J.A.C. Mackie

The 1941–1965 Period as an Interlude in the Making of a National Economy: How should we interpret it?

Abstract

The 1941–1965 period is a transitional phase in the long-term formation of the Indonesian national economy. In fact, that phase could be dated from the collapse of the colonial economy in the 1930s depression, which was more disruptive in Indonesia than elsewhere in Southeast Asia. Next, the Dutch-Indonesian conflict (1945–1962) led to a basically downward trajectory of economic change on a fluctuating curve, with the years 1957/58 as a major watershed. War damage was great, direct foreign investment came to a standstill and the multiple exchange rate had a malign impact.

1. Introduction

I want to start with a very broad schematization of the patterns of economic integration and development observable throughout the Indonesian archipelago in the course of its gradual transformation over the last two hundred years (or more) from an earlier set of essentially local economic units towards the kind of unified national economy it is today.[1] I will then raise some questions about the implications attaching to whatever periodization is chosen.

We see two formative periods of relatively fast growth and heavy capital investment occurring, first, during the half century or so before World War II and again since 1966/67, separated by an intermediate phase of chaos and deterioration between 1942 and 1966–7. It is tempting to dismiss the latter phase as little more than a brief interlude between the other two, or even as an aberration from the long-term trend over the last century. Instead of becoming more closely integrated and developed during that intermediate period, the Indonesian economy became

[1] I wrote this paper before reading Howard Dick's conference paper which warns us against over-estimating the degree of economic integration that had been achieved prior to 1941. He is probably right about that, so I must stress that I am more concerned here with the processes of productive investment and development occurring at that time than with commercial and financial integration a such.

more autarchic and drifted more dangerously towards political and economic disintegration between 1957 and 1965/66 than at any other time this century, first in the regional crisis of 1957/58, again in 1965/66. On both occasions the problems that arose owed a great deal to the maldistribution of export earnings between Java and the Outer Islands, created by the overvaluation of the rupiah and the disastrous effects of the multiple exchange rate system applying throughout that period. The country also suffered serious disinvestment and sharp falls in per capita incomes and consumption in the quarter of a century after Pearl Harbour. The reversal of those trends since 1967, associated with a resumption of rapid economic growth spurred by new investment on an unprecedented scale (state and private, foreign and domestic), has so much in common with the pattern of development observable between 1870–1941 that terms like interlude or aberration seem quite appropriate for the intermediate period. But was it really quite as simple as that?

Any periodization of Indonesia's economic history over that longer time-span would have to treat the interlude of stagnation (or worse) between 1941 and 1967 as a major break with the past, a radical disjunction, or change of economic trajectory–as also, I suggest, the decade of depression and disruption to earlier patterns of investment and international trade during the 1930s, which really marked the beginning of the collapse of the Dutch colonial economy. On the other hand, this entire period was also a time of new beginnings, or at least of a search for a new basis for the postcolonial economy, much of it disastrously misguided, no doubt, but not all. There has been a good deal more continuity also between the ideas, policies and institutions adopted between 1945–65 and since than the notion of an 'aberration' suggests; so we should not overstress the 1965–6 turning-point too much. My aim in this paper is to consider, therefore, what significance we might attach to those landmarks, and the ways in which this period should best be visualized. It will be an interpretive and impressionistic essay, essentially, in line with a suggestion made by the conference organizers, without the usual panoply of supporting statistics, references or stories to illustrate my points.

The break with the past in those middle decades of the century was a far more abrupt and disruptive process in the former Netherlands Indies than anything of the kind that happened in either Malaysia-Singapore, the Philippines or Thailand, although all four regions suffered essentially the same sequence of severe disturbances from the depression of the 1930s, the Japanese occupation and the later socio-economic disruptions associated with the decolonization process precipitated by the Japanese overthrow of the colonial empires (apart from Thailand where neither the Japanese occupation nor the collapse of Western investment was as serious as elsewhere). For example, in Malaya-Singapore a considerable degree of basic continuity prevailed on the economic side throughout those years, despite the events of 1941–1945 and the political turmoil associated with The Emergency between the late 1940s and the defeat of the communist insurgency in 1960. The economic patterns, structures and institutions prevailing there in the 1950s and 1960s were not radically different from those of the 1920s and 1930s, as those in Indonesia were (although greater changes were to occur in Malaysia twenty years later which could be interpreted as the aftershocks of the decolonization process).

Even the Philippines experienced nothing like the sharp disjunction between its pre-war and post-colonial patterns of economic life that Indonesia did, despite its controversial relationship with the United States and its sugar market in the eyes of strong nationalists. Yet the severe damage and hardships caused by the war and Japanese military occupation of the Philippines was far more disruptive than elsewhere in the region. In Thailand, which had not been a colony (and subject to neo-colonial subordination to the British only in a mild degree), neither the depression of the 1930s nor the Japanese occupation caused as much disruption or hardship as elsewhere. In fact, the country actually experienced quite a high degree of continuity of economic and political change between the 1930s and the 1950s. Burma and the French colonies of Indochina will be left out of account here as too complex and different to be easily compared with the experiences of the present-day ASEAN countries. The disruptions they suffered then were probably as bad as Indonesia's or worse, but too different to permit summary comparisons.

In Indonesia, however, the impact of the events of the 1930s and 1940s was extremely traumatic, and the aftershocks continued to be felt throughout the first twenty years of independence, right through to the great upheaval of 1965/66. The depression of the 1930s not only caused immense hardship, but also did great structural damage to the sugar industry. The severity of the depression in Indonesia was aggravated by the Dutch hard-currency policy of clinging to the gold standard until 1936 and imposing the costs of financial adjustment upon 'the natives' in a grossly regressive manner, thereby aggravating the severely deflationary effects of the collapse of exports, government revenues and expenditures, which impacted adversely on real incomes generally and purchasing-power. Since sugar had previously been the resource basis for Java's development over the previous sixty years, that damage, later compounded by the physical destruction of many sugar mills during the war and revolution, undermined any possibility that the development trajectory being pursued on Java in the period 1870–1930 could be restored to its former high levels of productivity and profitability for the Dutch, although it took until well into the 1950s before the full implications of the industry's contraction became clear.

The collapse of sugar exports made Java, in due course, far more dependent on the foreign exchange earnings of the Outer Islands than it had ever been before, a major structural shift which was to become a source of profound political and economic instability during the period 1941–1965, as we shall see. More generally, the collapse of international trade and of the production of cash crops during the 1930s and 1940s seems to have had a more drastic impact on the Dutch colony than it did elsewhere in Southeast Asia. It resulted in the complete cessation of the investment flows which had fuelled the colony's expansion over the previous fifty or sixty years, with very severe socio-economic consequences, far longer and worse than a comparable effect in Malaya.

But the greatest force creating a basic disjunction between the colonial-era pattern of economic life and the post-independence pattern was, of course, the struggle for independence itself and the antagonism towards Dutch capital, plantation companies, banks and other forms of investment that was generated by it. Hence the strong ideological thrust towards economic nationalism that prevailed amongst nearly all Indonesian political groups after 1945–which ultimately had disastrous economic consequences. The Indonesia-Dutch conflict of 1945–1949, extended through to 1962 by the West Irian dispute, had an impact upon the economic as well as the political history of those years for which there was no parallel in Southeast Asia, except in Indochina, where French obduracy had even more disastrous consequences.

Bastin and Benda made the observation in the 1960s that in those parts of Southeast Asia where independence had to be fought for (Burma, Indonesia Vietnam) the political and socio-economic consequences proved to be highly disruptive, whereas in the colonies where it was conceded peacefully (Malaya-Singapore, the Philippines, Cambodia) nothing like the same social upheavals and intensity of political mobilization occurred (Bastin & Benda, 1968). They did not have the economic history of the region in mind, but their observation is worth remembering as we try to interpret the course of events in Indonesia during those disrupted middle decades of the twentieth century, for the political context cannot be left out of account in any analysis of the economic divagations of that period, particularly the constantly strained relationship between Indonesia and the Netherlands. Behind that crucial factor, however, was a whole series of problems that came to the fore after the collapse of the Dutch colonial empire, which can be formally dated to 1941/42 or 1945 (or 1949), but had begun to surface with the depression of the 1930s and the crumbling of the colonial plantation economy.

From 1870 to 1930, economic policies had been determined primarily (in fact, almost exclusively) in the interests of Dutch capital. In the 1930s, a new approach became necessary, in which the interests of the ordinary people of Indonesia also had to be taken into account even by the Dutch authorities in the crisis circumstances of that decade. In the 1940s, an *Umwertung aller Werte* occurred, which made it inconceivable that anything like a return to the old colonial order could be brought about. The next twenty years was to be a period of constant but vain searching for an alternative basis upon which the colony might be reconstituted. Only after the Suharto regime came to power in 1966 was a new basis for successful development eventually found.

2. The trajectory of economic change, 1930–1966

The collapse of Dutch colonial rule over Indonesia in early 1942, in conjunction with their failure to re-establish control after 1945, was of course a major turning-point in Indonesia's history by any measure. It also ushered in a period of intense economic and social turbulence there over the next quarter of a century, of a kind that no other SE Asian colony suffered (except Vietnam). This period can be regarded either as interlude and aberration, as suggested above, or as a time of experimentation and transition from the colonial, Dutch-dominated economy through an erratic time of troubles towards the New Order phase of recovery and development under Suharto. But it is important to stress that the period was by no means all one of a piece. It must be seen as a series of quite distinct phases, each with its own dynamics, not all of them as misguided or disastrous as the final years of Sukarno's rule turned out to be. The trajectory of economic change throughout these years should be seen as a fluctuating curve, even though the basic trend was downwards, except between 1950 and 1956.

For students of Indonesian economic history, with our minds fixed more on the economic rather than the political variables, the most notable feature of those years was the great disruption of earlier trade patterns (starting in the depression in the 1930s and not remedied until the 1970s), the extensive destruction of property and productive potential during World War II and the struggle for independence, severe hardships for the entire population and a collapse of living standards throughout the decade. One effect was that productive investment dried up almost entirely (in fact, worse, there was serious disinvestment through neglect and destruction of property, infrastructure, and especially sugar mills and other vital productive assets), while numerous unresolved problems on the Dutch plantations contributed to the recurring foreign exchange crises of the 1950–60s, along with almost endemic inflation due to chronic budget deficits and a constantly depreciating, overvalued currency. That led ultimately to an almost complete collapse of economic development in the mid-1960s and the hyper-inflation of 1963–1966. The political variables were obviously very important in all this, but their precise connections with the economic changes of that time are not easy to pin down in a few words.

Some of the economic factors mentioned above can actually be traced back to the depression years of the 1930s, but that is of secondary importance to us here. The major point to be noted is that the Indonesian economy of that period came to differ in a basic structural sense from the system prevailing throughout the first thirty years of the 20th century, when new investment and new crops were opening up the archipelago and generating high growth levels on the basis of a hard currency and low wage levels.

It was not clear for a long time after 1941/42 just what sort of political or economic regime would replace the Dutch colonial empire, for the determined effort they made after 1945 to restore their rule by force delayed any resolution of the political side of the question till the end of the decade. The economic side of it was only temporarily settled at The Hague Conference in December 1949 after bitter wrangling which left a legacy of distrust and continuing disputes, finally culminating in the nationalization of all Dutch assets in 1957/58 and the expulsion of all Dutchmen from Indonesia (apart from a few who had become Indonesian citizens), an outcome that was to have profoundly disruptive effects throughout the following decade, as the economy slid increasingly out of the government's control.

In terms of economic policy, 1957/58 was a watershed almost as important as 1941/42 or 1945 in shaping the trajectory of change over this period, in three respects. One was the basic transfer of ownership and control of the commanding heights of the economy, the plantations, mines, banks, trading houses (the 'Big Five' and others) into the hands of the state, which had an adverse long-term effect on their productivity, efficiency and ability to finance new investment or replanting. Nationalization did not in itself result in an immediate slump in production or even of efficiency on the former Dutch plantations, although a gradual deterioration occurred over next decade (Mackie, 1961/62). It was in these years that Malaysia surged far ahead of Indonesia in the production of rubber and palm oil.

The second was the abrupt change of economic strategy and philosophy in 1958/59 towards Sukarno's 'Guided Economy' and 'Socialism à la Indonesia', with its stress on extensive state regulation of all forms of activity and downgrading of the private (*swasta*) sector to almost pariah status (Mackie, 1967). The effect of this was that the years 1958–1965 were more profoundly disrupted than the previous fifteen years had been, with little prospect of improvement without a basic regime change.

The third was the sharp increase in inflationary pressures due to chronic budget deficits, previously brought under control from time to time in the early fifties, but increasingly uncontrollable by the early 1960s as the government's various intruments of economic regulation atrophied. This culminated in the hyperinflation of 1963–1966, when the annual rate of price increases rose from about 100 per cent in 1962 (due to the military and diplomatic drive to recover West Irian) towards 600 per cent by 1966.

The division between the years before and after 1957/58 needs to be underlined, for there is a tendency to regard the whole period of Sukarno's presidency as one of constant economic disaster attributable primarily to him. He can indeed be blamed for much of what went wrong during his last eight or nine years, but not for the earlier phases when he was little more than a symbolic head of state without executive power (much to his chagrin). In the years 1950–1957, Indonesia achieved a quite impressive recovery and economic growth, despite inflationary pressures (externally induced in 1950/51 and successfully contained in 1952/53), to a point where there was good reason to believe in 1956/57 that the first Five Year Plan about to be undertaken could lay the basis for substantial development on a more diversified basis than previously. But for the political crisis sparked by regional dissidence in 1956–1958 (itself due largely to the adverse effects of the multiple exchange rate system, discussed below, one of the most troublesome features of the trade regime in the 1950s and 1960s), Indonesia might have experienced modest rates of growth of around 5–6 per cent during the following years and then reaped the benefits accruing from oil booms of the late 1960s and after. If any one event might be cited as the point when things began to slide out of control, I would designate the decision by parliament in March 1957 to abolish the legal nexus between the level of the money supply and the country's foreign exchange reserves. Until then, the governments of the early 1950s had been limited in their resort to deficit spending by the legal requirement that the approval of parliament had to be sought if latter figure fell below 20 per cent of the money supply, an action which could well result in the overthrow of the government of the day. It was a powerful and effective constraint upon deficit financing, but after its abolition no such constraint existed except the good sense of a government. If that change had not happened, her political and economic history over the last thirty years might have followed a very different course.

A useful periodization of this entire period, which helps us to see it against the broader sweep of the country's prior development, would be roughly as follows (taking the starting-point back to the beginning of the depression of the 1930s, as the effective end to the colonial trading regime, rather than 1941).

The years 1930–1941 saw the beginning of several trends which continued into the following decades and marked a major break with the past. The collapse of the colony's exports, particularly the sugar industry, which proved almost terminal, but also plantation rubber and other crops in lesser degree, was a structural shift of profound importance, for it compelled the colonial government to reconsider the basis of the country's productive capacity entirely. A marked increase in the extent of government intervention in economic life, reversing the (somewhat) *laissez-faire* tenets of official policy of the previous half-century, was the most noteworthy of these. It was not Sukarno or the nationalists who took the first and most crucial steps in that direction, but the Dutch themselves, for the protection of their own assets (Furnivall, 1944: 428–445). The beginnings of a shift towards manufacturing industry in the crisis conditions of the 1930s was another important new trend–due more to the investment of foreign and Chinese capital than Dutch, as it happened, but a pointer to the shape of things to come.

In the 1940s, the war years and the struggle for independence proved to be a very different phase when severe destruction and disruption of trade patterns occurred, along with acute shortages and price inflation. But the effect of all that was to push the Indonesian economy further towards a point of no return to the kinds of arrangement prevailing before 1930. Clearly, new directions would have to be found after independence, not only because of the political changes that had intervened, but also for basic economic reasons. The Dutch might cling to their plantations and the rest, but the incentive to make new investments was undermined quite fundamentally.

In the next phase, 1950–1957, Indonesia experienced something like a return to normalcy and steady growth, although it was widely felt to be inadequate to bring the good things that had been expected of *merdeka* by the people. Inflation became a serious problem under one goverment, in 1953–1955, but was then curbed remarkably over the next year or so. Food production recovered towards pre-war levels by 1954/55 and the economy looked promising for a time, although it still seemed to be plagued by the balance of payments problem, the currency black market and regional discontent, which seemed inextricably tangled. It was the regional crisis of 1957/58 that triggered the onset of serious inflation again and the overthrow of the parliamentary system which gave way in 1958/59 to Sukarno's proclamation of the 'return to the 1945 Constitution' and 'Guided Democracy', under his direct leadership. That ushered in a new and increasingly erratic phase of economic policy.

The years 1957–1963 can now be seen, with the advantage of hindsight, as the beginning of a slide towards worsening inflation and currency depreciation which accompanied the shift towards President Sukarno's system of 'Guided Democracy' and a strongly statist 'Guided Economy' in 1959. It did not seem quite as disastrous and gloomy at the time, however, despite the nationalization of Dutch assets and the disruption that inevitably followed, which was not as catastrophic as many had predicted. It was still possible to hope that if strong government could be established and budgetary stability achieved, the inflation might be brought under control, the external value of the currency stabilized and the economy might at last regain strength. That seemed to be happening briefly in 1960–1962, under the heavy-handed impact of the 'currency purge' (a 50 per cent cut in the value of money) of August 1959, shortly after Sukarno decreed the return to the 1945 Constitution. This caused such a drastic liquidity shortage that prices remained relatively stable until the end of 1961, the currency hardened and the balance of payments began to improve. But the incipient recovery was disrupted by a severe rice crisis at the end of 1961, followed by an explosion in the money supply in 1962 due to military expenditures on the West Irian campaign in its final spasm. Inflation rocketed again to an unprecedented annual rate of about 100 per cent. An attempt at stabilization was undertaken in mid-1963, broached soon after the ending of the West Irian problem, with financial backing from the United States and the International Monetary Fund, but that too was soon wrecked on the political rocks of the *Konfrontasi* campaign against Malaysia just at a point when it seemed to be reducing the rate of inflation to managable levels. The effects of that adventure proved disastrous, for the economy began to slide out of control inexorably over the next two years, as the main advocates of economic sanity and restraint found themselves isolated by the steady shift to the left that followed.

The years 1964 and 1965 were marked by hyperinflation that spiralled far above the 1962 rate of 100 per cent towards a rate of over 600 per cent by 1965/66. It is a period about which little need be said here, except that it was radically different from the earlier phases of inflation in that there were now virtually no constraining factors at work to curb the inflation, as previously, which might have been politically feasible. Only a radical change of regime of the kind that occurred in 1965/66 could hold out any prospect of improvement. Politics overrode economic factors as the basic dynamic behind the crisis of this period.

3. The basic contrast: monetary policy and the trade regime

Nothing reveals the contrast between the efficient, low-cost colonial economy and the erratic, crisis-dominated economic systems prevailing in the period 1945–1966 better than the story of the currency and the foreign trade regime over those two decades. (I will not say much here about the years 1942–1945, beyond noting that inflation was a constant problem even then.) The colonial economy had been characterized by high productivity levels, a hard currency tied to the Dutch guilder, key policy decisions made in The Hague mainly in the interests of the Dutch-dominated plantation sector and a strong local administrative machinery capable of promptly implementing the orders of the colonial authorities. The governments of the post-independence period created almost the reverse of that until the Suharto regime emerged–almost constant inflation, chronic depreciation of the currency and a deleterious currency black market, acute shortages of essential goods and crippling foreign exchange constraints which limited the government's freedom of manouvre in economic policy-making (Glassburner, 1971). It all reflected the political shift to a system of government that was unsure of the directions it intended to follow and almost incapable of making the hard decisions needed to pursue them (or of maintaining them when it did).

4. The foreign investment aspect

The almost complete cessation of direct foreign investment (DFI) after 1941 (in fact, ever since 1930, with a few minor exceptions)–and of private domestic investment also, to a lesser degree–was a crucial factor in the economic stagnation of the 'interlude' decades. The contrast with the previous fifty or so years is striking. Apart from oil (which has always been a special case in Indonesia), almost no new DFI went into any major industries during this 'interlude', and even replanting of tree crops occurred only at minimal levels so as to minimize costs.

While the Korea boom of 1950–1952 raised hopes briefly that the situation in the rubber industry, at least, might improve and new planting with high-yielding varieties be stimulated, prices fell too soon for it to have any substantial effect. Dutch-owned rubber and tobacco plantations had little incentive in the 1950s to invest because they faced so many difficulties in labour relations, rising costs, hostile dealings with the bureaucracy and remitting their profits back to the Netherlands (because of the adverse effects upon exporters of the multiple exchange rate system then applying); hence they were more concerned to transfer as much profit as they could out of the country by illegal or legal means than to reinvest in such an unfavourable climate. Widespread disinvestment occurred through the running down of existing equipment and reluctace to replant. At best, the Dutch planters and other big businessmen were adopting a 'wait and see' attitude to the various political struggles of the early 1950s, hoping for a government more sympathetic to them. Instead, the sharp swing to the left that occurred at the end of 1957 led to the nationalization of all Dutch investments in the colony and a mass expulsion of Dutch nationals, after a crisis over West Irian. Under the Sukarno-dominated 'Guided Democracy' and 'Socialism à la Indonesia' that followed soon after (1959–1966), the business climate became so adverse for private capital of all kinds that the remaining British and American companies also came under pressure to pull out (*e.g.* Shell Oil).

Some public investment did occur during this period (*e.g.* Gresik cement, the major project in the 1950s; minor *Bappindo* projects), probably on a larger scale than in the earlier decades of the century, under the impetus of the strongly nationalist and etatist ideology that prevailed. Some small-scale industrial investment in industries such as textiles, glass, paint, matches etc. was also undertaken, but the total volume was quite inadequate to generate much new employment or income, let alone derived investment in downstream or upstream industries. The entire economic philosophy of all post-independence governments was pointing in a direction which gave little incentive to large-scale private investment, either in agriculture (where the emphasis swung strongly towards the promotion of smallholder cultivation of export crops rather than plantation production) or in industry, where the promotion of small industries was seen as a top priority.

Hence, no new crops or industrial products (apart from some textiles and oil) were developed to serve as a new resource basis for a post-colonial pattern of development during the forty years after 1930. The only new or enhanced source of foreign exchange was oil exports, but even that did not increase much in volume or value until the late 1960s, and very little new capital was invested in the industry. Indonesia seemed to be caught in a process very like the 'involution' ascribed by Geertz to the agricultural sector, a turning in on itself as a rising population tried constantly to make do with (relatively) less, hence saving less and investing very little except on government account. Despite all Sukarno's passionate rhetoric, no major new source of income was developed (except in the public service!). The most enduring legacy of his time, however, was the profound suspicion of foreign investment along with an étatist ideology of control over economic life, both of which persisted until well into the New Order period. In both respects, the stagnant middle decades of the century were not just an interlude between two phases of quite dynamic development, but a period of attempted yet unsuccessful new departures in policy and economic ideology.

5. The anomalous status of Dutch capital

Because the large Dutch plantations and other investments (banks, the Koninklijke Paketvaart Maatschappij, 'the Big Five' trading houses, utility companies) remained in Dutch hands until 1957/58 when they were nationalized–*i.e.* throughout most of the period we are considering here–the economic history and significance the 1950s cannot be adequately understood unless their controversial and quite anomalous position in the political system and the policy-making process is appreciated. For whereas the holders of political and economic power had been operating in basic harmony throughout the seventy years before 1941, with the basic interests of the plantation industries and other major Dutch investors always prominently in the minds of the colonial administration in The Hague, Batavia and the *daerah*, particularly among men like Colijn and others who shared his views (an increasingly numerous and influential group by the 1920s), quite the opposite was the case after 1945. The Dutch still wielded control over large economic interests but no longer had much political influence at any level (unlike the British in Malaya for several decades after the war). Plantation interests were lower on the scale of priorities of Indonesian governments and officials in the 1950s than ever before, although never entirely negligible, of course.

Many nationalists were strongly opposed to the economic concessions made to the Dutch at the Round Table Conference in 1949 and some openly advocated the expropriation of Dutch properties, especially the PKI (*Partai Komunis Indonesia*). But the foreign exchange earnings and tax revenues generated by the Dutch estates were too indispensible to the needs of the country to be discarded lightly. In fact, attention had to be paid to their pleas for support in matters like land tenure issues and labour problems, even though that created intense political embarrassments to the governments of the early 1950s, even the more radical of them, such as the first Ali Sastroamidjojo government. Unless the Dutch were to be expropriated root and branch, which was too expensive to contemplate until the crisis of 1957/58, because of the compensation issue, there was little alternative to the policies that were in fact being pursued, apart from minor differences of emphasis. And when Sukarno did finally take the plunge towards the more 'revolutionary' course precipitated by the 'takeovers' of Dutch assets by left-wing elements in 1957/58, the outcome proved quite disastrous, for the country slid into accelerating chaos and disruption between then and 1965/66.

The contrast between the cozy colonial-era relationship between big business and the government and the antagonistic relationships that prevailed almost everywhere between 1945–1966 was of basic importance, in my view, for it was henceforth almost impossible for any Indonesian political leader to advocate any great degree of continuity with previous economic policies of reliance on the big plantations, despite their importance as the major source of foreign exchange. (Hatta came close to doing so, but paid a high price in political terms for his pragmatism.) A radical change of course, away from the colonial economy in all its manifestations, was almost the conventional wisdom of the age, so a lot of time and energy was devoted to speculation about the best sort of 'blueprint' for a new economic development model. The search for alternatives led, unfortunately, towards such wildly unrealistic policies and programs that the country's problems were compounded rather than ameliorated by these efforts to find solutions to its basic problems.

It has been persuasively argued by Schmitt and Glassburner that because of the almost unique pattern of property ownership Indonesia inherited from the Dutch colony there could be no resolution of the economic policy dilemmas facing the various Indonesian governments of the early 1950s until Dutch capital was expropriated (Schmitt, 1962; Glassburner, 1971). I am uncomfortable, when wearing my historian's hat, with all such arguments that rest on an assumption of historical inevitability, although in this case it is hard to reject the logic of the argument. The best counter-argument might be that neither Malaysia, the Philippines nor India found it necessary to take such drastic measures against British capital, with all the chaos and disruption involved, although they all ended up eventually with much the same final outcome.

While the New Order government was strong enough to reverse the previous policy towards foreign capital in general (although rejecting any suggestion of restoring the Dutch assets to their previous owners, for reasons of national pride) and preceeded to create an economic policy regime that had more similarity with the pre-war pattern than it did with that of the Sukarno era, it was able to do so only because the political circumstances were so different. Suharto was lucky, however, that Sukarno had cut the Gordian knot by ejecting Dutch capital (with minimal compensation, as it turned out) and had thus left the Suharto regime with a wider set of policy options open to it than his governments had faced. He was lucky also, perhaps, in the fact that the chaos and disruption that followed the takeovers resulted in such a backlash against Sukarno and his policies that it was relatively easy to change course on the issue of foreign capital.

In that respect, the Sukarno period could be seen as something more than just an aberration between two very similar periods of economic policy. It may have been a necessary phase of policy experimentation and new (albeit disastrously shaky) departures, before the conditions were ripe for the take off that occurred under Suharto. Perhaps it was a phase that Indonesia had to go through, high costs and all, to get to where she now is.

6. Physical damage, disruption and stagnation

The sheer extent of the physical destruction to existing capital and infrastructure that occurred during the Japanese occupation and struggle for independence is another factor that must not be ignored, for it was one of the key factors separating the pre-war economy radically from the post-war one. It was also largely responsible for the stagnation of the immediate postwar years, the sense of malaise and even hopelessness about the status quo (seen widely as an inescapable neo-colonial legacy which had to be transformed fundamentally, not reformed incrementally). Only 55 sugar mills were restored to production in the 1950s, out of nearly 200 in operation prior to 1930. Many had been destroyed or badly damaged in the years 1942–1949, others abandoned by their Dutch owners during the depression of the 1930s. There seemed to be no chance of restoring the industry to its pre-1930 levels of production and high productivity. In fact, productivity levels declined steadily through the 1950s and 1960s in both the fields and the run-down factories, undermining the Java sugar industry's high pre-war reputation as the world's most efficient and technologically advanced sugar producer. In the first International Sugar Agreement of the 1950s, provision was made for Indonesia's then low export quota to be adjusted upwards when her sugar industry regained its former 'historic' status as one of the world's leading producers, something that never happened. Indonesian sugar production was eventually surpassed even by Thailand, which had had virtually no sugar industry in 1950, having previously imported its sugar requirements mainly from Java, an extremely revealing story about the dynamics of economic development in both countries.

Other plantation crops like rubber and tobacco were plagued by land disputes resulting from the 'illegal' use of land for food production or squatter occupation during the 1940s, disputes that were never resolved, largely for political reasons. Land and sea transport also suffered severe deterioration throughout these decades. More seriously, the psychological malaise created by the sense that Indonesia was for that reason caught in a vicious circle of poverty, dire need for new investment, lack of capital and inability to compete on world markets resulted in a paralysis of will which was not overcome until the Suharto government actually began to achieve effective results in the late 1960s. Yet on three occasions before that it appeared briefly possible to believe that the Indonesian economy had turned a corner and was making real progress towards economic stabilization and development, *i.e.* in 1952/53 under the Wilopo cabinet (with Sumitro as Minister of Finance), in 1955/56 (again with Sumitro at the helm initially) and in 1960/61 (under Djuanda). But on each occasion, inflation soon followed and budgetary discipline foundered, for reasons which were all essentially political.

The physical destruction to capital and equipment could and should have been remedied in due course, as it was in the Philippines (where Manila had suffered some of the heaviest damage experienced by any capital city during World War II), or in Japan or Germany, where the need to rebuild from scratch was turned into an economic advantage by the creation of entirely new industrial structures–but only if there had been an institutional and political basis to provide adequate capital, incentives to invest and the will to get the job done. For the reasons well described by Feith in terms of his famous 'administrators versus solidarity-makers' dichotomy, none of those conditions were possible in the political circumstances of the time, until the drastic *bouleversement* that occurred in 1965–6 when Suharto's New Order regime took over (Feith, 1963).

7. The malign effects of the foreign exchange black market

So much stress has been put on the inflation and budget deficits of the postwar years and their adverse effects on the economy in the period we are considering that we tend to ignore the equally malign impact of the multiple exchange rate that prevailed through that time and the endemic foreign currency black market that was created by it. Yet as someone who experienced the daily problems of trying to live in Jakarta in those years without making use of the hard currency black market (something that became became increasingly unrealistic after

1957/58) I remember it as seeming at the time to be as intractable an ailment as inflation. In fact, inflation was brought under at least temporary control from time to time, and in principle could have been easily curbed if the political will to avoid budget deficits had existed (as under the New Order). But the foreign exchange problem then seemed much more deep-seated, curable only by a major increase in the production of export crops (Corden and Mackie, 1962).

It should be remembered that quite apart from the complexities of the multiple exchange rate (MRE), the discrepancy between the official rate of exchange and the daily black market rate of the rupiah against the US $ was rarely less than 300 per cent in the years 1950–1957; it then rose to around 1200 per cent by 1963, after which it spiralled to even more grotesque levels by 1965/66 during the final phase of hyperinflation. Most exporters and nearly all foreign residents involved in overseas transactions of any kind found it increasingly impractical to avoid using the black market for a large part of their transactions, despite the risks of being caught in the act of breaking the law, for which draconian penalties were threatened, although rarely applied. Some embassies, most notably that of the United States, operated an internal 'rupiah pool' at the current black market rate, from and to which their employees bought the rupiah they needed and sold dollars to acquire them, so that they were virtually unaffected by the official MRE system. Others, including the Australian, tried to maintain the principle (at least during my time there) that all official transactions should occur at the official rate–a procedure which resulted in some absurdly impossible outcomes at times.[2]

An economist might argue that the effective depreciation of the currency that was occurring throughout most of this period was an effect rather than a cause of the country's problems, that it was excessive demand in relation to the economy's productive capacity that was the basic problem, with budget deficits the main source of that ailment. While there is much truth in that, it could also be argued that the MRE system also became a contributory factor in the inflationary spiral as time passed by grossly distorting the distribution of foreign earnings from export commodities to the detriment of the producers while subsidizing consumers (the basic nitty-gritty of the Outer Islands vs, Java argument at that time). The system was deliberately designed to have that effect in 1950/51, when Dutch advisers were mainly responsible for it during the korea boom period when it might have had some rationale; but it was found too convenient a way to generate budget revenues to be abandoned later. Instead, governments became more and more reliant upon it as time passed. The institutional basis of the foreign exchange regime created its own built-in necessity. Even the New Order regime was able to dismantle it only gradually, taking nearly five years before it attained a single unified exchange rate.

[2] In some of the less scrupulous embassies, which must remain nameless, certain individuals became exorbitantly rich by exploiting their diplomatic privileges in conjuction with the enormous black market discrepancies.

8. What verdict on the Old Order: aberrant interlude or new formative phase?

The frame of reference within which we choose to interpret the significance of the thirty five years before the New Order came to power in 1966 will depend, inevitably, on the 'angle of vision' from which we view it, whether it be, as Smail so memorably put it, from 'the poopdeck of a Portugese man-o-war' or the ramparts of the fortress at Malacca. Indonesian nationalists are likely to see the period we are considering very differently from outsiders, political scientists from economic historians, in several respects.

To Indonesians, the political significance of 1945 shines out as the beginning of the new era of independence and the proud nationalist drive to recover control over their country and its economic resources, which they saw as having been taken from them unjustly and oppressively in the colonial era. While the steps taken to do that during the Sukarno period went badly astray because of the political conflicts of the post-revolutionary years and the economic naivety of President Sukarno himself, they are inclined to attribute that failure mainly to the faulty execution of the new government's policies rather than to the nationalist objectives then being pursued. On that view, the New Order represented not so much a radical change of course as a salutory corrective to the economic policies of the Dutch. The major change of Indonesia's historical trajectory in the mid-century is seen as having occurred in the 1940s with the overthrow of Dutch rule rather than in 1966 when the New Order came to power and reversed Sukarno's economic policies.

Western economic historians who want to demonstrate their even-handedness will be more inclined to trace both the continuities and the shifts in the development trajectory followed by the Dutch colonial government and the various Indonesian regimes throughout the course of the twentieth century. They will tend to stress the similarities discernible in the processes of economic integration, productive investment and commercial development that occurred during the late colonial regime and in the period since 1966. To them, the years between 1941 and 1966/67 are likely to appear as an unfortunate aberration from the norm of Indonesia's development. As the Old Order fades into historical obscurity as an almost forgotten, poorly documented and not well understood period of economic chaos and political tumult, a horrible object lesson about mistakes to be avoided henceforth, the idea that it should be seen as a deviation is likely to gain adherents. The old nationalist mythology about the heroic new start towards the creation of a better society and state will be based more on myth than historical data, unless it can be much better documented than it has been hitherto.

There is little point in debating which of these two interpretations is the 'correct' one, any more than it makes sense to argue about which of the seven versions of the Rashomon story gave a 'true' rendition of what actually happened. Both have a lot to be said for them–and a lot against. We might usefully discuss which of the two is the better interpretation of the known facts, the stronger case or the weaker, but not the issue of which is right or wrong.

From my own recollections of the 1950s, for what they are worth, I do not recall any sense whatever that we were struggling through an interlude between the past and the future; in fact, very much the opposite. The events of 1945–1950 symbolized new departures from an odious past. We felt we were ingaged in charting an entirely new course into a future that would have little or nothing in common with the *tempo dahulu*. The colonial period was widely regarded in Indonesia, by foreigners as well as Indonesians, as a period of exploitation and oppression of the common people which the newly independent Republic was determined to repudiate as fast and fully as possible. Independence was to be given substance by ensuring that the nation's natural resources were in Indonesian hands (in some way–a matter on which opinions differed widely), to be devoted towards the basic interests of the *rakyat*. It was axiomatic that the future would be radically different from the past, and above all much better.

When it gradually became clear that the policies being applied in the early 1960s towards the achievement of such a goal were proving disastrous, especially in their impact upon the well-being of the people, voices were heard calling for a change of course in economic policy. These came initially from men like Hatta and Sjafruddin Prawiranegara, later from the UI (*Universitas Indonesia*) technocrats like Widjojo, Sadli and Emil Salim, who called for a return to more effective utilization of market forces and the laws of supply and demand, in place of Sukarno's Canute-like attempts to disregard or defy them in his pursuit of an ètatist, collectivist version of 'Socialism à la Indonesia'. But even Sukarno's critics would not have repudiated their basic nationalist principles or sought to turn back the clock towards colonial-era patterns of development. They were able to sell their ideas on economic policy to Suharto in 1966/67 not so much because he was intellectually convinced by the economic doctrines they were propounding, it seems, as because there were no practical alternatives–and because their policies quickly proved amazingly successful.

The lessons learnt from the chaos of the mid-1960s by Widjojo and his colleagues can be regarded as one of the most important legacies of the Old Order period, since they shaped the basic policies pursued under Suharto so profoundly. The determination to curb inflation, keep the money supply under control through adherence to the balanced budget principle maintained throughout most of the New Order period (albeit interpreted on a most unorthodox basis), and to restrain ministerial authority to allow departmental expenditure overruns, which had run rampant prior to 1965, came to be enshrined as the basic principles of fiscal and monetary policy under the New Order, despite periodic lapses in their implementation. Opponents of the technocrats have never accepted the necessity for that sort of financial discipline, but the technocrats were surely right in their belief that it was the failure of Sukarno's governments to adhere to principles of that kind that gave rise to the financial chaos of the mid-1960s. They were able to convince Suharto that it was better to rely on market forces rather than to try to control them as Sukarno had done simply because the excesses of the late Sukarno period highlighted the lessons so strongly.

Another legacy of the Sukarno years points in quite the opposite direction, however. A lot of Sukarnoist ideology of the étatist, anti-capitalist, anti-liberal and economic nationalist kind has lingered in the minds of the older generations of Indonesians, including many influential New Order leaders, even though they mouth the free-market rhetoric of the technocrats (generally without much awareness of the incompatabilities involved). In this respect, the political and ideological *bouleversement* of 1965/66 has proved to be less sharp than the conventional wisdom depicts it. There has been a good deal of continuity of ideas and concepts between the Old Order and the New, which we should not ignore when we are tempted to draw sharp lines to separate one major period of Indonesia's socio-economic development from another. To that extent, there is a case to be made for the 'new start' interpretation rather than the 'interlude' or 'aberration' view of the middle decades of the century (how strong a case may be debatable), no matter how little or much we may agree with that particular Sukarnoist strand of Indonesian political and economic thinking. The fact that many Indonesians still adhere to it (including President Suharto himself on some issues) and admire the nationalism conjured up by Sukarno during the revolution counts strongly against a simplistic adoption of the 'interlude' approach.

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