, Insus. While the old Bimas programmes targeted individual farmers, the Insus worked with groups.

The groups had to work collectively and write proposals on what was needed in their group. Each group had an appointed leader (Lokollo 2002). This enabled a more efficient structure to spread new seeds and technologies. Extension officers would visit and instruct so-called contact farmers who, in turn, would spread the information to the larger group. The new system also permitted a stricter control of farmers ensuring that more of them followed instructions given by the officers (Booth 1988:152). The Insus programmes targeted several food crops but emphasis was on the rice sector. Insus meant that the system, of extension officers coming out to the farmers and training them in how to use new technologies, became the norm throughout the country (Booth 1988). The Insus programmes were specifically concerned with areas where the Bimas had been less successful or had not yet fully penetrated. For those who did not want to work within the group, there were options of joining general intensification programmes. Despite the new programmes, Bimas was still running and the old credit scheme was not abolished until 1985. Although the programme showed great success in terms of production, the default rate on the loans given to the farmers was well over 50 per cent (Sawit and Manawan: 1991:84, 98). By 1985 Indonesia had achieved self sufficiency in rice but even then there were indications that the effects of the Insus programmes were wearing off and Indonesia was struggling to maintain the high levels of production as well as keep up with the demands of a growing population with a growing demand for rice (Sawit and Manawan: 1991:82).

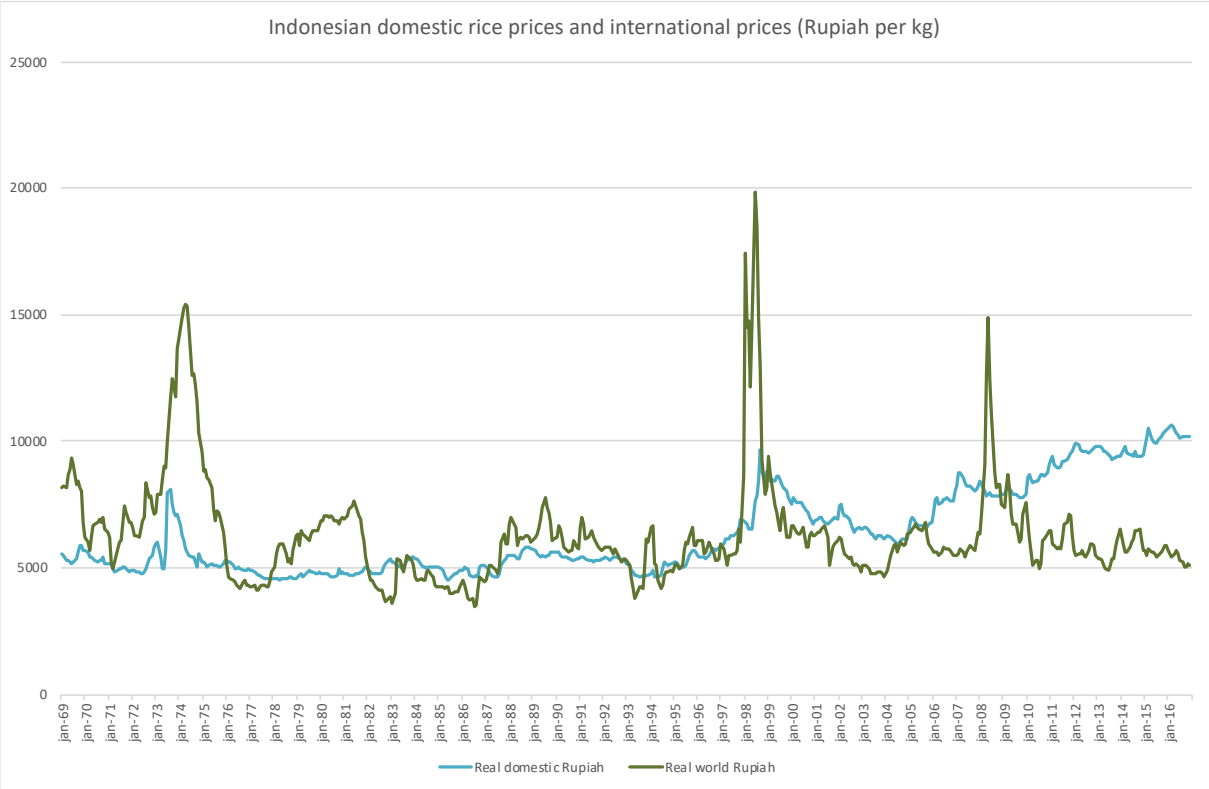
According to the Ministry of Agriculture, there were three problems in Indonesian agriculture. First, the land under cultivation was steadily decreasing in order to give way to industries, infrastructure and garden plots. Second, the intensity of crop cycles had to be lowered as a means to battle pests. Finally, farmers found it difficult to adopt new types of rice (Dinas 1985). In response to the looming food crisis, the Supra Insus programme was introduced in 1987 (Sawit and Manawan 1991:83). The Supra Insus programme was built on its predecessor with farmers groups and contact farmers, but extended by increasing contact between different farmer groups, thus allowing them to exchange information on how to implement new technology, battle pests etc. with a wider group. In addition, the Supra Insus programme also increased the interaction of farmers, cooperatives and producers of inputs needed in modern farming.

The programme consisted of two parts. One was to give the farmers important information on modern varieties, cropping patterns, balancing the use of fertilisers, cultivation densities etc., and the other to serve as a support network for the farmers. This was done by increasing the number of extension officers visiting the groups and aiding in any way they could, but also by involving village cooperatives as agents trading inputs and providing support to companies selling farm inputs (Sawit and Manawan: 1991:84). n addition, the new inputs were to be financed through a new credit system, the Kredit Usaha Tani, KUT, which was distributed to farmer groups through the village cooperatives (Sawit and Manawan: 1991:84-86). Just like the previous programmes, the Supra Insus effort started out as a small-scale project in a number of villages in West and Central Java, and was gradually implemented across the country. Since the early 1980s, there have been so-called Opsus programmes running alongside the other programmes but Productivity in Javanese Agriculture Under Suharto directed at areas which need improved management and increased production (UNDP 2001: 82).

The end of the New Order meant an end to the broad and encompassing agricultural modernisation schemes of the past. Instead it is a decentralised system where each region is responsible for its own funding which of course also means that poor agricultural regions will be struggling to maintain its services especially in expensive project like irrigation (Simatupang and Timmer 2008, Firman 2009). Consequently, the organised efforts of the past are no longer in place. Instead we see the old extension system struggling while NGOs and private interests have gained ground promoting new cultivation practises, mechanisation of agriculture and more importantly focus has shifted towards agri-business and marketing of agricultural products (Bank, 2007).

At the same time as the Suharto regime introduced the support for agricultural intensification the regime worked with an increasingly sophisticated price manipulation. To this end the regime created the Badan Urusan Logistik (BULOG) in 1967. BULOG was given the task to ensure food security across Indonesia (Yonekura 2005). This was to be done by increasing the storage capacities evening out the supply across the year and through building a logistic capacity with the capability to transport food across the archipelago. In effect, BULOG was given a monopoly on the on agricultural products in general, and rice in particular. This monopoly also included imports of foodstuffs. This allowed the allowed BULOG to set prices both at farm gate level and for consumers, which meant protection of producers, and consumer in tandem with price stability (McCulloch and Timmer 2008). The monopoly was in place until the end of the Suharto regime but it has been argued that it was most important up until Indonesia had achieved self-sufficiency in the mid-1980 (Yonekura 2005) and it is clear that it was a costly organisation, which was rife with corruption and mismanagement(se for example Bresnan 1993 and Yonekura 2005). This being said, figure 7 shows that the rice price is remarkably stable throughout the Suharto regime insulating the domestic market from regional downturns and fluctuations (Jones 1995)(Timmer, 1996, McCulloch and Peter Timmer, 2008).

Figure 7.



Source: own calculations based on Dawe (1993), Timmer (2006, 2018)

Concluding remarks (pending work on the role of SME in the diversification of the economy)

We draw a number of preliminary conclusions at this early stage of the paper. First, Indonesia has successfully increased its resilience to shrinking and growth has become less volatile over time. It is clear that after the regime shift in 1965 Indonesia has only experienced three occasions of shrinking. In all but the last instance, the economy has bounced back into positive growth already the year after. In this paper we argue that this increased resilience is a consequence of Indonesia developing its social capabilities as measured by autonomy and accountability. Autonomy in this paper is defined as fiscal prudence and autonomy of the banking system. We examine how Indonesia has managed inflation, balancing the budget and reform its tax system. The bifurcation point is the regime change in 1967. Despite being authoritarian and marked by crony capitalism, the Suharto regime managed to create autonomous institutions conducive to growth. A first measure was to reinstate the autonomy of the central bank and thereby the banking system at large.

Secondly, to curb hyperinflation the new regime introduces a balanced budget rule to curb unrealistic development projects. While this may have been hard to abide by, the principal was on several occasions used by ministers and even Suharto himself to justify halting or postponing expensive

project. Focus was not only given to curbing costs but also to improve revenue. This was done to reduce not only the dependence on aid but more importantly oil. Major tax reforms were carried out in the mid 1980s and in the early 2000s. While these reforms differ in nature and success, one characteristic sticks out. Namely, their autonomy. This is particularly clear in the 1980s where the president and minister of finance kept the process under wraps until it was ready to be implemented in law. This meant that vested interests had little powers to manipulate the process and that the laws could be implemented autonomously. This being said, vested interests soon gained influence again. Not least through president Suharto himself. This resulted in weak long-term effects of the tax reform and possibly even contributed to the crisis in1998. The tax reforms of the early 2000s sought to rectify this.

Accountability is defined in terms of delivering public goods for all, in this paper we examine food security. Here we find that the Sukarno era, was marred not only by shrinking but also chronic food shortages. The Sukarno regime clearly recognised the problem but severe lack of funding in conjunction with mismanagement meant deteriorating food supply. The Suharto regime inherited the threat to food security. The critical juncture came with the rice crisis of 1972, which almost lead to the ousting of Suharto. Suharto recognised that food security equalled political survival and the, to Indonesia, fortunate geopolitical events which led to an increase in oil prices presented the means to address the issue in earnest. Therefore, the agricultural development institutions of the Sukarno era were expanded and invigorated stimulating food production and by 1984 Indonesia had achieve rice self-sufficiency. In short, the Indonesia had succeeded in delivering food security. At the same time as the state invested in agricultural intensification systems it also created a food monopoly through a state procurement agency, Bulog, with the outspoken mandate to ensure food security. With the monopolistic powers and funds from the oil revenues the state could ensure stable rice prices while protecting both the consumers through a ceiling price, and the producers with a floor price.

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