Impact of the Decade of Reformasi on Economic Policy Making

Ross H. McLeod

Indonesia Project
Australian National University

ross.mcleod@anu.edu.au

Indonesia's Decade of Democratization: The Rise of Constitutional Democracy

Jakarta, 21-22 May 2008
The Soeharto Era

• Under Soeharto’s near dictatorship, Indonesia’s economy enjoyed success matched in very few other developing countries
  – rapid growth over three decades
  – dramatic decline in poverty
  – an inconvenient truth for those who argue that democracy is key to prosperity
• Yet the regime fell apart abruptly (economically and politically) in 1997-98
• What has Indonesia gained, and what has it lost, in the following decade?
Indonesia under Soeharto had the trappings of democracy

- Five yearly election cycle
- Three political parties
- Parliament (electoral college presidential system, not direct election of presidents)
- This was enough to satisfy the international community
- And left the people with some hope of reform other than by revolution
In reality Soeharto created a political monopoly

• Appointed a majority of the people who ‘elected’ him (always unopposed)
• Only 2 parties allowed to compete with Golkar for seats in parliament (but Golkar always won 60-70% of vote)
• Military suppressed opposition, using ‘territorial organisational structure’ and threat of violence
• As did judiciary (imprisonment for opponents) and bureaucracy (suppression/co-optation of opponents)
Concept of government of the people, by the people, for the people

replaced by

government of the people, by and for the elite
Government as an instrument of perverse income and wealth redistribution

• The Soeharto franchise
  – Government captured by an elite
  – Coercive powers of government used to transfer income and wealth from general public to elite

• Elite objective was income growth well in excess of economic growth
  – General public was ‘privately taxed’ for this purpose
Private tax transfers from elite to non-elite.
The Soeharto Franchise

Beneficiaries/Elite ('insiders')
- Conglomerates
- Large foreign firms
- First family firms
- Other franchise affiliates

Franchise (Public Sect. Inst's)
- Legislature/political parties
- Judiciary/legal bureaucracy
- Military/police
- Bureaucracy/non-dept. agencies
- SOEs

Tax targets/Non-elite ('outsiders')
- Domestic firms/individuals
- Small foreign firms

Soeharto
A Better Class of Corruption…

• To prosper, cronies had to make profitable investments in the economy, not accumulate the spoils in overseas bank accounts
• The system ultimately failed, not because the investments were bad, but because the system was inherently unsustainable
• The franchise was a victim of its own success:
The system worked well

• Soeharto family and cronies became extraordinarily wealthy
• Yet the general public also benefited greatly from the regime
• The paradox is explained by Soeharto’s innate understanding that rapid growth served the objectives of the elite …
• … plus his consolidation of a political monopoly that allowed him to follow broadly growth-oriented policies
The Soeharto Legacy

- Soeharto left a strong foundation on which to build continued economic growth
- And (surprisingly) he left a political-electoral system able to be very quickly rehabilitated and made to work satisfactorily
- Behaviour of the five branches of the public sector has changed greatly…
- … but this is not to say they all now put the interests of the general public first
The Soeharto Legacy

• **Military/police** no longer see their principal role as protecting the regime from its opponents

• But military not in good shape to protect Indonesia against external threat

• And police do a rather poor job of maintaining law and order
The Soeharto Legacy

• **Legislature** now contains many more political parties, and no longer does the bidding of the government.

• But no shortage of scandals involving members of parliament accepting/demanding bribes in return for their votes.
The Soeharto Legacy

- **Judiciary** no longer sees its main purpose as protecting the regime from legal attack by its opponents
- But ‘justice’ is still on sale to the highest bidder, and limited competence results in poor decisions even when bribery is not involved
The Soeharto Legacy

• **Bureaucracy** now far less monolithic than previously
• Many ministers are drawn from a coalition of political parties, each with their own separate agendas
• But key legacy is a system of recruitment, promotion and remuneration that fails to find and utilise the best available people
The Soeharto Legacy

• Reform of state owned enterprises still a work in progress
• Appears to be considerably less scope now for using the SOEs as cash cows
• But much remains to be done to raise efficiency to levels comparable to private sector
Policy Making under Democracy

• Quality of economic policy making has suffered with transition to democracy
• Because sometimes the best policies are unpopular
• Soeharto could ignore this, given his political monopoly
• But SBY cannot take—or is unwilling to risk taking—unpopular policy decisions, as he has no such monopoly
E.g. 1: Labour market regulation

- High minimum wages worsen, rather than reduce, poverty
  - Not profitable to employ low-skill workers in formal sector
  - They are forced into the informal sector, where they push down wages even further (since regulations can’t be enforced here)

- Similar argument for large severance pay requirements
E.g. 2: Fuel subsidies

- Soeharto saw the OPEC oil boom as a blessing
- Used huge increases in oil revenues for investments in infrastructure, education and health, with lasting benefits
- SBY sees current oil price boom as a curse
- Tens of billions of dollars being frittered away in subsidies of no lasting benefit
But Indonesia is doing quite well...

• Growth rate of 6%+ has been sustained for some time
• Not quite as good as Soeharto era 7%+, but still not bad
• Casual observation suggests that the economy is well and truly on the move