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# Escaping the Resource Curse: The Case of Indonesia

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**ABSTRACT** Numerous studies have suggested that natural resource abundance is bad for development. In this context, Indonesia's rapid growth during the 1970s and 1980s seems remarkable. Why was Indonesia able to grow strongly and what are the implications of its experience for other resource abundant countries? I argue that its rapid growth was not simply a matter of policy elites making rational economic policy choices, but rather reflected two more fundamental factors: (i) the political victory of counter-revolutionary social forces over radical nationalist and communist social forces in Indonesia during the 1960s; and (ii) the country's strategic Cold War location and proximity to Japan. Accordingly, the main implication of its experience is that improved economic performance in resource abundant countries requires shifts in structures of power and interest and the emergence of external political and economic conditions that provide opportunities for growth.

**KEY WORDS:** Indonesia, resource curse, class, economic policy, geopolitics

Since the mid-1980s, a large number of studies have presented evidence to suggest that natural resource abundance, or at least an abundance of particular natural resources, reduces economic growth and is, in this sense, a curse rather than a blessing. Wheeler (1984), for instance, found that within sub-Saharan Africa, countries that were rich in minerals grew more slowly than those that were not rich in minerals during the 1970s. Similarly, Gelb and Associates (1988) found that mineral economies experienced a more serious deterioration in the efficiency of domestic capital formation during the boom period of 1971 to 1983 than non-mineral economies, leading to negative economic growth in hard mineral economies and dramatically reduced growth in oil exporting economies. Sachs and Warner (1995) examined the experiences of a large and diverse set of natural resource economies between 1970 and 1989 and found that natural resource abundance was negatively correlated with economic growth. Leite and Weidmann (1999) and Gylfason and colleagues (1999) produced similar results also using large datasets. Auty (2001) found that the per capita incomes of resource-poor countries grew at rates two to three times higher than resource abundant countries between 1960 and 1990. Neumayer (2004) examined whether natural resource abundance had a negative

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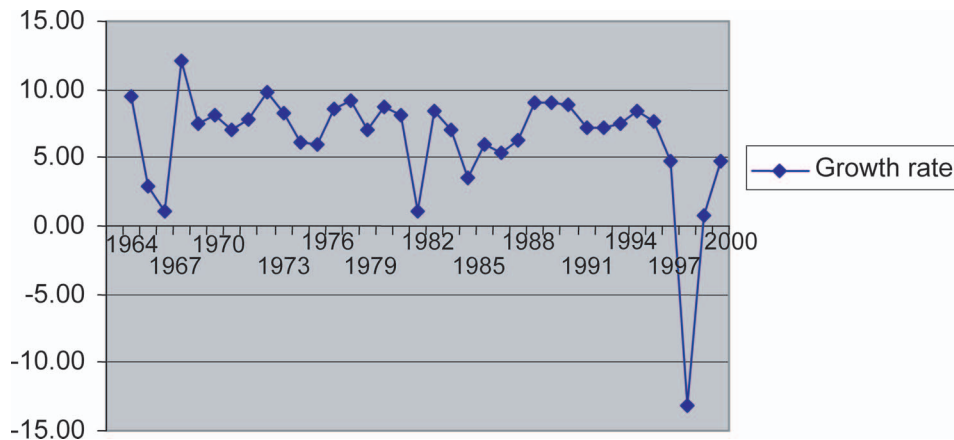
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effect on economic growth if the latter was measured in terms of “genuine income” – that is, GDP minus the depreciation of produced and natural capital – rather than GDP. He found that it did.

There are a number of reasons to treat these findings with caution. Some scholars have suggested that these findings may not be robust to differences in the measurement of natural resource abundance (Stijns, 2001). Others have noted that, while these studies provide evidence that natural resource abundance – or at least an abundance of particular types of natural resources – and poor economic growth are *correlated* with one another, they do not prove that the former *causes* the latter (Schrank, 2004). Finally, some scholars have suggested that the relationship between natural resource abundance and poor growth may be entirely spurious – that is, that their correlation with one another may simply reflect the influence of an unidentified third variable (Ross, 2003). Despite these reasons for caution, however, the overall weight of evidence so far is clearly in favour of the idea that natural resource wealth reduces economic growth.

In this context, Indonesia’s rapid economic growth during the 1970s and 1980s seems remarkable. The oil and gas sector accounted for as much as 80% of the country’s total annual exports and 70% of the central government’s annual revenues during these decades (Rosser, 2002: 42-3). But, despite this massive natural resource wealth, the country’s economy grew strongly during the 1970s and 1980s. As Figure 1 shows, annual real economic growth was more or less consistently in the 6%-10% range each year during the 1970s, except for a couple of years during the mid-1970s. During the 1980s, economic growth was somewhat slower, due mainly to the contracting effects of the two-stage collapse of international oil prices in 1981-82 and 1985-86, but was still strong overall. So strong was Indonesia’s economic growth during the 1970s and 1980s that by the early 1990s, the country had become widely regarded as one of East Asia’s so-called “miracle” economies (World Bank, 1993).

Why did Indonesia manage to overcome the natural resource curse and grow so strongly during the 1970s and 1980s? And what are the implications of Indonesia’s



**Figure 1.** Indonesia – real economic growth, 1965-2000.  
Source: World Bank, *World Development Indicators CD-ROM*

experience for other resource abundant countries? This article addresses these questions.

The answer provided here is that Indonesia's success in overcoming the resource curse was not simply a matter of policy elites making rational economic policy choices but, rather, reflected two more fundamental factors: (i) the political victory of counter-revolutionary social forces over radical populist and communist social forces during the 1960s; and (ii) the country's strategic location during the Cold War and its geographical proximity to Japan. The first factor meant that there was strong pressure on President Suharto and his ministers to promote capitalist development and hence manage the economy well during the 1970s and 1980s. The second meant that the country benefited from economic opportunities not available to most other resource abundant countries and that served to ameliorate certain aspects of the resource curse. Accordingly, it is argued that the main implication of Indonesia's experience is that improved economic performance in resource abundant countries is contingent upon prior shifts in structures of power and interest and the emergence of external political and economic conditions that provide opportunities for rapid growth.

In advancing this argument, I begin by discussing existing approaches to understanding economic outcomes in resource abundant countries and outlining an alternative approach that addresses what I see as the main weaknesses of these approaches. In the following three sections, I then present an explanation of Indonesia's rapid economic growth during the 1970s and 1980s that uses this alternative approach. In the final section of the article, I present in detail the argument above concerning the lessons of Indonesia's experience for other resource abundant countries.

### **Explaining Economic Outcomes in Resource Abundant Countries**

In explaining economic outcomes in resource abundant countries, many scholars, particularly those operating from neoclassical/public choice or behaviouralist perspectives, have focused on the extent to which policy elites in these countries have been guided by economic rationality in their policy-making decisions. Mitra (1994) and Krause (1995), for instance, have argued that one of the main reasons why resource abundant countries have performed less well in economic terms than resource poor countries is that resource booms have often caused policy elites in the former set of countries to become myopic, slothful, and/or over-exuberant (Ross, 1999: 309). Other scholars have suggested that this difference in economic performance has stemmed mainly from the effect of resource booms on policy elites' propensity to engage in rent-seeking behaviour. Ross (2001), for instance, has argued that resource booms in Indonesia and Malaysia during the 1970s created severe economic problems because they encouraged political and bureaucratic elites to either directly seize the rents created by these booms or try to gain control over the right to allocate them rather than invest them productively. Conversely, Prawiro (1998) has explained Indonesia's success in overcoming the resource curse during the 1970s and early 1980s in terms of the strong influence of technocratic ministers over economic policy, particularly macroeconomic and fiscal policy. As he puts it, this period saw the "relinquishing of the extreme, emotion-charged focus on ideology

[of the previous regime] for a more detached, analytical, and flexible approach based on pragmatism” (Prawiro, 1998: 87-8).

A second group of scholars has focused on the link between natural resource wealth and state capacity. They have pointed to the economic problems of so-called “rentier” states – that is, states that receive regular and substantial amounts of “unearned” income in the form of, for instance, taxes on natural resource exports or royalties on natural resource production (Mahdavy, 1970; First, 1974; Skocpol, 1982; Beblawi, 1987; Luciani, 1987; Tanter, 1990; Chaudhry, 1994; Vandewalle, 1998). These states, it is argued, tend to develop greater capacity in distributive functions such as social welfare, education, and health and productive functions than in functions related to the regulation and supervision of the economy and domestic taxation because of the state’s domination of the economy (Garaibeh, 1987; Chaudhry, 1994). This in turn, it is suggested, reduces the potential for economic policy-making geared towards private sector development. In this perspective, resource abundant countries are only likely to achieve sustained rapid economic growth when state formation occurs prior to natural resource domination of the economy. In these cases, it is suggested that state capacity is likely to be less skewed across the different functions mentioned above, in turn facilitating the promotion of private sector development (Karl, 1997; Vandewalle, 1998). For example, Karl (1997) has explained Indonesia’s economic success compared to other “petro-states” such as Nigeria and Venezuela in these terms.

A final group of scholars has focused on the role of social factors in shaping economic outcomes in resource abundant countries. Torvik (2002) has argued that natural resource abundance increases the rewards that social actors can gain from rent-seeking, which in turn provides them with greater incentive to engage in such unproductive behaviour. Others have suggested that natural resource abundance strengthens well-connected business groups or land-owning groups, increasing pressure on governments to pursue economic policies that serve the interests of these groups rather than the common economic interest or the interests of the poor (Urrutia, 1988; Broad, 1995; Mahon, 1992). And another group has suggested that natural resource abundance undermines social cohesion and in turn limits the capacity of governments to manage the politics surrounding economic shocks. In this context, powerful vested interests typically win out, with the result that economic policy reforms are not pursued (Isham et al., 2002: 18-9; see also Rodrik, 1999 and Hausman, 2003).

There are two main problems with the three sets of approaches I have just reviewed. First, none of these approaches adequately addresses the role of social forces in shaping economic policy-making in resource abundant countries. In elite-centred and rentier state approaches, policy elites are assumed to have a high degree of autonomy from domestic social groups because states are financially independent of them. Because domestic social groups do not have to fund the state, it is argued, they tend to make few demands of it. However, as Okruhlik (1999: 309) has argued in relation to oil producing states, this view ignores the broader historical influence of social forces:

Life did not begin, as many imply, in 1973 with the quadrupling of oil prices. Rather, oil enters into an ongoing process of development and into a

constellation of identities. The extent to which social forces were corporate groups before oil has indeed proven important.

The work of Torvik (2002), Isham and others (2002), and the other scholars included in the third group above is better at accounting for the role of social forces in shaping economic outcomes in resource abundant countries. But it is still problematic in certain respects. With one or two exceptions (e.g., Mahon, 1992) this work tells us little about the structural characteristics of societies in resource abundant countries – that is whether, groups are defined primarily in class, ethnic or religious terms and what the relationship between different social elements is. By and large, it is assumed that these societies consist of rational utility maximising individuals who group together only to pursue common economic interests. The specific class, ethnic or religious identities that define societies are ignored.

Yet, there would appear to be considerable variation in the social characteristics of resource abundant countries and the economic outcomes associated with different kinds of societies. Delacroix (1980) has observed that social groups in resource abundant countries tend to be defined largely in ethnic and religious terms rather than class terms because, with access to large amounts of unearned income, governments in these countries have not generally needed to promote capitalist production in order to survive. But, in some resource abundant countries, class is clearly a significant feature of social structures because of historical processes that preceded natural resource domination of the economy. Acemoglu and colleagues (2003), for instance, have argued that Botswana was able to grow rapidly after diamonds came to dominate the economy in part because chiefs and cattle-owners, the dominant class elements, developed an interest in the creation of strong economic institutions and, in particular, strong protection of property rights as a result of their involvement in ranching and other economic activities. Similarly, Schrank (2004) has presented statistical evidence to suggest that the extent to which capitalist social relations exist in resource abundant countries has been an important determinant of their economic performance: countries that have developed capitalist social relations have generally done better in terms of economic growth than those that have not. These analyses suggest not only that social structures differ across resource abundant countries but that these differences can in turn lead to different economic policies and economic outcomes. It is therefore imperative that scholars trying to explain economic performance in resource abundant countries address the character of social structures in these countries and the way that these influence the nature of countries' economic policies and in turn their economic performance.

Second, none of the above approaches examines the way in which countries' external political and economic environments shape economic outcomes in resource abundant countries. Economic outcomes are seen as being solely the product of domestic economic policy choices and the domestic politics underlying them. Yet external political and economic environments have been crucial in shaping the economic opportunities of resource abundant countries. On the one hand, resource abundant countries' respective positions in relation to the geopolitical interests of powerful states such as the US have determined their respective access to foreign aid, technology and lucrative Western markets: countries that have been important in geopolitical terms have generally had better access to foreign aid, technology and

markets than those that have not.<sup>1</sup> On the other hand, resource abundant countries' proximity to rapidly growing manufacturing-based economies has influenced their ability to diversify away from natural resources into manufacturing. Where resource abundant countries are in close proximity to rapidly growing manufacturing economies – as in Southeast Asia – they have generally been better able to attract manufacturing investment from these economies as a result of product cycle dynamics than countries that are further away (Stubbs, 1994; 1999; Beeson, 2001).<sup>2</sup> In short, a country's geopolitical and geo-economic environments are an important mediating factor in the relationship between natural resource wealth and economic performance and deserve greater attention than they currently receive.

Given these points, it is argued here that economic performance in resource abundant countries needs to be understood in terms of two factors. The first is the extent to which propertied social forces achieve political dominance. In countries where the propertied class and its allies achieve political dominance, governments are more likely to pursue economic policies that are conducive to capitalist growth. In countries where other class elements achieve political dominance or where societies are defined primarily in ethnic or religious terms, governments are less likely to pursue such policies. The second factor is the extent to which resource abundant countries' respective external environments provide opportunities for them to attract large flows of foreign aid, gain privileged access to foreign markets, gain access to technology, and attract foreign direct investment, particularly in non-resource sectors. Where external environments provide these opportunities, resource abundant countries are likely to grow relatively strongly.

In accordance with this framework, I argue that Indonesia's success in overcoming the resource curse during the 1970s and 1980s reflected two factors: (i) the political victory of counter-revolutionary social forces over communist and radical populist social forces in the mid-1960s; and (ii) the economic opportunities opened up by the country's geopolitical significance during the Cold War and its geographical proximity to Japan and the "tiger" economies of East Asia. The first of these factors, I argue, laid the political foundations for the Indonesian government to reorient its economic policies away from the radical economic nationalism of the 1950s and early 1960s and towards an economic policy agenda more favourable to capitalist economic development in the 1970s and 1980s. In particular, it laid the foundations for more conservative economic management in the macroeconomic and fiscal realms, greater investment in infrastructure and agricultural development, and the pursuit of an exchange rate policy conducive to the maintenance of international competitiveness in non-oil and gas sectors. The second of these factors opened up economic opportunities for Indonesia that other resource abundant countries did not have. These included the receipt of generous levels of foreign aid, privileged access to lucrative Western export markets, access to important new technology (especially in the agricultural sector), and opportunities to attract large amounts of foreign direct investment in labour-intensive manufacturing industries during the 1980s and 1990s. The combined effect of both of these factors was that Indonesia was able to keep a lid on foreign indebtedness, avoid a serious post-commodity-boom growth collapse, and successfully diversify its economy away from a reliance on natural resources – in short, it avoided the main economic problems associated with the resource curse.

Before developing this argument further, however, it is necessary to discuss in greater detail the contending social forces that have shaped Indonesia's economic policies since independence in 1945 and, in particular, during the periods of parliamentary democracy (1949-59), Guided Democracy (1959-65), and the New Order (1965-99).

### **The Contending Forces**

As noted above, the social forces that have shaped Indonesia's economic policies in the post-independence era fall into two broad groups: counter-revolutionary social forces, on the one side, and radical populist and communist social forces, on the other.

#### *Counter-revolutionary Forces*

On the counter-revolutionary side, the most important social forces that have shaped Indonesia's economic policies in the post-independence period have been foreign capital, Chinese Indonesian capital, and military-bureaucratic capital (Robison, 1978).

*Foreign capital.* Foreign firms – particularly Dutch, American and British firms – gained control over the commanding heights of the Indonesian economy – notably, the country's natural resource sectors – during the colonial period and retained this control during the early post-independence period. Many foreign firms were forced to withdraw from Indonesia during the late 1950s and early 1960s as a result of the country's increasingly radical economic policies. But many of those that left returned following the fall of Sukarno's Guided Democracy and the establishment of Suharto's New Order regime in 1965, this time bringing with them a significant amount of Japanese foreign direct investment. As during the colonial, parliamentary and Guided Democracy periods, foreign investment during the early New Order period was concentrated in the natural resource sectors but it became increasingly focused on inward-looking, large-scale industrial projects during the mid-1970s and early 1980s. During the 1980s, foreign firms from newly industrialised East Asian countries began investing in labour-intensive manufacturing activities, as the country shifted away from import-substituting to export-oriented industrialisation.

*Chinese Indonesian capital.* The ability of Chinese Indonesians to access international Chinese trading networks and their exclusion from the commanding heights of the economy during the colonial period led to many performing a "middleman" role during this period. After independence, given their political weakness, the success of Chinese Indonesian entrepreneurs became a function of the extent to which they developed close relationships with senior army officials. Such relationships meant privileged access to import licences, subsidised state bank credit, and other state facilities. For their part, senior army officers maintained these relationships to enrich themselves and, in light of low government budget allocations for the army, to generate additional resources for army activities. Much Chinese Indonesian capital fled Indonesia during the economic crisis of the early 1960s. But, like foreign capital,

it returned following the establishment of the New Order. Some Chinese Indonesian entrepreneurs, most notably Liem Sioe Liong, were able to establish large business empires during the first decade or so of the New Order period as a result of their good political connections and access to government licences and subsidised credit. (McDonald, 1980; Robison, 1986; Winters, 1996).

*Military-bureaucratic capital.* Senior army officials became increasingly involved in business activities during the 1950s and 1960s, particularly following the nationalisation of foreign assets in the Guided Democracy period. Most nationalised businesses were placed under army control and management. After this, these businesses “virtually became agencies for the allocation of import licences and distributorships to Chinese or foreign importers, who continued in practice to dominate the import sector” (Robison, 1978: 25). The army’s business interests expanded significantly after 1965. On the one hand, the economic role of the state oil company, Pertamina, led by General Ibnu Sutowo, expanded dramatically following the onset of the oil boom in the early to mid-1970s. On the other hand, the army’s control over the state apparatus and its facilities and enterprises made it possible for the army to build a massive private business empire. By the mid-1980s, army-owned private businesses had become involved in a range of sectors including forestry, automobiles, banking, and airlines, construction, plant hire, and hotels and tourism (Robison, 1986: 259-66).

In general, Chinese Indonesian capitalists and military-bureaucratic capitalists have tended to support state-led capitalist development rather than liberal market economic policies because of their relatively strong reliance on access to or control of state facilities and resources. Foreign capitalists, by contrast, have tended to be more supportive of liberal market economic policies, although those involved in inward-looking industrial activities also benefited from state protection and facilities. Whatever the differences between these forces over the merits of the liberal and state-led models of capitalism, however, they have had a *common* interest in strong protection of private property and the maintenance of macroeconomic stability. The latter has meant that they have had a common interest in the adoption of conservative macroeconomic and fiscal policies.

In prosecuting this agenda, these sections of capital were constrained in the immediate post-independence period by the fact that Indonesia’s major political parties supported either radical populist or communist agendas. It was difficult for foreign capitalists and Chinese Indonesian capitalists to organise themselves politically during this period; foreign capitalists for obvious reasons, and Chinese Indonesian capitalists because they were part of a vulnerable minority. In this context, the army became the main political vehicle through which the counter-revolutionary agenda was pursued. With business interests of its own and strong links to Chinese Indonesian capital, it was the only political organisation at the time that constituted the collective interests of counter-revolutionary forces.

#### *Radical Populist and Communist Social Forces*

On the radical populist and communist side, the most important social forces that have shaped Indonesia’s economic policies have been small indigenous capital, the peasantry, and the industrial working class.

*Small indigenous capital.* This section of the capitalist class became locked into small-scale trading and commodity production during the colonial period as a result of foreign economic domination and the Dutch use of Chinese firms as intermediaries. During parliamentary democracy, their role in the economy declined, despite the introduction of various initiatives aimed at promoting greater indigenous economic participation. This decline continued into the Guided Democracy and New Order periods as military bureaucratic capital and then also foreign and Chinese Indonesian capital came to dominate economic activity (Robison, 1978: 18-23; 1986: 36-65).

*The peasantry and industrial working class.* At independence, the vast majority of Indonesians were peasant farmers, living in rural areas and working in subsistence-related agricultural activities. The general failure of governments during the parliamentary democracy and Guided Democracy periods to promote labour-intensive manufacturing activities meant that the peasantry remained by far the largest class. Although an industrial working class existed during these periods, it remained small. It was only with the shift to a labour-intensive export-oriented industrial strategy in the late 1980s and early 1990s that the industrial working class increased significantly in size (Hadiz, 1997: 111).

In contrast to counter-revolutionary social forces, small indigenous capitalists, peasants and industrial workers have tended to support radical forms of state intervention in the economy. Small indigenous capitalists have generally called for greater state intervention to promote indigenous business enterprise and restrict the activities of foreign and ethnic Chinese businesses, a viewpoint that Chalmers and Hadiz (1997) have called “radical populist” (see also Robison, 1978). Peasants and industrial workers, by contrast, have tended to be more concerned about exploitation of workers and peasants than the relative positions of indigenous, foreign and ethnic Chinese capital. During the 1950s and 1960s, a number of labour unions and peasant organisations sought to pursue this agenda through communist-inspired and backed radical programmes of land ownership redistribution and nationalisation of foreign assets.

Radical populist and communist social forces were better represented by political parties after independence than counter-revolutionary social forces. Small indigenous capital, for instance, found significant support from the main non-communist political parties: the Indonesian Nationalist Party (PNI), the Indonesian Socialist Party (PSI), and the large Islamic political parties, Masyumi and Nahdatul Ulama. Prior to 1949, these parties had all committed themselves to broad programmes of economic nationalism and the Islamic parties and the right wing of the PNI were committed to the promotion of private indigenous enterprise in particular (Robison, 1986: 37-8). While this radical populist agenda did not mean that these parties the simple instruments of small indigenous capital, it did mean that they often represented its interests in debates over economic policy. Peasants and industrial workers, by contrast, were represented mainly by the Indonesian Communist Party (PKI). A number of other political parties had links to trade unions and, as Mortimer (1982: 61) has pointed out, the PKI also drew support from sections of the Indonesian elite. Nevertheless, among the major political parties, it was the PKI that was the most active and consistent champion of peasant and industrial worker

interests during the 1950s and 1960s. Hasibuan (cited in Hadiz 1997: 50) has argued that the PKI-linked trade union, SOBSI, was better able to fight for the interests of industrial workers because, in contrast to the other major political parties, the PKI did not have members in positions of control within the state-owned enterprise sector.

### **The Counter-revolutionary Political Victory: Economic Policy Reorientation after 1965**

During the parliamentary democracy period, Indonesia was ruled by a series of coalition governments in which the PNI, the large Islamic parties, and the PSI were, in some combination or other, the main elements (Ricklefs, 1981: 225-44). The PKI was largely excluded from these governments because it had been tainted by its attempt to seize power through a coup at Madiun in 1948 and was, in any case, trying to pursue a markedly different political agenda. At the same time, the army had no official representation in parliament and so no formal role in the policy-making process. The dominance of the non-communist political parties and their broad alignment with small indigenous capitalists thus led to economic policy having a radical populist flavour during this period. A range of policies aimed at promoting private indigenous business enterprise was introduced during this period, the most significant of which was the Benteng initiative, a programme that gave indigenous business groups privileged access to import licences (Robison, 1986: 44-6). However, the failure of this initiative made it clear that small indigenous capital lacked the financial and other resources to replace the colonial economic structure (Robison, 1986: 38). One result was that efforts to promote greater indigenous involvement in the economy came to centre on increasing the role of the state in the economy, most notably through the establishment of state enterprises in key sectors such as banking, trade and manufacturing (Robison, 1978: 23). But the various governments that ruled Indonesia during this period were reluctant to take the more extreme step of nationalising foreign assets on a wide scale. While they wanted to increase indigenous involvement in the economy, they believed that only foreign firms were capable of successfully exploiting the commanding heights of the economy (Robison, 1986: 38).

As the 1950s progressed, however, power and influence gradually shifted away from the non-communist political parties and the social interests they represented and towards the PKI and the army and the social interests that they respectively represented. On the one hand, the non-communist political parties failed to promote national economic development and deliver stable and effective rule. The outbreak of a series of violent regional rebellions in 1957-58 that threatened the unity of the republic provided a clear sign of their weakness. On the other hand, both the PKI and the army strengthened their respective positions during the 1950s. The PKI successfully created a solid base of support among the Javanese peasantry and the industrial working class during the early 1950s and, by the mid-1950s, had become one of the largest and most popular political parties in the country. In the 1955 national parliamentary elections it secured roughly 16% of the vote, putting it in fourth place behind the PNI, Masyumi and Nahdatul Ulama, and giving it substantial representation in the national parliament. In the 1957 provincial council

elections, it did even better, gaining 34% of the vote, a result that made it the most popular party in electoral terms, and gave it significant representation at the provincial level (Ricklefs, 1980: 236-8, 248). For its part, the army strengthened its position by promoting greater internal professionalism and corporate cohesion, building an elite strike force, acquiring with Soviet assistance a sizeable navy and air force, expanding its business interests, and suppressing the regional rebellions (Anderson, 1983: 483).

By the late 1950s, therefore, it was possible for President Sukarno to bring an end to parliamentary democracy and establish the authoritarian Guided Democracy regime. Guided Democracy constituted an ultimately unsuccessful attempt to balance the competing interests of the army and the PKI and the respective social forces that they represented. Initially, Sukarno and the counter-revolutionary forces represented by the army were the dominant elements within Guided Democracy. But over time, radical populist and communist forces became increasingly influential reflecting Sukarno's encouragement of the PKI as a counter-balance to the army. This shift was reflected in the country's economic policies (Legge, 1972: 311-36). In the late 1950s, the government nationalised Dutch assets after PKI-led trade unions took over a large number of Dutch enterprises as a form of retribution for the Dutch government's opposition to Indonesia's attempts to secure control over West Irian. In 1964-65, it nationalised British and American assets as well after the PKI's trade unions launched a new wave of takeovers as part of the government's campaign of "confrontation" against Malaysia. It also permitted the PKI to pursue a land reform agenda, enacting new agrarian laws and allowing the PKI to promote their implementation. Early attempts to implement these laws foundered because of opposition from landholders who dominated the local boards responsible for land reform and who were able to use their positions and close relationships with local government and military officials to prevent redistribution of their lands. In 1963, however, the Indonesian Peasant Front (BTI), a peasants' organisation aligned with the PKI, began encouraging peasants unilaterally to seize and redistribute land, a move that was strongly resisted by landholders and their allies but not prevented by the government (Crouch, 1988: 63-4; Robison, 1993). Finally, with the political climate becoming increasingly anti-imperialist, President Sukarno told Western countries to "go to hell" with their foreign aid.

In the end, it proved impossible for Sukarno to continue juggling the competing interests of the army and the PKI and the respective social forces that they represented. A failed coup attempt in September-October 1965, apparently involving the PKI and sympathetic officers in the army, led to the collapse of Guided Democracy and the establishment of the army-backed New Order under Major-General Suharto.

The rise of the New Order marked the victory of counter-revolutionary social forces over communist and radical populist social forces. Early on in its rule, the New Order outlawed the PKI, jailed and executed many of its leaders, replaced supporters of Sukarno in the military and bureaucracy with military officials loyal to Suharto and his allies, and oversaw and encouraged the murder of perhaps hundreds of thousands of suspected communists. Subsequently, it reorganised the non-communist political parties into two uneasy coalitions and placed such restrictions on them that they were unable to compete successfully in elections with the New

Order's electoral vehicle, Golkar. It also established a series of corporatist organisations to represent social groups including industrial workers, peasants, and small indigenous capitalists. As MacIntyre (1990: 22-59) has explained, these organisations were formally supposed to represent these groups and articulate their interests, but in reality served to prevent them from organising and engaging in autonomous political activity. At the same time, the New Order began working co-operatively with the IMF and other Western donors to stabilise the Indonesian economy and promote its reintegration into the global capitalist system. It also began direct discussions with several large foreign firms over the terms of their re-entry into Indonesia (Winters, 1996: 47-94).

This shift in the structure of power and interest produced an immediate corresponding shift in economic policy. Within a few years of coming to power, the New Order returned many of the foreign assets that had been nationalised during the late 1950s and 1960s to their original owners and brought an end to the PKI's land reform campaign. At the same time, it also introduced new foreign and domestic investment laws that served to facilitate the re-entry of foreign and Chinese Indonesian capital into the country. Finally, it accepted substantial amounts of Western aid. Overall, these changes served to bring an end to the communist-inspired programmes that had featured among Indonesia's economic policies under Guided Democracy and replace them with a programme of capitalist development centred on foreign, Chinese and military-bureaucratic capital (Rosser, 2006: 56-7).

It is in this context that the New Order's successful avoidance of the resource curse needs to be understood. The oil boom period witnessed increased calls from small indigenous capitalists for the government to do more to promote indigenous business enterprise. These calls culminated in the outbreak of widespread rioting in Jakarta in early 1974 in which foreign assets were targeted for destruction. At the same time, the oil boom made it possible for the government to fund the ambitious plans of military-bureaucratic elements, particularly within the state-owned oil firm, Pertamina, for state-led industrial development. The government responded to these pressures by introducing a range of subsidised credit programmes for indigenous entrepreneurs and initiating a programme of industrial development aimed at increasing state control over the economy and creating an autonomous industrial structure. Led by Pertamina, this programme involved new investments in the steel industry, aluminium smelting, high-tech industries such as aviation, and other industrial activities. But despite these moves, the government was careful to ensure that such nationalist and radical populist activities did not disrupt the broader process of capitalist development. When Pertamina's excessive borrowing on international markets threatened to bankrupt the government and derail the development process, President Suharto acted swiftly: Ibnu Sutowo, the head of Pertamina, was dismissed and liberal technocratic ministers were given greater control over the company. At the same time, the government also acted to prevent the onset of the "Dutch disease" – a condition whereby a resource boom leads to appreciation of the real exchange rate and in turn damages the competitiveness of manufacturing and other tradable goods sectors – by devaluing the currency, maintaining tight control over government spending, and investing heavily in agricultural development and infrastructure such as roads, energy, and education (Prawiro, 1998: 104-24). Finally, when oil prices collapsed in the early to mid-1980s,

the New Order shifted away from an import-substitution industrialisation strategy towards an export-oriented industrialisation strategy focused on labour-intensive manufacturing, despite the fact that much military-bureaucratic, foreign and Chinese Indonesian capital was invested in import-substitution industrial activities.

In essence, then, the New Order government's successful avoidance of the resource curse reflected the fact that its social base consisted of counter-revolutionary forces. This situation meant that the New Order was compelled to act in a manner conducive to the interests of capital-in-general, notwithstanding demands from small indigenous capitalists and military-bureaucratic elements for greater promotion of indigenous enterprise and state-led industrial development respectively. This social base did not make it inevitable that President Suharto and his technocratic ministers would succeed in managing the economic challenges created by the oil boom – they could have made mistakes. But it did create a dynamic whereby they were compelled to do enough in this respect to ensure the continued reproduction of capital within Indonesia's borders. To have done otherwise would have been to threaten the survival of the New Order itself.

### **The External Environment and Economic Opportunities**

These internal developments intersected with developments in Indonesia's external circumstances that opened up a range of economic opportunities during the 1970s and 1980s.

The first of these was the intensification of the Cold War in Southeast Asia. The New Order gained power at a time when the Vietnam War was just beginning and there was widespread fear within the US and other Western countries that communism would spread, domino-like, throughout Southeast Asia. As Anderson (1998) has noted, the result of this fear was a series of US initiatives aimed at incorporating Southeast Asian countries within its sphere of influence. Generally, these involved "creat[ing] loyal, capitalistically prosperous, authoritarian anti-Communist regimes – typically, but not invariably, dominated by the military" (Anderson, 1998: 16). The US government had been very concerned about the growing strength and influence of the PKI in Indonesia during the early 1960s and was worried that it might at some point take power (Ricklefs, 1981: 259-69). When the New Order seized power, the US government thus moved quickly, in conjunction with other Western governments and international organisations, to offer it financial support and assist its attempts to consolidate its rule.

The economic benefits of this situation for Indonesia were immense. Driven by a concern to keep Indonesia on-side, Western governments pumped large sums of aid into the country through the Inter-governmental Group on Indonesia (IGGI), a donor forum established in 1966. Although flows of official development assistance and aid never amounted to more than 6% of Indonesia's Gross National Income (Rosser, 2006), they were extremely large compared to aid flows to other developing countries (see Table 1). The Indonesian government also received significant assistance during the late 1960s from the IMF in the form of policy advice during the early New Order years. Over the remaining years of the New Order, IGGI, along with the World Bank and the Asian Development Bank, the ownership structures of which were dominated by the major Western governments, continued to provide

**Table 1.** Top ten recipients of official development assistance and official aid, 1965-90 (in \$US million)

	1965	1970	1975	1980	1985	1990					
India	1,276	India	825	Egypt, Arab Rep.	2,210	India	2,189	Israel	1,978	Egypt, Arab Rep.	5,429
Pakistan	494	<b>Indonesia</b>	465	India	1,582	Syrian Arab Republic	1,698	Egypt, Arab Rep.	1,763	Bangladesh	2,095
Vietnam	313	Vietnam	436	Bangladesh	1,030	Egypt, Arab Rep.	1,382	India	1,591	China	2,037
Brazil	233	Pakistan	421	<b>Indonesia</b>	691	Bangladesh	1,290	Bangladesh	1,129	<b>Indonesia</b>	1,722
Korea, Rep.	218	Korea, Rep.	274	Syrian Arab Republic	678	Jordan	1,275	Sudan	1,128	India	1,406
Turkey	186	Brazil	188	Pakistan	664	Pakistan	1,183	China	939	Israel	1,371
Algeria	144	Turkey	175	Israel	467	Turkey	953	Pakistan	769	Poland	1,321
Congo, Dem. Rep.	139	Egypt, Arab Rep.	172	Jordan	424	<b>Indonesia</b>	944	Morocco	766	Philippines	1,274
Israel	121	Colombia	160	Vietnam	390	Morocco	899	Ethiopia	720	Turkey	1,207
Egypt, Arab Rep.	113	Papua New Guinea	147	Papua New Guinea	305	Israel	892	Syrian Arab Republic	610	Kenya	1,185

*Notes:*

(i) All figures are current dollar amounts.

(ii) In 1965 Indonesia was the 27th and in 1985 the 11th largest recipient of official development assistance and official aid.

*Source:* World Bank, *World Development Indicators* CD-ROM.

generous amounts of aid as well as policy advice. As Table 1 shows, Indonesia remained one of the world's top recipients of official development assistance and aid until the end of the Cold War in the late 1980s and early 1990s. This assistance and aid was particularly important in helping Indonesia deal with the "Dutch disease" during the 1980s when, along with increased FDI, it provided an important alternative source of investment funds to declining oil and gas revenues.

As Western governments re-engaged Indonesia, foreign capital followed. The success of Western governments and multilateral organisations in helping the New Order consolidate its rule and stabilise the economy signalled to foreign investors that Indonesia was now a relatively secure place to invest, contributing to a wave of new foreign investments during the late 1960s and early 1970s, as noted earlier. In 1980, as part of its broader attempts to incorporate the country into its sphere of influence, the US government granted Indonesia privileges under its Generalised System of Preferences (GSP), a mechanism to encourage trade between the US and developing countries. These privileges became particularly important in helping Indonesia shift away from an import-substitution industrialisation strategy towards an export-oriented industrialisation strategy following the collapse of international oil prices in the early to mid-1980s.

The Cold War also opened up opportunities for the New Order in the agricultural sector. As Perkins (1997) has pointed out, the US government's investment in the production of new high-yielding crop varieties reflected concern on its part that the spread of communism would be precipitated by food scarcity and population growth in developing countries. The Rockefeller and Ford Foundations were central to these efforts, running a range of agricultural programmes to fund the development of high-yielding crop varieties. For instance, the two foundations established the International Rice Research Institute (IRRI) in 1960 in the Philippines to produce high-yielding varieties of rice for Asia (International Rice Research Institute, n.d.: 3). IRRI's success in producing these varieties provided an opportunity for the New Order government to achieve something that Indonesian governments had been trying to do since independence: make Indonesia self-sufficient in rice. It was an opportunity the New Order had good reason to take. Achieving rice self-sufficiency would: help the country save scarce foreign exchange by reducing its need to import rice; help the New Order achieve political stability by increasing the chances that affordable supplies of rice reached urban areas; and clearly demonstrate the New Order's ability to promote economic development, something that was particularly important given the developmentalist ideology promoted by the regime. By fuelling the development of a key non-oil and gas-related sector, the New Order's agricultural policies also served to reduce the potential "Dutch disease" effects of the oil boom during the 1970s and 1980s.

The second major development in Indonesia's external circumstances that created economic opportunities for the country during the 1970s and 1980s was that, for various reasons, Japanese and other East Asian businesses involved in resource industries and labour intensive manufacturing began looking for investment sites outside their home countries. In the late 1960s, the Japanese government removed controls on the export of capital in an attempt to promote industrial upgrading, precipitating a large wave of foreign investment into Southeast Asia. In Indonesia's case, a significant chunk of this investment went into natural resource industries,

although there was also substantial investment in manufacturing (Steven, 1988: 44). Another wave of Japanese investment, this time concentrated in labour-intensive manufacturing industries, flowed to Indonesia following the signing of the Plaza Accord in 1985, as Japanese manufacturers sought cheaper bases from which to export to the US. As the currencies of the East Asian NICs – particularly South Korea, Taiwan, and Hong Kong – began to appreciate during the late 1980s and their privileges under the GSP came under threat, large amounts of labour-intensive manufacturing investment also flowed from these countries to Indonesia (Steven, 1988; Beeson, 2001; Rosser, 2002: 128; Stubbs, 1994; 1999). By 1992, as Table 2 shows, Japan accounted for around 31% and the East Asian NICs more than 35% of total cumulative foreign investment in Indonesia since 1967. These flows, particularly those into export-oriented manufacturing activities, were very important for the Indonesian economy following the collapse of international oil prices in the mid-1980s. When oil prices fell, the New Order was forced to attract alternative sources of investment to drive economic growth. This relocated investment from Japan and the NICs provided the required stimulus. Combined with increased aid flows and the trade privileges extended through the GSP, these factors helped Indonesia avoid a decline in the non-resource tradable sectors.

### Implications

What, then, are the implications of Indonesia's experience for other resource abundant countries?

First, the Indonesian experience suggests that the political victory of social forces that promote and develop capitalist economic relations is an important prerequisite for overcoming the resource curse. As we have seen, it was only once Indonesia's revolutionary social forces had been defeated that the Indonesian government began pursuing broadly pro-capitalist economic policies and, in particular, the conservative macroeconomic, fiscal and industrial policies that enabled it to cope with the oil boom. Prior to that time, the influence of radical populist and communist social forces had made pro-capitalist economic management politically impossible. In this

**Table 2.** Major foreign investors, 1980 and 1992

Country	1980	1992
Japan	44.4	31.8
East Asian NICs	16.2	35.2
Australia	3.1	3.1
Other Western Pacific	6.9	1.5
Europe	17.1	21.7
USA	10.5	4.8
Other	1.8	1.8
Total	100	100

*Note:* Percentage of cumulative total of approved investments, excluding oil, gas and financial services from 1967.

*Source:* Hill (1996: 90).

sense, this study confirms Schrank's (2004) findings and suggests that the findings by Acemoglu and colleagues (2003) concerning the role of propertied elements in Botswana extend to other successful resource abundant countries.

None of this is to argue that the New Order's particular model of capitalist development is the only one conducive to overcoming the resource curse. And it certainly is not to argue that resource abundant countries have to experience a violent transition to counter-revolutionary political dominance, as Indonesia did in the mid-1960s, to overcome the resource curse. But it is to argue that governments in resource abundant countries are unlikely to overcome the resource curse unless their political and social environments are conducive to the introduction of pro-capitalist economic policies and conservative macroeconomic, fiscal and industrial policies in particular. Put differently, there are structural prerequisites to successful management of resource booms and avoidance of the resource curse.

Second, the Indonesian experience suggests that the nature of countries' external environments is also an important determinant of economic outcomes in resource abundant countries. While the government's adoption of conservative macroeconomic policies, its investment of resource windfalls in infrastructural and agricultural development, and its reorientation of the country's industrial strategy were probably necessary for success in overcoming the resource curse, it is not clear that they were sufficient. The positive effect of these economic policies was greatly enhanced by the fact that Indonesia had privileged access to foreign aid, markets and technology and was located in a region that offered opportunities to attract investment in labour intensive manufacturing industries. These were all functions of Indonesia's location in the global political economy.

Finally, the Indonesian experience suggests that the resource curse is likely to remain a serious development problem for some time to come. The fact that some resource abundant developing countries such as Indonesia have achieved rapid economic growth suggests that, as Auty (1994: 24) has pointed out, the resource curse is less an iron law than a strong tendency that can be overcome given the right political, social and economic conditions. Nevertheless, the analysis here suggests that the conditions that enabled Indonesia to overcome the resource curse will be difficult to replicate. On the one hand, the political victory of capitalist social forces is something that is unlikely in most resource abundant developing countries, given that in most of these countries the main political and social groupings are principally defined in ethnic, religious, family or tribal terms (Delacroix, 1980; Okruhlik, 1999; Schrank, 2004). For capitalist social forces to achieve political power in these countries would require their complete social and political transformation. The old primordial identities and divisions would have to fade away and new class-based identities and divisions emerge in their place. And, as in Indonesia, the class-based political and social struggle that resulted would have to end in political victory for the counter-revolutionary side. It is difficult to imagine either of these things happening in most resource abundant developing countries at any point in the near future.

On the other hand, the current global political economy does not seem to offer the same opportunities to other resource rich developing countries as it did to Indonesia. The end of the Cold War has eliminated the strategic imperative that led the US and other Western governments to provide Indonesia with privileged access to foreign

aid, markets, and technology. In so far as continuation of the Cold War may have led to similar opportunities for other resource abundant developing countries, its end increases the likelihood that these countries will continue to suffer from resource curse. It is possible that the West's current "war on terror" may generate new economic opportunities for oil rich developing countries, as the US and other Western countries seek to cultivate stronger relationships with oil rich countries outside the Middle East. Volman (2003) and Booker and Minter (2003) have pointed out that the US is already trying to develop closer relations with Nigeria and a few other sub-Saharan Africa countries through increased military assistance aimed at guaranteeing continued oil production and exports.<sup>3</sup> The developed countries' expressed commitment to achieving the UN's Millennium Development Goals may also generate new economic opportunities for resource-rich developing countries in Africa and elsewhere, especially if it leads to increased aid flows to these countries and better access for them to Western European and North American agricultural markets.<sup>4</sup> But whether these things will occur remains to be seen.

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### Notes

- <sup>1</sup> See, for instance, Maipose and Matsheka's (n.d.) discussion of the role of "good luck" in Botswana's development. See Beeson (2001; 2004) for a similar discussion in relation to Southeast Asia.
- <sup>2</sup> In contrast to this argument, Arrighi (2002) has suggested that natural resource abundance has prevented countries from attracting labour-intensive manufacturing investment and hence diversifying their economies. More specifically, he has suggested that one of the main reasons for East Asia's relative economic success compared to sub-Saharan Africa was the relative abundance of labour vis-à-vis natural resources in the former region. This, he argues, made it a more natural location for labour intensive manufacturing than sub-Saharan Africa. But this overlooks the fact that the East Asian "miracle" economies included a number of resource abundant countries in Southeast Asia, most notably Indonesia and Malaysia. This would suggest that natural resource abundance is not necessarily an obstacle to manufacturing activity and economic diversification.
- <sup>3</sup> Of course, it is possible that such closer relations may simply serve to undermine democracy in these countries as the US insists on strong action against Islamic radicals rather than provide new economic opportunities. Glassman (2005) and Beeson (2004) have suggested that this has been precisely the effect of the war on terror in Southeast Asia.
- <sup>4</sup> See White (2005) on the benefits likely to accrue to poor countries from dramatically increased aid.

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