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The Indonesian Paradox**

*Working Papers Series*

**No. 52  
September 2003**



**香港城市大學  
City University  
of Hong Kong**

**The Southeast Asia Research Centre (SEARC) of the City University of Hong Kong publishes SEARC Working Papers Series electronically.**

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# NEO-LIBERAL REFORMS AND ILLIBERAL CONSOLIDATIONS: THE INDONESIAN PARADOX<sup>1</sup>

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There are few developing economies where the influence of market-oriented technocrats and international agencies such as the World Bank have been so embedded in the policy process as in Indonesia and where relationships between the government and Western economists have been so close. This embrace began as a newly established Soeharto government found itself confronting a legacy of hyper-inflation, debt and infrastructure collapse in the mid-1960s. Desperate to reverse these disasters and to reactivate investment and aid from the West, the new government began to dismantle many of the old nationalist policies and to impose monetary and fiscal discipline. Western-trained economists soon headed strategic economic ministries and worked closely with US economic advisory teams, drafting new macro-economic policies, negotiating debt rescheduling arrangements with creditor nations and writing legislation that re-opened the door to foreign investment (Thomas and Panglaykim 1973).

A second wave of market reform, more thoroughly influenced by neo-classical economics, followed the dramatic collapse of oil prices in 1982 and 1986. Technocrats were able to push through a series of reforms in trade, banking, finance and to eliminate many state monopolies as Indonesia's state revenues and foreign earnings came under threat. But it was after the economic crisis in 1997/1998 that neo-liberal reformers seized the policy levers in the most decisive way. With its economy and its currency in crisis, its corporate giants paralysed by debt and the Soeharto regime itself unraveling, the Indonesian government was forced to agree to extensive IMF demands for reform. These included more deregulation, dismantling the state owned sector, introducing institutional reforms in banking and public management and, significantly, diluting central state authority.

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<sup>1</sup> Funding supporting some of the research reported here came from a University Grants Commission fund administered by the City University of Hong Kong as a Strategic Research Grant (7001403) and from a 2002-04 Australian Research Council Discovery Grant, 'Changing East Asia's Economic and Political Regimes: What Kind of Markets? What Kind of Politics?' (DP0209838).

However, the transformation of Indonesia into a liberal market economy was ambiguous and uncertain. Deregulation had been selective and the state continued to play a critical role in shaping the market and controlling access to it. Predatory alliances of state and business oligarchies stamped their ascendancy in the economic and political spheres. Neo-liberals attributed this problem to poor policy choices, the partial implementation of market reforms or their incorrect sequencing. More recently, the blame has been laid on poorly developed regulatory institutions, a lack of state capacity, or a civil society with inadequate social capital to support markets.<sup>2</sup> In contrast, we propose that the difficulties of market reform in Indonesia do not originate in technical problems of policy implementation or institutional capacity, although these exist. They are, instead, primarily questions of politics and power. The question, therefore, is how a system of predatory power relations and the ascendancy of politico-business families and corporate conglomerates have survived successive waves of reform and why has crisis not resulted in the political ascendancy of alliances supporting the neo-liberal agenda. Thus, we make three broad propositions.

First, the reform project was continually compromised by conflicting priorities among those interests supposedly broadly supporting the central objectives of the neo-liberal agenda. Because strategic and security interests of the US and other Western governments required a stable and secure political regime in Indonesia, financial and political assistance continued to be delivered to a regime that was blatantly state capitalist through the 1960s and 1970s. This support continued through the 1980s and 1990s to a regime that was now increasingly predatory in its orientation. At the same time, market reform agendas collided with the interests of international corporate groups and banks that were enthusiastic lenders and investors in projects where political influence, guarantees and collusion rather than market mechanisms provided the basis for commercial success. Their willingness to provide loans and equity to Soeharto cronies in the 1980s was critical in consolidating such interests and facilitating a system of economic relationships profoundly opposed to neo-liberal agendas.

Second, while neo-liberal economists believed that progressive macro-economic reforms would, in themselves, be sufficient to transform and undermine rent-seeking interests, private oligarchies controlling the state apparatus and business proved able to hijack them to consolidate and extend their own position. They used market reforms to seize lucrative monopolies formerly vested in the system of state capitalism and its state-owned sector. Third, and following from this point, the political failure of neo-liberalism was not, as neo-liberals and rational choice political economists propose, a failure to ensure the insulation of reformist technocrats from predatory forces. It was, instead, the failure of economic crisis and political decay to generate a politically

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<sup>2</sup> Two sources where the general neo-liberal position is most consistently set out are the World Bank country reports (see, for example, World Bank 1998, 1999), and the *Bulletin of Indonesian Economic Studies*. See also; McLeod and Garnaut, 1998, and Hill, 1996.

cohesive and effective coalition to drive the neo-liberal agenda and to secure its ascendancy over state power.

After an analysis of how market reform agendas were expropriated to support predatory interests in the Soeharto era, we focus on the continuing difficulties of neo-liberal reform agendas even after the economic crisis and the fall of Soeharto. Specifically, we examine two flagship cases. First, the protracted attempts to restructure Indonesia's banking and corporate system and to enforce a resolution of the huge structural debts of powerful politico-business interests. Second, the attempts to shift power to a progressive civil society through policies of political decentralisation and the countervailing efforts by entrenched political interests to reconstitute their power within parliaments and parties, nationally and locally.

### **THE STRANGE RELATIONSHIP: LIBERAL REFORM, AUTHORITARIAN RULE AND PREDATORY POLITICS, 1965-1997**

Coming at the height of the Cold War, the rise of Soeharto in 1966 was welcomed by Western governments. Their enthusiasm was confirmed by the appointment of Western-trained technocrats to key economic Ministries and agencies and by the new regime's willingness to re-open Indonesia to foreign trade and investment. For many Western economists the new government represented nothing less than a victory of economics over politics, of rationality over patrimonialism (Arndt 1967; Glassburner 1971). Although these Western-trained technocrats continued to see an important role for the state in both investment and in planning until well into the 1970s, there quickly emerged a strong antipathy among them to trade and industry policies and a preference for free market agendas. This was not least because state power in the context of these policies had become increasingly the instruments of collusive arrangements between powerful officials and business cronies (Sjahrir 1997: 154). Nevertheless, critics, including those within the student movement and among populists in the small business sector, regarded the new regime as nothing less than a *comprador* alliance that placed Indonesia at the mercy of international corporate interests (Arief and Sasono 1973; Mortimer 1973).

But they were wrong. Soeharto used the relationship with the West formerly eschewed by Soekarno to consolidate and extend the existing system of authoritarian rule and state capitalism, rather than to drive Indonesia towards unfettered market capitalism. Foreign aid and loans boosted the state budget and foreign investment established a surge of export earnings in the oil and resources sector, Indonesia's economy began to recover from the inflation and declining production of the late Soekarno years (Robison 1986: 170-204). However, technocrat influence over economic policy failed to extend much beyond fiscal and monetary policy. Instead, increasing oil revenues were used to finance a revival of the same ambitious nationalist industrial projects of the Soekarno era (Hill 1996: 102, 103; Soehoed 1977; Robison 1986: 131-175). At the same time, technocratic decision-making became a political justification for

authoritarian rule and continued exclusion of popular interests in the political process (Moertopo 1973).

All this appeared threatened when oil prices collapsed in the 1980s. Indonesia's technocrats were then able to force through a series of important reform packages, opening the banking sector to private entry and progressively eroding lucrative import trade monopolies, including some owned by the Soeharto family and their associates. State monopolies in key sectors of the economy, including telecommunications and TV broadcasting, power generation, banking, road building and public works, were also progressively removed (World Bank 1995: 40-42). But these reforms did not herald the long awaited transition to a world of free markets.

Although banking reforms were hailed by neo-liberal economists and policy-makers (McLeod 1994; Cole and Slade 1996), these were poorly regulated and allowed owners to use the banks as cash cows to finance their own business groups in contravention of legal lending limits (MacIntyre 1993; Rosser 2001: 51-84). Although forced out of lucrative import monopolies by trade reforms, many conglomerates found easy refuge in domestic trade cartels and oligopolies, moving, in particular, into public infrastructure projects where they now secured lucrative opportunities in power generation, telecommunications and public infrastructure, sectors formerly the preserve of the state (Schwarz 1999; 128-130, 143-145; Robison and Hadiz 1993). This did not signal the end of state intervention. The state remained intact but now became more instrumentally the mechanism through which monopolies were allocated to powerful private interests and their commercial success guaranteed. Political and economic oligarchy had gained ascendancy over state capitalism.

Thus, powerful Chinese business conglomerates and new politico-business families established huge commercial empires on the basis of credits from state banks, monopolies in trade and large infrastructure projects, contracts for supply, construction and distribution issued, usually without public tender, by key government ministries and agencies like the state oil company, Pertamina and the state electricity company, PLN (Robison 1997). While a burgeoning private sector had emerged, the illusion of reform masked a world where investment decisions continued to be made on the basis of political guarantees and access to rents and where predatory state-business relations determined commercial success.

Economists and policy-makers at the heart of the neo-liberal reform project recognised the problems of predatory behaviour that emerged from the deregulation process (Soesastro 1989). They attributed these in part to inappropriate sequencing of reforms. Yet, the sequencing of reforms was less a product of technical calculation than the possibilities for reform initiatives offered by existing configurations of power (Robison 1997: 35-36; Pincus and Ramli 1998). The essential problem lay in attempting to introduce market reforms into an economy where predatory and statist interests were hegemonic. Thus, for example, attempts by reformist technocrats to constrain borrowing by

conglomerates were brushed aside while several high ranking officials lost their jobs when they protested the large scale plunder of public contracts and licenses (Schwarz 1999: 149-55; Robison 1997: 54, 61).

The paradoxical relationship between predatory capitalism and neo-liberal reform operated at another level as growing deregulation of global financial markets enabled investors and lenders to provide the flood of investment capital and bank loans to projects clearly sustained by little more than political guarantees and favours (Winters 1997; 2000). Able to make huge profits, international business had no interest in calling for fundamental reform to a system of centralised rent-seeking of which they were beneficiaries. When Western and other governments intervened in the auctions of public infrastructure contracts, it was often to ensure that their firms were not excluded in favour of foreign competitors (Schwarz 1999: 145). Even though neo-liberal economists continued to complain about the lack of economic and institutional reform, their belief that this would eventually flow from good macro-economic fundamentals meant that Soeharto remained their best bet. Thus they continued to praise Indonesia's economic performance in general well until the onset of economic crisis in 1997.

## **CRISIS AND THE UNRAVELING OF THE SOEHARTO REGIME**

Soeharto's Indonesia was to be dramatically unravelled by capital flight and panic in the wake of the Asian economic crisis of 1997/98. Heavily reliant on largely unhedged US\$ denominated borrowings from global capital markets, Indonesia's corporate moguls found themselves with little option except to default on their debts as the rupiah plunged between July 1997 and January 1998.<sup>3</sup> A desperate government decided to call in the IMF on 8 October 1997. But IMF intervention failed to calm the panic as many had hoped. Soeharto was left to deal with the conditions imposed by the IMF in return for its US\$43 billion bailout. Between late 1997 and May 1998, he was to play a protracted and duplicitous game with the IMF in an attempt to stall agreements and circumvent the enforcement of reform programs (Robison and Rosser 1998). Unable to control the currency or to contain inflation and corporate collapses, the political regime faced growing dissent on the part of students and other domestic opponents. Most important, it began to fracture from within as its own lieutenants deserted. In May, 1998, Soeharto was forced from office.

Between 1997 and 2000, the Indonesian government was required to sign no less than sixteen Letters of Intent to the IMF outlining its agreement to fulfil various reform programmes (Government of Indonesia 1997, 1998, 1999, 2000). Such agreements struck at key politico-business empires at the heart of the Soeharto regime, requiring the cancellation of large industrial projects and trading cartels. Perhaps the two pivotal IMF demands were those relating to the recapitalisation of Indonesia's banks and the decentralisation of administrative authority. They most clearly implied, not only the political and economic demise

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<sup>3</sup> Initially estimated at US\$54 billion, Indonesia's private sector debt was reassessed at US\$81 billion with over US\$34 billion due for payment in 1998.

of those families and their associates who had presided over the former regime, but also a deeper structural reorganisation of economic and political power.

### **Neo-Liberal Reforms and Predatory Economic and Business Relations and Interests: the role of IBRA**

The economic crisis resulted in a surge in non-performing loans (NPLs) within the domestic banking sector as private business began to default on repayments. Standard and Poor's estimated these NPLs would reach around 85% of total loans by the end of 1999 (*Asian Wall Street Journal, hereafter AWSJ*, 21 July 1999: 1). Thus, one of the IMF's main objectives was the recapitalisation of this moribund banking system and the proper regulation of a sector where widespread neglect of prudential requirements had developed. A banking restructuring agency (IBRA) was established in January 1998 and given substantial powers to close and to take over banks, to seize the assets of debtors and to sell both confiscated assets and debt. Its authority extended beyond the technical problems of restoring a functional banking system to the more fundamental issue of restructuring the very patterns of ownership in the banking sector and to divest some of the most powerful corporate figures of their corporate empires.

By mid-1999, 66 private banks had been closed and a further 12 of the largest banks taken over by the state and recapitalised out of a total of 240 before the crisis (World Bank 1999). Although several well-connected business families, including Liem Sioe Liong and some of the Soeharto children lost their banks, IBRA's swathe through the system left most banks in the hands of their owners and provided generous injections of state capital to several banks whose prospects were dubious. As I Putu Gede Arya Suta (2000), later Head of IBRA, was to observe, Indonesia's private banks remained primarily in the hands of existing owners and recapitalisation proved to be little less than an attempt to, '...reconstruct an obsolete and defective structure. ... instead of rigorously separating ownership of private banks from borrowers, there is an eagerness to return banks to their original owners – as long as they can raise capital to repay government loans.

Perhaps the real significance of the recapitalisation exercise was the power it delivered to IBRA to enforce a major restructuring Indonesia's corporate interests. IBRA's potential leverage came from its newfound position as chief creditor. By 1999, the government had injected approximately US\$87 billion (around 82% of GDP) into recapitalising the banks and purchasing NPLs. IBRA was therefore under pressure to recoup these funds from bank owners and debtors, if necessary, by seizing and selling assets and taking recalcitrant debtors to court. By the end of 2002, however, only 20% of assets pledged to IBRA were actually recouped. The government had not only been forced to carry the main burden of the recapitalisation and to warehouse corporate debt but had failed to significantly make inroads into the patterns of corporate ownership or change entrenched state-business relations.

How, then, did the major corporate interests avoid expropriation and keep their assets, however devalued, largely in their hands? IBRA was always going to face difficulty dealing with bank owners who were also their main borrowers and debtors. Insolvent banks were expendable to these owners whose main interest was to hang onto their larger corporate assets. Their intentions were made clear when they diverted much of the Rp.146trillion (around US\$11 billion) in Bank Indonesia Liquidity Assistance (BLBI) injected by the government to guarantee deposits and meet emergency bank loan commitments. As the Supreme Audit Agency (BPK) and the State Comptroller of Finance and Development (BPKP) reported, almost all of these funds were immediately used for new overseas investments, currency speculation and debt servicing on other companies in the group (*Kontan Online*, 8 February 1999 and 3 July 2000). In other words, the BLBI constituted a sudden cash injection for embattled conglomerates enabling them more effectively to prop up other elements in their business groups and to supplement assets outside the reach of Indonesian authorities.

In the meantime, the main debtors were able to stall debt negotiations with IBRA and foreign creditors. When they were finally forced to the table, it proved difficult to penetrate the opaque financial statements of companies to discover the real value of assets. While Master Settlement and Acquisition Agreements (MSAA) were signed with the main debtors in September of 1998, it soon became clear that these were not what they seemed. For example, to cover a debt of Rp.47.7 trillion, the Salim group surrendered assets of Rp.53 trillion spread across a complex package of 105 companies, making due diligence a nightmare. Subsequent government audits valued the Salim assets at Rp.24 trillion, imposing a loss of around Rp.29 trillion on the government. The same pattern was repeated in asset agreements between the government and other big debtors (*Panji Masyarakat* 19 August 1998: 16-26; *Tempo* 11 June 2000: 130).

In dealing with this problem, the government had few resources to draw on. Perhaps the major advantage enjoyed by the conglomerates was the corruption of Indonesia's judicial institutions where leading business figures walked away from bankruptcy proceedings and criminal charges in the Commercial and Supreme courts in a series of startling acquittals (Lindsey 2000; *Jakarta Post* 11 March 2000: 1 and 13 March 2000: 4). In the end, so few major business figures were prosecuted that both IBRA and foreign creditors soon recognised that debt had to be resolved through negotiation.

At another level, the government's attempts to force restructuring through threat of confiscation and prosecution were softened, partly because of a fear that the urgently needed capital of Indonesia's Chinese corporate groups would remain offshore. Not only did the need to encourage a revival of investment bring pressure for concessionary deals, the growing budget deficit also increased the pressure to drop prosecutions, and compromise on debt restructuring. While negotiated settlements reportedly speeded up the process, the lack of transparency in deals struck with well-connected conglomerates, including the petrochemical giant, Chandra Asri and the industrial conglomerate, Texmaco,

generated widespread criticisms. Widely seen as government bailouts, these deals and the failure to take legal action against many of the business leaders generated suspicions that old relationships between politics and business were being rekindled (*Tempo*, 26 March 2000: 98,99).

The position of IBRA was, perhaps, most significantly damaged by the failure of foreign investors to buy up the assets now in the possession of IBRA. Much store had been placed in such asset sales to break up old conglomerates, impose new regulatory regimes and raise funds for a budget under stress. Foreign investors were frightened by continuing political instability and by continuing opposition to sales from nationalist elements in parliament and by employees of companies involved. Despite successful sales of Bank Central Asia and the automobile company, Astra, only around 20% of pledged assets had been sold by 2002 (Siregar 2001: 296; IMF 2002: 47). Beyond this, most of the pledged assets remained uncertain quantities. Indicating its suspicion of the holding companies appointed to manage unsold assets after 2004, the IMF argued that, '... care will be needed to ensure that the holding companies do not simply become a warehouse for assets that are deemed either too politically contentious or otherwise too difficult to sell' (IMF 2002: 45).

Conglomerates were thus in a strong position both to further forestall debt restructuring and to actually repurchase their own assets at a cut price despite a government ban on repurchase of assets by owners who had not cleared their debts. Controversy surrounded the role of existing owners in the sale of Bank Central Asia and the auto manufacturer, Indomobil and in the restructuring of the petrochemical giant, Chandra Asri (*Tempo* 19 – 25 March 2002; Laksamana. Net, 25 January 2002). Market reformers found themselves in a difficult situation. On the one hand, the IMF, the World Bank and other investors urged the government to negotiate on asset values and to accept lower recovery rates on assets (World Bank 2000: 13). Kick starting investment rather than extracting justice was the main objective. At the same time they were clearly worried that discretionary negotiations over debt and assets sales were undermining transparent governance and transferring huge losses onto the public purse (*AWSJ* 24 May 2000: 1, 7; *JP* 16 July 2000: 104). Such negotiations could not be separated from the resurrection of old faces and the rehabilitation of old power relationships.

The old politico-business families and conglomerates also benefited from the increasingly desperate position of a government intent on rekindling investment and addressing budget problems. The choice had become one of justice or cash. For politicians now facing the reality that parliamentary and electoral politics required huge financial resources, accommodation with embattled conglomerates offered the potential basis for such resources. In the end, the old conglomerates and politico-business families emerged from the tunnel with their business empires substantially intact, having shifted much of the burden of debt onto the state. Money politics soon emerged as the new political lifeline for the old interests and the new framework in which old state-business relations might be re-established.

## **Neo-liberalism, political reform and the reorganisation of entrenched interests**

As we have seen in the introduction to this edition, there is a deep ambivalence towards democracy within neo-liberal thinking. While the mainstream liberal tradition had assumed that markets required the liberation of a self-reliant and progressive middle class from authoritarian rule, many neo-liberals, specifically public choice political economists, feared such transitions would open the doors to predatory forces, constraining economic technocrats in their task of protecting markets from politics (Dorn 1993). For the latter, civil society could be an obstacle to markets. In the case of Indonesia, however, neo-liberals in the World Bank and elsewhere generally welcomed the dramatic shifts towards democratic politics that followed the fall of Soeharto.

The tumultuous events that led ultimately to the re-establishment of free and open elections in 1999 and to the rise of parties and parliaments were the product of domestic political dynamics rather than any policy initiative by the IMF or the World Bank. Nevertheless, these and other agencies had for some time advocated the decentralisation of state authority as a means of breaking up centralised state power and, thus opening the door to market reforms. These agencies, together with USAID and other donor organizations specifically linked administrative decentralisation with the emergence of democracy, good governance and markets (USAID n.d). One of the central themes within the various LOI focused, therefore, on measures to ensure administrative and political decentralisation.

However, the fall of Soeharto in May 1998 and the dismantling of his highly centralised authoritarian regime did not produce a swift and unambiguous transformation towards markets or liberal modes of governance. There are two ways of explaining this apparent disjuncture in the Indonesian case. In the terms of the 'democratic transitions' literature (e.g. O'Donnell and Schmitter 1986), it is argued that democratic transition is set in train when the right combination of elites manage to form pacts able to craft the appropriate institutional frameworks of democratic governance (Van Klinken 1999, Budiman 1999). These institutions themselves create imperatives for political behaviour. Hence, once the institutions are in place, liberal democratic ideals and practises will slowly gain ascendancy as a form of institutional imperative (Liddle 2001). The problem is, in this view, one of time. By contrast, it is suggested here that Indonesia is no longer in a transition at all. The pervasiveness of money politics – and political violence – in post-New Order politics should not be understood as the mere growing pains of a slowly maturing liberal democracy. Instead, they are more fundamentally inherent to the logic power relations that define an illiberal form of democracy already consolidated and entrenched.

This does not mean that momentous changes have not occurred in Indonesia. The most obvious change in Indonesian politics has been the establishment of free and open elections. The parliamentary poll of June 1999 – held during the

brief interregnum of the Habibie Presidency (May 1998-October 1999) – was the first meaningful ones since 1955. At the same time parliament and political parties have become far more significant institutions. Severely constrained during the long New Order, these have now become true vehicles and arenas of political contestation. As discussed below, another significant change is that local elites and institutions, including local parliaments, are emerging as important players in their own right – because central state authority has tended to erode since the New Order's demise. Serious and often brutal contests over power now permeate down to the local level – characterised by the rise of more diffuse power centres – in ways that would have been unimaginable under the highly controlled and regulated politics of the New Order.

But why haven't these shifts in the institutional apparatus of power produced the liberal political and economic results some observers had expected? We suggest that the key to the puzzle lies, not simply in the institutional arrangements that emerged but in the sort of social conflicts and alliances that forged the post-Soeharto political scene. It was soon evident that many of the elements that had been nurtured under the authoritarian New Order could survive within the framework of a new, more democratic, regime, albeit through new and more diffuse alliances and vehicles. In fact it is the reorganisation of the old predatory power relations within a new system of parties, parliaments and elections that has been the central dynamic of politics in the post-Soeharto era.

It was crucial to the post-Soeharto trajectory that *reformasi* did not sweep aside the predatory and illiberal social and political forces nurtured by the New Order. In fact, because of the very hesitancy of *reformasi* (Hadiz 2000), these were allowed to reconstitute themselves within new political vehicles and institutions, and therefore remain ascendant even though they were now more fragmented and disorganised. Second, the legacy of three decades of authoritarianism runs deep, even if its institutional framework has unravelled. Soeharto's New Order had systematically pursued a policy of disorganising civil society, effectively paralysing most independent capacity for self-organisation among groups like the urban middle class and the working class. In such circumstances it is no surprise that when the structures of authoritarian rule finally gave way, it was the interests that had been nurtured by the New Order that were the most well positioned to take advantage of the opening up of political space.

The survival of old interests within the new arenas of power was assisted by two developments. Populist ideologies were deployed effectively by contending new alliances of politico-bureaucratic and business power – usually now expressed as political parties – which typically take the form of the egalitarian symbols of Islamic struggle, or more secular expressions of nationalism. These are utilised to legitimise anti-liberal political and economic agendas, which in the specific context of post-New Order Indonesia, tends to facilitate the persistence of predatory control over public institutions and resources, and the replication of old relationships more strongly at the local level.

A second factor has been the utilisation of new strategies of selective mass mobilisation and political violence through paramilitaries or militia groups, whose memberships frequently intersect with the shadowy world of organised crime (Ryter 1998; Hadiz 2003). The actual power of these groups may vary in different localities, but they basically provide the muscle when elites need to jostle for control over government offices or resources. Thus, if groups like the *Pemuda Pancasila* and the *Ikatan Pemuda Karya* are prominent in North Sumatra – both were state-backed youth/crime organizations during the New Order – the *Banser* militia of former President Abdurrahman Wahid's PKB (National Awakening Party) is prominent in the Islamic heartland of East Java. Organizations like these have grown prominent as the bodyguards of the powerful, wealthy and ambitious, even as the military-proper, which used to play this role, has been pressured to retreat from politics.

The new circumstances described above have a number of important consequences, not the least being that business can no longer just look to powerful centres of politico-bureaucratic power within the predatory departments of state for protection, as it did during the New Order. Business must now ally with parties and parliamentary forces that compete to attain control state institutions, at the national level, and increasingly, the local.

While political decentralisation has taken place, from the Presidency to the parliament, and from Jakarta to the regions, it has hardly liberated those progressive elements of civil society that were so crucial to the expectations of liberals and neo-liberals alike. What is ignored from this viewpoint is that anti-liberal interests incubated under the old regime have been able to hi-jack Indonesia's new democratic institutions, including at the local level. Rather than 'natural' political entities premised on concrete agendas of reform or reaction, the newly liberated political parties, for example, now constitute tactical alliances that are largely concerned with new ways of organising control of and access to the spoils of state power. The major parties are inhabited by many of the same political entrepreneurs and fixers, business and bureaucratic interests, henchmen and enforcers who had been part of the vast network of patronage that was the New Order. For example, the PDI-P (Indonesian Democratic Party for Struggle) of President Megawati Soekarnoputri includes former functionaries of the former state party, Golkar, and retired military officers, while PAN (the National Mandate Party) – the party of one of her chief political rivals, Amien Rais – is dominated by Muslim politicians and activists once courted by the New Order (e.g. Hefner 2000).

### **Decentralisation: The Emergence of Local Politics**

The process of regional decentralisation in Indonesia – promulgated through laws 22 and 25 of 1999 (and enacted in early 2001) – provides a good case through which to examine the hi-jacking of democratic institutions by coalitions of predatory interests. As we have indicated, decentralisation has been a key element in the reform strategy of the IMF following the economic crisis of 1997. This confidence in decentralisation is found too in World Bank policy, which

asserts that decentralised governance would 'alleviate the bottlenecks in decision making that are often caused by central government planning and control of important economic and social activities' and 'help cut complex bureaucratic procedures'. For the World Bank in particular, decentralisation has also been linked to such virtues as innovation and creativity – providing the milieu for local 'experimentation' in effective governance (World Bank n.d.).

It was a process that was to also to a considerable degree based on the liberal assumption that decentralisation would enable a naturally progressive civil society to assert itself over a naturally intrusive state (World Bank 2000b). Equally importantly, the literature on regional decentralisation as produced by international development agencies typically implies that policy makers, if properly insulated from vested interests, can choose and craft the most appropriate form, pace, and sequencing of decentralisation (e.g. World Bank n.d.). In this neo-liberal world-view, just as markets need to be protected from politics so the dysfunctional effects of politics can be excluded from the real technocratic business of decentralisation.

However, the outcomes of regional decentralisation have thus far been very different from those expected by neo-liberals. As we shall see, it has resulted in the disorder and unpredictability that has led to an exodus of mining and resource investors. New demands from regional and provincial governments have posed threats, for example, to financial responsibility and austerity in fiscal management. As was the case in economic reform, decentralisation was to be forged and given its character, not by technocrats insulated from vested interest but within conflicts over power and influence between competing interests. The most important question to ask, therefore, is what sorts of interests are driving and shaping the regional decentralisation process. Only then is it possible to appreciate that the relationship between decentralisation, democracy, good governance, and a strong civil society in Indonesia is far more ambiguous than often suggested by neo-liberals (e.g. World Bank 2000b).

One of the lessons of the Indonesian case is that factors of transparency and accountability, and other associated aspects of 'good governance', are no more inherent within decentralised government than within national levels of government. These were to contradict the interests of forces now ascendant at the local level. Such interests included former bureaucrats and gatekeepers, entrepreneurs at least partly dependent on state projects and contracts, professional politicians with links to the old New Order parties, or activists of such organisations as the HMI (*Himpunan Mahasiswa Islam*), KNPI (*Komite Nasional Pemuda Indonesia*), or GMNI (*Gerakan Mahasiswa Nasionalis Indonesia*), from which the New Order used to recruit apparatchik and political operators. Others include the henchmen of the old regime's informal apparatus of violence – like the *Pemuda Pancasila*. Many of these are intent on securing their position in the scramble to gain ascendancy over state institutions and their resources, as well as to build new, localised systems of patronage and business alliances.

Not surprisingly, at the onset of the decentralisation process, fears were already expressed by some of these local politicians about the emergence of decentralised networks of KKN (the Indonesian acronym for 'corruption, collusion, and nepotism').<sup>4</sup> In the meantime, political newcomers – typically hailing from academia or NGOs – that were often more reformist and disentangled from predatory networks, find themselves constrained in what they are able to achieve. Many have found that they have little option but to latch on to existing coalitions to survive: coalitions with more established sources of money and an apparatus of violence for their own political survival.<sup>5</sup>

The province of North Sumatra – a major centre of manufacturing industry, as well as forestry and agro-industry – provides some good illustrations of how regional decentralisation has yielded unexpected results. Here *preman* (gangsters), typically linked to youth/crime organisations, have emerged as increasingly important political actors. Some of their members even hold local parliamentary seats and some top executive positions in local government. Indeed, the election of the current mayor of the capital city of Medan – a local entrepreneur – took place through a process heavily tainted by accusation of money politics and political intimidation in which *preman* reportedly played a key role (Ryter 2000; Hadiz 2003).<sup>6</sup> Similar cases have been reported in other provinces, such as Yogyakarta and East Java. In essence, what is happening in the regions is the replication *ad infinitum* of the predatory pattern of state-business relations, which under New Order rule, was concentrated in Jakarta, but is now growing rapidly more or less autonomously at the local level.

The stakes that are involved are not uniform across the sprawling Indonesian archipelago. They may be relatively low in such natural resource-poor areas like Nusa Tenggara Barat, but very high for the political entrepreneurs in resource-rich places like the regency of Kutai in East Kalimantan, where oil and forestry revenues make it far wealthier than the vast majority of other localities. Here, tremendous opportunities present themselves by independently replicating at the local level the old centralised relationships between state and capital. For local officials in places like these, breaking free from the shackles of Jakarta makes immense economic and political sense.

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<sup>4</sup> <sup>4</sup> Interview with Khairuddin, head of the Golkar faction in the Yogya parliament, 5 January 2001; Interview with Syukri Fadholi, Head of the PPP faction in the Yogya parliament, now Deputy Mayor of Yogyakarta city, 15 December 2000; Interview with Victor Simamora, member of the North Sumatra provincial parliament for the small Partai Bhineka Tunggal Ika, 3 July 2001, who accused his colleagues of taking bribes in the tendering of projects; Interview with O.K. Azhari, PDI-P member of the Medan municipal parliament, 5 July 2001.

<sup>5</sup> E.g. interview with the late Ryadi Gunawan, then head of the PDI-P faction in the Yogyakarta provincial parliament, 9 December 2000. A noted NGO activist and academic before he entered politics, he found that he had to accept co-existence in the PDI-P with former Golkar operators and moneymen as well as the party *satgas* (militia), which had quickly developed an unsavoury reputation for thuggery. Though Ryadi retained enthusiasm for what he felt he could achieve, he admitted to being only '70 per cent satisfied' with developments in the party.

<sup>6</sup> This was confirmed in personal communication with Martius Latuperisa, Medan parliamentarian and head of the local *Forum Komunikasi Putra Putri Purnawirawan ABRI*, a military-linked 'youth' organization, 17 July 2002.

However, the growing assertiveness of local officials can cause headaches for local business and for foreign investors, presenting an important dilemma for market reformers and fractures within the neo-liberal camp. One source of distress is the penchant of local officials for instituting new levies on businesses as means of producing new sources of local revenue.<sup>7</sup> Compounding the problem is a lack of consensus about what the decentralisation legislation entails in terms of investment procedures. Officials at all levels of governments – central, provincial and local – claim ultimate authority over many kinds of investment activity, thus causing much unpredictability as far as the common practice of bribing officials for licences and the like is concerned.<sup>8</sup> It is instructive that local politicians also proposed the idea that regional administrations should be allowed to borrow money from overseas (Simandjuntak 2003). The idea was quickly quashed by Jakarta, however, no doubt to the relief of neo-liberals in the IMF, who had become increasingly fearful of local financial mismanagement.

All of the above contradicts neo-liberal assumptions that, by placing government more closely within the ambit of civil society, political decentralisation embodies a natural affinity with democracy and good governance and a strong civil society (World Bank 2000b). The Indonesian case demonstrates that democratised and decentralised institutions of governance can be just as readily appropriated and captured by decidedly ‘uncivil’ groups like political gangsters and corrupt alliances formed by elements of a defunct authoritarian regime, including its old bureaucracy (e.g. Malley 2003). This is especially the case in a context in which there is no organised and cohesive liberal political coalition to effectively compete with them, such as in post-Soeharto Indonesia.

## **WHERE IS THE NEO-LIBERAL ALLIANCE?**

We have essentially argued that entrenched power relations are able to consolidate themselves across periods of institutional change. The case of Indonesia shows that interests that were dominant under the New Order may shape the new democracies or economic regimes and preserve and consolidate their authority within them as effectively as they did under centralised authoritarianism. An important part of the story, as mentioned earlier, is the fact that these entrenched interests remained relatively intact despite the devastating shocks of the crisis that were assumed to make reform impossible to resist. Nor were they swept aside by *reformasi*, which was hesitant and

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<sup>7</sup> Interviews, with Yopie Batubara, head of North Sumatera Chamber of Commerce and Industry, and Surya Sampurna, businessman, respectively 8 September 2001 and 6 July 2001.

<sup>8</sup> This was found during fieldwork in North Sumatera. Officials at different levels of government would privilege the role of their respective institutions in ‘facilitating’ investment. Abdul Hafid, the *bupati* (regent) of Deli Serdang – a major manufacturing centre as well as the site of major plantations – was particularly adamant that he had absolute authority to do what he wished with most investment applications. Interview, 7 September 2001. Not surprisingly, this information is contradicted by the Governor of North Sumatera, T. Rizal Nurdin, interview 7 July 2001. The latter, a retired general and New Order appointee, has just been re-elected with the support of the PDIP.

gradual, and more importantly, they were not replaced by a viable neo-liberal coalition. Indeed, the failure of events to produce such a coalition is critical to the story.

Of course, the failure of such a coalition to emerge had to do with the great success the New Order had encountered in controlling and suppressing dissent and independent organization. A rigid state-corporatist system was imposed for three decades whereby all societal organization was compartmentalised into state-backed corporatist institutions (for business, labour, youths, etc.) As the depoliticisation of civil society proceeded, the emerging urban middle class and bourgeoisie also grew increasingly conservative – relatively unscathed by the sort of violent political repression that had taken place in Latin America and basking in their privileged position and prosperity in the New Order (Robison 1996). Thus they were hardly ever a source of serious demands for fundamental reforms. As mentioned earlier, nor were international corporate interests: these were quite happy to co-operate with Soeharto and to engage in profitable business ventures with his cronies.

It is instructive that, today, many foreign business interests have decided to defend the privileges they gained under the old regime rather than play any active part in pressing for political reform.<sup>9</sup> We find an implicit and sometimes explicit nostalgia for the Soeharto regime among international investors – as we do among sections of the Indonesian middle class (*Jakarta Post* 15 May 2002). It is clear, therefore, that such groups have less of an interest in liberal democratic reforms than they do in social order, predictability and the protection of property rights – all of which could be accommodated within a range of political regimes other than a liberal democratic one. Ideally, what they really seek is the sort of regulatory state, or system of authoritarian liberalism described by Jayasuriya (2000); a system that will guarantee the freedoms of the market, at the same time that these are upheld by force – in order to brush aside potential opposition from organised labour, environmental groups, or others that may challenge the social inequalities produced by the free market.

But this regulatory state, like all modes of organising power, requires a social and political base, which as yet does not exist in Indonesia. Neo-liberals within the World Bank and the IMF expected liberal economic reforms to transpire as a matter of course after the shock of a devastating economic crisis. At the same time, some political observers of Indonesia expected a gradual but more or less linear change in the direction of liberal democratic modes of governance, once Soeharto's regime had crumbled and the institutional skeleton of markets and democracy had been put in place. However, rather than being a simple technical problem of institutional design, the Indonesian case has underlined the fact that economic and political reforms of any type needed to be enforced politically and through political struggle. Building markets, constructing

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<sup>9</sup> Thus, foreign energy companies, vigorously supported by governments that had provided billions of dollars through export banks and insurers to support their bids, moved against PLN when it defaulted on payments and sought to cancel contracts after the economic crisis of 1997/1998 (e.g. *FEER* 21 October 1999: 63-64; *AWSJ* 9 March 2000:1).

institutions and institutional capacity or even engineering regime change is not enough without a politically cohesive and effective mode of organization of interest – e.g. in the form of a genuinely effective liberal party with a rule of law or market reform agenda. In the present conjuncture, save for isolated pockets of liberals in a few government ministries and agencies, and some academics and intellectuals, the building blocks for such a vehicle is virtually nowhere to be found.

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