ISBN 0-612-16491-8

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ABSTRACT

INDONESIA'S FOREIGN TRADE IN DEVELOPMENT

This study is intended to explore some potentialities and problems of Indonesia's trade expansion and rapid growth as they relate to its development trajectory. Since the change of regime in 1966, the economy has been transformed by effective economic management and the capability of taking advantage of a favourable international environment. The size of the economy, that is, the real gross domestic product, has expanded by around 500% since 1966. The country has completed its first period of sustained economic growth, which, while it may not have been equivalent to the very high growth rates of the Asian NICs, has been among the best of all developing countries. The stride of socio-economic change is divulged by a few basic statistics. Agricultural production has extensively increased, but structural change in the economy has meant that agriculture's share of GDP has declined from 50% to 19%. Manufactures grew from a negligible proportion of merchandise exports to over 55% in 1993, with most of the expansion occurring during the second half of the 1980s.

Undoubtedly, trade has proceeded rapidly, although in some instances the benefits to welfare of the mass of the people are debatable. While analyzing the nature and prospect of trade in southeast Asia and examining the shifts Indonesia has had to get through since 1966, compared to the Old Order era, the study seeks to reveal all the circumstances that have brought about the changes and to look at how foreign trade has acted as both the expediter and engine of growth. The study also tries to unravel some of the above topics by exploring not only the standard economic argument, but also the element of history and the political economy of the economic reform. In elucidating rapid trade expansion and the striking growth of the economy, this study found that Indonesia is still confronted by the problems of growth with equity. There is strong pressure amidst criticism of the expansion of large business enterprises that a competition policy is also necessary to curb unfair competition. The role of the state as the 'referee' of the game is raised as an issue. While the country, as most southeast Asia countries, has adopted a more outward trade orientation since the mid-1980s in particular, the tendency of prolonging the interventionist policies and reliance on foreign capital in assembly type manufacturing has obstructed efforts to develop an adequate industrial strategy for structural competitiveness.

Halifax, August 15, 1996

Ruslan U. SITEPU

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ACKNOWLEDGEMENTS

I would like to express my deep appreciation to Dr. Henry Veltmeyer, the chairperson of my graduate committee, for his assistance and expertise in completing this thesis. Without his help, I would not have been able to write this graduate work. I exceptionally acknowledge him for his invaluable comments and reviews of the earlier draft of this thesis. My sincere thanks also goes to Dr. James H. Morrison, Coordinator Asian Studies, for giving me some advice and sharing his thoughts with me. Gratitude is due as well to my professor, Dr. Surendra J. Patel, who inspired me with many ideas and perspectives in this subject.

I would also like to extend my grateful to my other graduate committee members, Dr. Gerry Cameron, for his precious time to read the entire draft and offer suggestions regarding language style for which I have had some English problems. My IDS colleague, Arif Fadillah, deserves credit for assisting me in data collecting and saving me much time from computer troubles. Special thanks go to the Directorate General for International Trade of the Ministry of Trade and Industry of the Republic of Indonesia to which I belong for approving me a-thirty one month absence from my routine job for further study at Saint Mary's University. Needless to say my dearest mother, Mrs. T. Sembiring, who always prays for the success of her son and who has always been the grip of my source of strength in the course of the study, in particular since my scholarship was terminated in the middle of this work. Eventually, my deepest debt is to my beloved late father, Mr. Pinlan Sitepu, and all my sisters and brothers for their supports and concerns.

I understand, of course, this study is far from being perfect. Therefore, I am the person who will be solely responsible for any error I made in writing this thesis.

I. INTRODUCTION

A. PROBLEM STATEMENT

During the period of 1948-1965, under Sukarno's administration Indonesia pursued its national development through delinking from the international capitalist system. Self-reliance with national sovereignty and ownership of strategic resources was believed to be essential if economic development was to be internally dynamic and sustainable. However, it was clear that the Old Order regime with its policy failed to increase the output of domestic agricultural and industrial production for the home market, to raise living standards, and to settle the foundation for a new organisation of the economy which would be less dependent upon foreign aid and trade. An inward-looking perspective with import-substitution made virtually no progress in indigenous capitalist development, the production of foodstuffs for domestic consumption declined (rice had to be imported in increasing amounts), infrastructure for the indigeneous material exports remained underdeveloped, and none of the traditional products attained their pre-war export levels (*Taylor*, 1974 : 15). As a result of these failures, average per capita income declined and valuable foreign exchange reserves were spent on food imports, and these losses were aggravated by constant deficits and high rates of inflation.

Political conditions have been seen as responsible for this economic crisis. The fragmentation of political alliance interests to guide and control the state under Sukarno presented a real obstacle to the formulation of the policies necessary for the carrying out of the economic plan. The tension between contending political forces and their interests, objectives and strategies produced a piecemeal and half-hearted attempt to transfer parts of the economy to national ownership (*Robison*, 1986 : 40). Unsurprisingly, the firm ideological commitment to national capitalist development in the private and public sectors was never carried out in practice.

With the collapse of the old order administration, new opportunities opened up, and the whole economic policy framework was changed. The year 1966, when the so-called New Order government took power, marked the beginning of dramatic changes in the country's foreign policy. Indonesia reentered into international division of labour and rejoined the United Nations. That same year, as conflict with Malaysia ended, Indonesia joined Malaysia, the Philippines, Singapore, and Thailand to plan the formation of a new regional grouping, the Association of Southeast Asian Nations (ASEAN), which was then formally established in 1967.

Despite being known as one of the world's poorest nations with a $50 per capita income in the mid-1960s, Indonesia has registered rapid development over the past 25 years. From 1965 to 1990, domestic production increased at an average rate of almost 7% per year, far above the average for low- and middle-income developing countries and comparable to other East Asian economies (*Bhattacharya and Pangestu,* 1993 : 3). This growth performance was maintained and even exceeded over the last 2 years - 7.5 % and little above 8% in 1994 and 1995 respectively, while per capita income reached almost US$ 1000 in 1995. Substantial structural change, led by an oil and commodity boom in the 1970s and more recently by an expansion in manufacturing has taken place. There has been a significant shift into the private sector and a greater effort to relate its domestic economy to the external environment. The role of trade and foreign investment in the economy has played an important part in stimulating growth and development since the New Order administration took charge.

What is more, the economy of most developing countries during the decade of the 1980s was generally considered to be in a state of slump. It clearly was not the case for Indonesia and other ASEAN economies. During 1981-1989, Indonesia's average annual rate of growth of domestic production was 4.3% (*Booth*, 1992 : 1). Although this was not the highest rate of growth among ASEAN countries (Thailand 7.1%, Singapore 6.1%, Malaysia 4.9%, the Philippines 0.7%), it was faster than in many other parts of the developing world. Such a favourable growth rate was quite an achievement in that this took place in a period of reduced primary commodity prices, increasing protectionist regimes in the advanced-industrialized economies and sluggish global economic growth.

There are some plausible reasons that can be given to elucidate this economic performance. First, guided capitalism with its underlying theoretical foundation in both structural and neo-classical economics has flourished in most Asian nations as a predominant development model. An outward-looking market oriented development model coupled with a non-oil export led-growth has been put in use in Indonesia since 1983. Early in the 1980s, non-oil and gas commodities constituted only 20% of export revenues, however, since 1986 this figure has significantly increased to around 60% (*Djiwandono*, 1991 : 75). In the period of 1986-1989, non-oil and gas exports doubled in value from US$6.5 billion to about US$13billion. This indicates that foreign trade has acted as a powerful engine of economic development. Secondly, for the purpose of strengthening the country's competitive position in the global ec[illegible]ly the role of the administration in managing and regulating the economy has gone through the so-called deregulation and debureaucratisation. This does not necessarily mean that the administration does not intervene in economic development, but the government's role is to provide economic infrastructure and an economic climate to bolster an operative and competitive market economy (*Salim,* 1992 : 259).

Eventually, in spite of a recession largely induced by a fall in oil prices, Indonesia has administered a thorough restructuring of the economy. Needless to say, in spite of the success story of Indonesia's economic reform, it would be completely inaccurate to assert that the economy is free of protectionist strategies. The difficulties in dislodging monopoly powers and various forms of non-tariff barriers are point to the failure of efforts to fully reform the economy. On trade and industrial policy in particular, there has been a long-running debate between those favouring a guided industrial strategy and groups advocating a less-interventionist policy. This has led to the strategy pendulum swing back and forth, between periods of engaging more or less in *laissez faire* attitude. Nothwithstanding this reality, the country has gone through a period where major liberal reforms - (1967-1972 and after 1985) - have been implemented with success (*Hill*, 1994 : 66). This of course calls for outstanding competence of development policy makers in identifying sectors where changes can, and can not, positively be pursued. The expansion and decline of interventionist-developmental policies seem to have a direct correlation with the resources availability of the government.

By 1991, the value of manufacturing output exceeded that of agriculture for the first time, indicating that Indonesia had crossed a key starting point in the trajectory to industrialisation. Manufactured exports grew from less than US$ 1 billion in the early 1980s to more than US$ 9 billion in 1990. As a result of a relatively consistent high rates of economic growth and trade, Indonesia, along with other ASEAN-4 (Malaysia, Thailand and the Philippines), is deemed to be in the next generation of the East Asian newly-industrialized countries (NICs). According to World Bank, these East Asian NICs are characterised by :

> stable macroeconomically, have high shares of international trade in GDP, invest heavily in people, and have strong competition among firms. But these characteristics are the outcome of many different policy instruments. And the instruments chosen, especially in the northeast Asia, Japan, Korea, and Taiwan, China, sometimes included extensive government intervention in markets to guide private-sector resource allocation. The success of these northeastern economies, moreover, stands up well to the less interventionist paths taken by Hongkong, Malaysia, and more recently **Indonesia** and Thailand (*World Bank* , 1993 : 10).

Given the status as a more open economy and the desire to persist in its reliance on non-oil exports, the Indonesian economy has gradually been integrated into the regional and international economy, moving from inward-looking into outward-looking trade strategies.

B. RESEARCH QUESTIONS

Like othor Southeast and East Asian nations, Indonesia has implemented more export-oriented Industrialization strategies, while it still maintains an interventionist and protectionist regime to some extent. In particular in 1986, a sharp decline in oil prices forced the government of Indonesia to shift its policy approach to industrialization with a greater emphasis on increased efficiency, competition and export push. As a result, there has been a rapid growth in investment and production, which has contributed to the take off in manufactured exports (mainly labour intensive products). Thus, government policy has meant that Indonesia moved to the traditional labour intensive export led growth path followed by many East and Southeast Asian economies at a much later stage (*Pangestu*, 1993 : 274). However, this economic change has raised some questions as follows :

1). Is it possible for Indonesia and the ASEAN-4 to follow the development paths of East Asian NICs?

2). What benefits can be expected from regionalism in ASEAN, especially in regional trade, not only by Indonesia but also by the ASEAN members as a whole?

3). To what extent does foreign trade, directly or indirectly, affect national economic development?

4). Referring to the core of the economic development objective, namely to advance general welfare, who takes most of the benefits of Indonesian foreign trade development? I address to this question since gains from trade have been unevenly distributed, leading to a growing gap in income per head as well as economic disparities among various regions of Indonesia..

5). What determines the success of economic development, international trade or the government *per se* ?

C. THESIS STATEMENT

Since the so-called New Order government in power adopted economic liberal reforms, Indonesia has experienced the growth of exports of manufactures and the development of the industrial sector, both of which have increased their share of national production. This is to say, there appears to be a strong relationship between trade and growth. As *A. Chowdhury and I. Islam* points out in the case of Indonesia and Costa Rica exports are found to have caused economic growth in the sense that export expansion preceded economic growth (*Chowdhury and Islam*, 1993 : 80). With reference to this assumption, however, I will first argue that in the case of Indonesia, the international trade system, no matter how it works, is not the only determinant of either success or failure of national economic development. The achievement of Indonesia's strong economic performance has been largely determined by both the ability of the administration to control the levers of economic management and the global-reach provided by outward-oriented trade strategy. In other words, 'state' and 'market' are inseparable but reciprocal conditions for economic development. Second, neither structuralist-dependency theory noı neo-classical one does fully fit in examining and elucidating the underlying causes of uneven distribution of gains from Indonesia's foreign trade development.

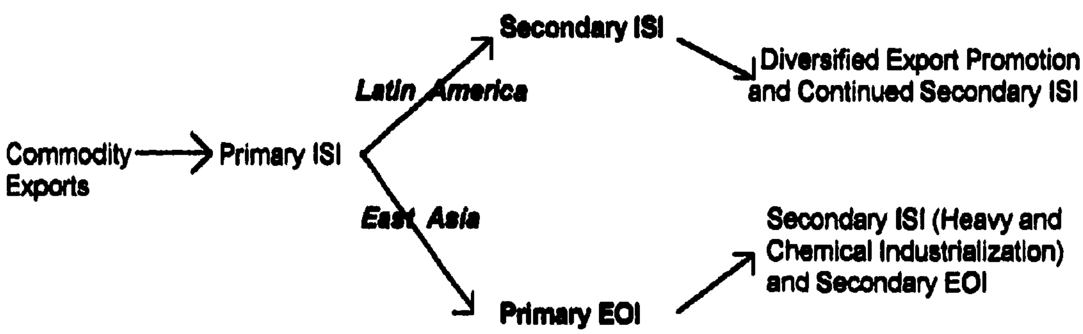
D. METHODOLOGY

1. DEFINITIONS

Before proceeding further, it is necessary here to draw a clear picture of the features of inward and outward-oriented development strategies, which have frequently been used in the literature to contrast Latin American import substitution (ISI) to East Asian export promotion (EOI) development model respectively. This distinction is actually exaggerated and oversimplified. Although it might be relevant to a certain period of time, a historical perspective suggests that each of these NICs has adopted both inward- and outward-oriented approaches, as the model of industrialisation paths of the two regions suggests in the table below.

TABLE 1.1 Trajectories of Industrialisation in Latin America and East Asia : Commonalities, Divergence, and Convergence

Mexico and Brazil 1880-1930	Mexico and Brazil 1930-1955	Mexico : 1955-1970 Brazil : 1955-1968	Mexico : 1970-present Brazil : 1968-present



Taiwan:1895-1945 Korea :1910-1945	Taiwan : 1950-59 S.Korea: 1953-60	Taiwan : 1960-72 S.Korea:1961-72	Taiwan and South Korea 1973-present

Source : Gereffi,Gary, 1990 : 18, *'Paths of Industrialization : An Overview'*, in Gereffi and Wyman (eds.), Manufacturing Miracle.

By the same token, since the world was in stagnation in the early 1980s, a few countries - whether the advanced-industrialised countries or the developing nations of the South - have changed into opposite direction, import substituting countries have become exporters, and export promoting countries have become importers, although some still practise the same old strategy (*Harris*, 1986 : 144). Rather than being mutually exclusive approaches, the import substitution and export orientation development paths in fact seem to have been complementary and interactive.

From a broad historical standpoint of industrialisation in both Latin America and East Asia regions, we can identify five main phases of industrial development. Three of these are outward-looking : a commodity export phase, primary and secondary export-oriented industrialization (EOI). The other two are inward-looking : primary import-substituting industrialization (ISI) and secondary ISI (*G. Gereffi*, 1990 : 17). Throughout this study, EOI will be defined to mean a set of trade and industrial policies which do not discriminate between production for the domestic market and exports, or between the purchases of domestic goods and foreign goods (*Chowdhury and Islam*, 1993 : 44).

Gereffi makes a more detailed distinction of the kinds of products involved in the subtypes within the outward and inward approaches. In the commodity export phase, the output typically is unrefined or semiprocessed raw materials (agricultural goods, minerals, oil, etc.). The two phases of EOI both involve manufactured exports. The output in the primary EOI is prone to be labour-intensive products, while secondary EOI includes higher value-added items that are skill-intensive and require a more fully developed local industrial base. On the other hand, primary ISI entails the shift from imports to the local manufacture of basic consumer goods, and in almost all countries the key industries during this stage are textiles, clothing, footwear, and food-processing. Secondary ISI involves using domestic production to substitute for imports of a variety of capital and technology-intensive manufactures :

consumer durables (e.g., automobiles), intermediate goods (e.g., petrochemicals and steel), and capital goods (e.g., heavy machinery).

2. FOCUS OF ANALYSIS

Chapter III will scrutinize trade and development in the ASEAN region in order to examine as to whether we should encourage South-South trade as an alternative to the existing South-North trade trend, which has been taken for granted to involve an imbalance relation by the proponents of dependency school of thought. The central points of my arguments in Chapters IV and V relate predominantly to the sphere of trade-based economic development, with reference to wealth distribution in the course of Indonesian emerging manufacturing industries.

To analyze the scope of the thesis, any types of written secondary sources such as books, articles in academic journals or official documents related to the topic will be used. Quantitative data are basically relied upon the publications of the Indonesian government, international development organizations, and the existing studies conducted by other researchers.

3. THE STRUCTURE OF THE STUDY AND ARGUMENT

The study is divided into six chapters and organised as follows. Chapter I contains the introduction, which consists of a problem statement, the listing of the research questions, the thesis statement, and methodology. The focus of the chapter is on the nature of Indonesian foreign trade development and economic growth in general. Chapter II provides an overview of literature, which falls into two sections.

First, the focus is on the neoclassical and dependency arguments on international trade, which allows us to draw out the preoccupation of each school of thought with issues of export orientation and import substitution, respectively, both of which Indonesia has had to get through. Second, by contrasting market-failure to state-failure approaches to economic development I intend to identify the most feasible approach to economic development of the developing countries. Chapter III examines intra ASEAN regional trade development and trade patterns in the region. This chapter is also intended to answer the question as to what prospect can be expected in the trade liberalization in the region. Chapter IV provides a historical background of Indonesian political economy along with its foreign trade patterns from the colonial time to 1965. The change of development policies in 1966 into the New Order style is included in order to analyze different paths of trade and industrialization policies pursued by the state. Chapter V will basically present the role of trade in stimulating economic growth. Subsequently, the trickle-down effect of Indonesia foreign trade development will be evaluated as to whether gains from trade, as a result of growing manufactured industries' value added, give rise to labour welfare. Chapter VI will summarize the achievement of Indonesia, including east Asia in general, in its foreign trade expansion with the challenges and restraints it faces in subsequent possible phases of economic development.

II. LITERATURE REVIEW

A. NEO-CLASSICAL AND DEPENDENCY ARGUMENTS ON TRADE

The expression 'trade as the engine of growth' is based on the neo-classical theory of comparative advantage, which affirms that if countries produce what they can do best and leave to other nations what they can produce with less efficiency, then real output, income and consumption will be higher than it could be in the absence of trade. The higher consumption gives rise to a bigger domestic market, increased specialisation, greater economies of scale, and higher capacity utilization; the higher income establishes the foundation for expanded investment for domestic production. In turn, the broader markets and larger investment lead to even higher income, with further rounds of economic stimulation. Trade also encompasses imports of capital goods and technology, which might accelerate the progress of developing countries. Neo-classical theory provides the economic framework with the notion that free trade would gradually reduce the income gap between the rich and the poor countries.

Such views have been much challenged by the trade counterrevolution of the dependency school on the ground that international trade itself is to blame for underdevelopment. International trade and investment lead to unequal exchange between the developing countries and advanced-capitalist economies to the disadvantage of the former. Therefore, trade is neither the engine nor an expediter of growth. On that account, trade is associated with the expropriation of economic surplus from its satellites by the metropolis and appropriates it for its own economic development (*Frank* ,1967 : 9). *Frank* purports to elucidate underdevelopment in the Third World, Latin America exclusively, as a consequence of the transfer of surplus from backward areas to the metropolis (the 'exploitation' of one nation by another). At the same time, income inequalities are prone to widen internationally as well as domestically.

However, this trade argument has been criticized for not having an appropriate scrutiny by neo-classical theorists, which points to a growing number of countries in the Third World with a high degree of export trade participation, Southeast and East Asian NICs in particular, which in the 1960s and 1970s pursued outward-oriented industrialization and as a result underwent very respectable rates of capital accumulation over quite prolonged periods of time. During the initial phase of East Asian NICs export expansion in the 1960s, the rapid growth of these East Asian nations was founded on light, labour-intensive industries like textiles, garments, and consumer electronics. In subsequent phases, however, South Korea, Taiwan and Singapore achieved success in much heavier industries like steel, petrochemical, shipbuilding, vehicle manufacture, and computers that were further removed from their original factor endowments - i.e., limited raw materials, unskilled labour, and small markets (*Gereffi*, 1990 : 4). The Asian NICs impressive export achievement starting in the 1960s and early 1970s was possible in that it took place when the world market was buoyant and the developing countries had easy access to both finance and market in the developed countries. It would be a completely different exercise for other developing countries to follow suit in the 1980s and

1990s, marked by recession, growing protectionism and debt crisis (*Folke, Fold and Enevoldsen*, 1993 : 61-62).

The *dependentistas* contend that the East Asian industrial growth indicated undesirable features that distinguished it from economic growth in advanced industrialist countries. The argument made is that such growth was not induced by an autonomous indigenous capitalist class in these countries so that they remained incapable of engendering their own internal growth dynamic. Instead, the underdeveloped economies remained dependent on the world metropolitan countries for access to technology, markets, and finance. As a result, being exacerbated by the continuing class alliance between the domestic elite of the periphery and the metropolitan bourgeoisie, the pattern of change in the periphery continue to be determined by the center.

The 'theory of unequal exchange' is employed to describe a situation when profits are equalized internationally while wages become increasingly unequal as productivity improvements bring about better wages in the center but not in the periphery (*Emmanuel,* 1969 : 146-7). Accordingly, the achievements of the periphery's technological progress are transferred into the center by means of the deterioration of terms of trade. As a result, international income inequalities will increase over time with free trade leading to calamity to the periphery. Similar argument was posed by structuralist dependency theorists in the early postwar; it is argued that Third World development could not be achieved through trade based on a comparative advantage in the production of primary agricultural and mineral products as the secular decline in the value of such commodity exports in the post-depression period resulted in the deterioration of the terms of trade of the periphery (*Prebisch,* 1962 : 4 and *Singer,* 1950 : 477). It is here that Prebisch and Singer offer import substitution industrialisation (ISI) strategy with infant-industry arguments.

Such a policy, it is believed, would help developing countries lessen balance of payment burden. Import substitution, stimulated by a moderate and selective protection policy, would help correct the tendency toward a foreign constraint on development resulting from the low income elasticity of demand for imports of primary product by the centers, compared with the high income elasticity of demand at the periphery for manufactures from the centers (*Prebisch*, 1984 : 179). Therefore, Prebisch discouraged exports of manufactures to the centers, because suitable industrial infrastructure was lacking and conditions in the centers were unfavourable. Instead, he recommended the stimulation of exports of manufactures as well as primary goods among developing countries in Latin America, with preferential arrangements by regions or subregions that would lead in the course of time to a common market (*ibid.* : 178). Nevertheless, in *Krueger* view, there are, broadly, two classes of influences that appear to make an export-oriented growth strategy more conducive to rapid growth than one based on import substitution. First, there are some strictly economic factors, such as returns to scale, indivisibilities, and the impact of competition, that probably produce a more satisfactory economic performance under an export-oriented strategy than under import substitution. Second, an export-promotion strategy appears to place certain kinds of constraints upon economic policy and its implementation; those constraints, in turn, limit the magnitude and duration of policy mistakes and also tend to force policies to work through pricing, rather than quantitative, interventions (*Krueger*, 1978 : 284).

The *dependentistas* also assume that labour markets are competitive in the periphery but not in the center, where the bargaining power of the unions allows the workers to share in the fruits of technological progress. It is deemed therefore that economic growth in the developed countries typically leads to higher income in the form of wages because the labour supply is relatively inelastic. Further, the leading manufacturing countries have gone through a technological revolution leading to major advances in productivity since the late nineteenth century. According to the theory of comparative advantage, this should have been depicted in a decline in the price of their exports, and a consequent improvement in the terms of trade of primary exporters. However, *Prebisch* argues that this has not transpired because of the downward rigidity of wages and prices in the advanced-industrialist countries and the lack of organisation among workers employed in primary production in the periphery in order to obtain wage increases comparable to those of the center. It would seem here more appropriate to refer to the lack of effective unionisation itself due to the low-cost labour supply surplus in the periphery. Instead, these productivity gains have been fully absorbed within the industrially advanced countries in the form of higher real wages and profits. Consequently, the terms of trade of primary exporting countries, which should have improved, have declined.

Prebisch (1962 : 4) interpreted the apparent improvement in the terms of trade of the United Kingdom in the period 1876-1880 to 1946-1947 as implying the deterioration of the terms of trade of the periphery. However, such an interpretation is based on the inappropriate assumption that the trading partners of the industrially advanced countries, for which the terms of trade have been estimated, are developing countries (*Balassa*, 1989 : 87). They ignore the fact that developed countries also export manufactured goods to other industrially advanced countries and they exchange primary products among themselves as well. Therefore, it is argued that the presumed deterioration of the terms of trade of the periphery remains in doubt. In Michaely's estimates, according to which unit value indices for primary products exported by low-income countries rose by 27% between 1952 and 1970, compared to an increase of 10% for primary products exported by high-income countries (*Michaely*, 1985: 144-5). Further, he indicates a 27% improvement in the terms of trade for primary products in the case of low-income countries, compared to a 23% deterioration for high-income countries during the period. The unit values of manufactured goods exported by low-income countries also grew more rapidly (45%) than those exported by high-income countries (19%) between 1952 and 1970. And the terms of trade for manufactured goods increased by 14% in low-income countries and declined by 12% in high-income countries. For the commodities traded as a whole, there was a growth of 19% in the terms of trade for low-income countries, and a deterioration of 14% for high-income countries in the period of 1952 - 1970.

Foreign ownership is considered to be the mechanism of the transfer of surplus value as well (*Frank*, 1967: 6). He postulates that the profit repatriated by foreign capitalists will raise over time as wages are maintained at the subsistence level in the periphery, notwithstanding increases in productivity. In his view, this situation is the result of a political alliance between the capitalists in the center and the landowners in the periphery who are unfriendly to the development of capitalism in their countries. The landowners, in turn, demand luxury goods whereas mass markets for consumer goods cannot flourish in the periphery due to low wages.

Furtado claims that economic growth will be impeded by an increasingly unequal distribution of income combined with the fact that the capitalist class spends a considerable fraction of its consumption expense on relatively capital-intensive products (*Furtado,* 1970 : 411). At the same time, both the deterioration of terms of trade and foreign ownership will act as mechanisms for transferring surplus value from the periphery to the center. Contrary to this view, as *Levitt* says (1994 : 79), the role of multinational corporations is evaluated favourably by the neo-classical theorists, who advocate export led growth strategies. Apart from providing market outlets, these companies are said to have a positive impact on developing countries by bringing in industrial skills and training local workers. Since they are better equipped to evaluate opportunities and explore alternatives, foreign firms are more likely than domestic ones to choose more labour intensive techniques. The international character of multinational firms would lead to a rationalization of their worldwide activities correcting the distortions in factor use in the countries where they operate. In this fashion, it is argued, outward looking strategies would assist employment creation and alleviate income inequality.

The *dependentistas'* policy recommendation to trade is the core of self-reliant national development. They affirm that withdrawal from the international division of labour, whether full or selective, would provide the less developed countries with the possibility to escape from the vicious circle of underdevelopment. The reason is that reducing their primary exports would lead to welfare gains by means of improvements in the terms of trade of the periphery. The assumption made is that developing countries have a monopolistic power in the markets for their primary export goods. However, as *Balassa* says (1989 : 89-90), apart from tropical beverages, it has to be considered that there are competing suppliers and substitutes for these commodities in the advanced-industrialised countries. Accordingly, reducing primary exports, whether directly through export taxes or indirectly through import protection, has led to declines in export market shares.

The application of such protectionist measures encouraged high-cost import substitution in the industrial sector so that countries employing such measures failed to participate in the expansion of manufactured exports (*ibid.* : 15-6). Moreover, highly-protected less developed countries underwent a decline in the rate of growth of factor productivity. The misallocation produced by import substitution strategies not only cut down total output below the level that it might have otherwise reached, but it also decreases the growth rate, predominantly through its effects on productivity growth and the flexibility of the economy (*Bruton,* 1970 : 140). Therefore, high protection does not allow the developing countries at all to exploit the possibility provided by international trade. In turn, withdrawal from the international capitalist system may be deemed as an extreme case of protection as it essentially requires prohibitive protection with the corresponding economic cost.

To sum up, the preoccupation of neo-classical perspective with EOI or dependency view with ISI has its own specific arguments and strengths, and it is a kind of difficult to judge which one is more superior over another. ISI has some weaknessess, but it may serve as a prerequisite for the successful adoption of EOI based on national entrepreneurs, which has been embodied by East Asia experience. At the same time, it can help developing countries reduce balance of payment burden in time of unfavourable condition in the international market, especially if the developing countries - with little manufacturing as a percentage of GDP - have not had some original industrial base, some adequate level of technology, and some supportive sector of banking, transport, communications, and insurance. On the other hand, EOI might offer disadvantages for the developing countries with abundant natural resources, when primary commodity prices are prone to go down. What is more, EOI works based upon the principle of comparative adavantage, which emphasizes specialisation in production and a certain quality of products. Some of the poorest countries simply have not been present at that level of technological capability. Finally, each trade strategy adopted is actually not only a matter of economic, but it also has to do with international, domestic, political, and social changing conditions. All of these conditions determine the rise or decline of the policy and trade performance at different time.

B. MARKET FAILURE AND STATE FAILURE IN ECONOMIC DEVELOPMENT

This section is intended to determine the best approach to economic development for developing countries by evaluating two dominant notions of development, market versus state. In the context of developing countries, societies need to be protected by government regulations. A balance between market forces and government power has to be achieved. If markets and trade expand rapidly and political control lags behind, danger looms - but the reverse is also true. Over-regulation of markets by authoritarian governments can hamper or even destroy an economy and the well being of the population (*Evers*, 1989 : 13).

To begin, the collapse of centrally planned economies in Eastern Europe, the failure of markets in some developing countries, and the growth of state-led economies in East Asia's newly industrializing countries (NICs) indicate that productive roles for markets and states are not mutually exclusive, but inter-related and complementary for economic development. Some development theorists call this new approach the 'statist' approach to development, where state plays an indispensable role in economic management without perturbing the market mechanism.

The market economic approach and state-led economic approach to development have been a subject of great debate in the post-War period, during which the pendulum of focus swung between market and state from time to time. Opinion among theorists remains divided about the two dominant approaches to economic development. Neo-classical liberals argue that markets perform effectively stimulating economic development when there is no state intervention. The critics of the market economy argue that the states' intervention is necessary to regulate market functions in order to stimulate economic development. The recent success story of East Asia NICs has sparked further discussion on the subject.

The champions of a free market economy believe the self-regulating mechanism of the market to be the most effective tool in stimulating necessary economic growth. They also argue that healthy competition created by the free market economy would provide equal opportunities to buyers and sellers and motivate innovation (*Gilpin*, 1987 : 18). A market economy is defined as one in which goods and services are exchanged on the basis of relative prices. The market is where transactions are negotiated and prices are determined. The proponents of such an approach to development contend that free market enterprises would allocate resources most efficiently and lead to more equal development when it is free from state interference.

On the other hand, the state led-development theory suggests that the state intervention in the economy is essential for creating conducive environments both internally and externally for market relations to take place. In this regard states are considered to be an indispensable catalyst for fueling economic growth. According to advocates of statist approach the state shall become a complementary engine for development rather than master of the game. In other words, a state led-economy does not necessarily mean a centrally planned economy. It is a state facilitated or guided economy. In addition, the proponents of the statist approach argue that the interventionist role of the state should decline as the economy matures and industrialization advances, because it is believed from the experiences of socialist economies that state intervention is most productive at the initial stage of the development, in preparing the economy for stages of growth as in *Rostow's* terms, precondition and take off (*Broad, Cavangh, Bello*, 1991 : 157). However, it becomes counter productive if state intervention grows with the economy. Therefore, the role of state ought to decline as the economy advances, giving way to the market mechanism to effectively come into operation.

During the 1960's and 1970's, most economists and developmentalists advocated an interventionists state that would mobilize and manage national resources. This was necessary because markets failed in developing countries. However, in the 1980's and 1990's, the pendulum swung to the opposite direction. Associated with the former argument, the latter was justified by the fact that the private sector has to take the lead in economic mobilization and management on the ground that the states had failed to do so (*Klitgaard*, 1991 : 16).

The upsurge of the East Asia NICs has added a new dimension to the theoretical discussion on markets versus states, in part because the model adopted by these countries remained largely isolated from the theoretical debate. Apparently, the model draws a middle course between the two dominant perspectives of development , 'modernization' and 'dependency' (*Deyo*, 1987 : 20). This is to say that their economic success illustrate what can be termed as a mingle between state and market without seriously affecting each other but being complementary. Nonetheless, the NICs' model was based in large part on the neo-classical liberalism which emphasized on export oriented industrialization strategies characterized by trade liberalization, private enterprise and linkage of domestic economic activities with other nations in terms of foreign capital, markets and technology.

A point of departure from the liberal theory found in the NICs' trajectory is the assumption made by the right wing theorists that the state or government played an insignificant or minimal role in economic management. Contrary to this belief, many analysts argue that the states in East Asian NICs engaged in an interventionist role which was largely acclaimed by analysts as one of the secrets of their success. Jenkins comments that there is now strong empirical support for the view that state intervention has in fact been substantial in the East Asian NICs and that this has played a crucial role in their successful industrialization (*Jenkins*, 1991 : 199).

A leading analyst of the NICs' model of development, *Deyo*, describes two kinds of statist approaches for economic development. The first is a state-led approach, where strategies in capitalist economies require continuing and selective intervention by state agencies (in private sector decision making and market transactions) to achieve strategic goals. This is also the version of the World Bank's 'market friendly' approach (*World Bank*, 1993 : 10), suggesting the opportune role of government is to ensure adequate investments in people, provide a competitive climate for private enterprise, maintain the economy open to international trade, and uphold a stable macroeconomy. Beyond these roles, it is argued, governments are likely to create more negative effects than positive one. The second type is the state induced strategy which emphasizes the role of the private sector in implementing strategies within a broad political, legal, infra-structural and economic framework that the state establishes to pursue its chosen development objectives. According to *Deyo*, the state induced approach was less effective in advancing economic development. He claimed that most of the Latin American NICs which failed to reach their anticipated development, did so because of this approach and also partly because of their import substitution policies and lack of effectiveness of interventions accomplished by the state. *Jenkins* (1991 : 197) argues that the states in Latin American NICs were also not autonomous from the dominant classes and their extensive intervention involved distortions from the state-led theory of economic development.

The state-led tenet of economic management has been the approach adopted by all three NICs of East Asia (excluding Hongkong) and Southeast Asian nations. In this approach, the state has been fairly autonomous and has given timely direction for taking measures to make the internal and external environments conducive to economic development. The government established competent institutions to plan and supervise economic activities and intervened in foreign investments as circumstances necessitated such actions. It also trained the required skilled labour, built necessary infra-structure and introduced measures to stimulate public saving. Despite unfriendly attitudes shown toward labour movements, the governments ensured political stability through democratic practices except in South Korea. Therefore, it has been widely considered that statist approach is most applicable for struggling economies of developing countries.

The reason to recommend the state-led approach is that, as *Klitgaard* says, at national levels markets turn out not to function as well as the text books advertise. The states capacity has to be built before the free market can be introduced. And again markets for products, credit and labour also need to be democratized (*Klitgaard*, 1991 : 15). For without these conditions states cannot expect effective outcome from the market economy. Markets have failed in many developing countries because they were introduced at a premature phase before the states were supported by the right environment. The reality in developing countries is, according to *Klitgaard* that, neither markets nor government works well according to the given blue print.

The state-led approach to development has to be clearly understood in order not to confuse it with centrally planned economies in socialist countries. It is a market friendly approach where state as the facilitator help market mechanism to function effectively. It corrects the mechanism if it deviates or develops the system so that it does not malfunction. The socialist command economies in Eastern Europe failed principally because they did not use market mechanisms and the state became over burdened with unmanageable task of economic development which ultimately led to inefficiency, corruption and stagnation while innovation and incentives declined (*Brood, Cavanagh, Bello*, 1990 : 145). Unlike centrally planned economies, East Asian NICs expanded the application of market principles as the necessary growth was stimulated and the state slowly withdrew from the economy as the market began to replace state functions more effectively.

If the state extends its intervention over time irrespective of market development, the government is prone to do more harm than good. It might become inefficient and corrupt. The state hampered the economy and through deficits created inflation (*Klitgaard*, 1991 : 21). The state-led approach to economic development advocates the benevolent role of the state which is supportive and market friendly. In assuming this role state sometimes becomes authoritarian, which some analysts deem to be necessary as a catalyst for industrialization and inducing the conditions for advancing democracy (*Broad, Cavanagh, Bello*, 1990 : 160).

The foregoing discussion on market failure versus state failure approaches to development proposes that the state-led approach is more viable and applicable to developing countries given the recent experiences of East Asian NICs and some Southeast Asian nations. The role of the state is indispensable at the early phase of the development for creating conducive environment for market mechanism to function. This is simply because states are required to stimulate public savings, attract foreign investments, provide fundamental infrastructure and discipline labour for creating entrepreneurial climate. It needs to introduce land reform and progressive taxation as well (*ibid.*, : 157). Through the state, one creates, maintains and regulates markets for economic growth, the results of which should be distributed as fairly as possible throughout society. In addition, the state played a strategic role in fostering full employment even in advanced-industrialized countries in the West (*Patel*, 1993 : 73). *Nigel Harris* indicates that the developed economies also exercised a state-led approach to development at times of crisis and at the precondition stage (*Harris*, 1986 : 157). Therefore, It is difficult to argue that the state-led industrialisation approach, is not favourable to the economic development of the developing countries.

III. TRADE IN SOUTHEAST ASIA

Southeast Asian nations have become more closely integrated with the western and southern rim of the Pacific Ocean nations through trade and investment links since 1960s. Japan, replacing the US, has become the major trading partner of most ASEAN countries. Hongkong and Taiwan are now the largest foreign investor in Indonesia and Malaysia. Instead of the existence of trade preference among ASEAN countries, trade liberalization and market integration in the region seems to have been difficult to reach. Indonesia, as the largest market in Southeast Asia, has generally been blamed by both outside observers and the other members of ASEAN for the lack of progress in ASEAN economic cooperation (*Anwar*, 1994, 91). However, discriminating against each other exports in the ASEAN-4 (Indonesia, Malaysia, Philippines, and Thailand) to protect their own domestic industries, along with their similar industrial structure as well as the technocrats' attitude towards the cooperation, seem to be a plausible reason of explaining the obstacles in ASEAN regional economic cooperation.

In reality, the growth performance of each ASEAN country has been impressive for the last two decades and these states are taken for granted as the next generation of Asian Newly Industrializing Countries (NICs). This gain, however, to some extent does not seem to have been deemed successful. In other words, many have been questioning how to achieve faster growth within the the context of this cooperation.

A. THE ESTABLISHMENT OF THE ASEAN ORGANIZATION

The economy of the developing countries has increasingly worsened since 1970's and early 1980's during which the world underwent economic downturns . During this period of time the Western countries were experiencing higher inflation and unemployment. Consequently, and due to the impact of the oil price rises on living standards, Western governments were less able and willing to make concessions to the developing countries (*Gill and Law*, 1988 : 187). This situation was exacerbated by protectionism that has been common in international trade.
In an such international political economic situation, the Association of South-East Asian Nation (ASEAN) emerged to the surface.

1. The Political Challenge in the Region.

The foundation of the Association of South East Asian Nations (ASEAN) was formally declared in 1967, when the foreign ministers of Indonesia, Malaysia, Singapore, Thailand, and Philippines signed the ASEAN Declaration at a meeting in Bangkok. Indeed the way to go to such arrangement had long been carried on. The previous two decades had indicated that regional cooperation schemes among developing countries was difficult; many of the groupings have now vanished or have been reorganised with fewer members. In sum, ASEAN was not the first attempt at regional cooperation within Southeast Asia, but it has certainly been the most successful. In the early 1960s, the ASA (the Association of Southeast Asia, consisting of the Malayan Federation, the Philippines and Thailand) failed to be an effective organisation due to its limited membership and prestige, especially in terms of Indonesia's absence. In mid-1965, MAPHILINDO (Malaysia along with the Philippines and Indonesia) did not succeed as a device for regional cooperation since the confrontation between Indonesia and Malaysia occurred at that time. These two institutions could be regarded as the root for ASEAN's foundation.

In other words, ASEAN was actually formed with regard to a political challenge in the region as well as regional apprehension towards the Vietnam War for the sake of regional security. Until the first half of 1960's, Indonesia, Malaysia, Singapore, Philippines and Thailand as well as Brunei, though it did not join the institution until 1984, were involved in some conflicts which threatened the regional stability. At the same time, each ASEAN country also underwent internal-political problems. For instances, Indonesia, under President Sukarno, was about to reach both economic and political bankruptcy. Malaysia was faced with the problem of finding ways to redress the uneven distribution of wealth between the indigenous Malay population and its considerable and more prosperous Chinese population. Singapore with its ethnic diversity encountered the problem of political and economic survival after its separation from Malaysia. From its inception, it is clear that political and security issues were the main focus of the activities, and cooperation in the economic sphere was at first limited. From its foundation until 1976 ASEAN limited itself virtually completely to annual meetings of the foreign ministers.

2. Movement towards Economic Cooperation.

Actually during the period since 1967, the pressures encouraging economic cooperation and fostering greater regional trade and industrial cooperation, have grown in intensity. In particular, the member states have become concerned about the rise of trade protectionism in the North, and the emergence and strengthening of other regional trade groupings. As a result since early 1976, when a regular annual series of meetings among ASEAN economic ministers was instituted and ASEAN Secretariat was established in Jakarta, economic cooperation has been put at the highest rank within the cooperation with further agreement on ASEAN Preferential Trading Arrangements (ASEAN PTAs) was signed in 1977.

ASEAN has come to be regarded as an important regional grouping of nations from an economic as well as a political point of view. The Association is often deemed to be the most successful of all regional cooperation groupings among developing countries. Nevertheless, the economic importance of the association could perhaps be said to stem more from the rapid growth and development performance of some of its member economies than the collective strength and cohesion of the association itself. Over the years of its existence, the association has made several attempts at greater economic cooperation, especially in trade, but its achievements in this regard remain rather patchy.

The share of intra-regional trade has been relatively small, no more than 20 % of its total trade since 1970, and its growth has been insignificant (*UNCTAD*, 1994 : 35). Nevertheless, by 1977, the year when Preferential Trading Arrangenments (ASEAN PTAs) were instituted, intra-ASEAN trade had increased marginally to 17 % of total Asean trade. By 1993, intra-ASEAN trade had increased to around 20 %. Compared to other Third World regional groupings, the value and percentage increase of intra-ASEAN trade is slightly higher (as Table 3.1 indicates).

TABLE 3.1 Intra-Regional Trade of Developing Countries, 1970-93
(US$ million)

REGIONAL GROUPINGS	1970	1980	1985	1990	1992	1993
Andean Group	97	1,161	768	1,312	2,210	2,939
LAIA (LAFTA/Latin America)	1,263	10,982	7,137	12,331	19,377	22,702
CACM (Central America)	287	1,174	544	671	908	935
UEMOA (West Africa)	54	476	431	625	502	578
ECOWAS	86	693	1,026	1,539	1,501	1,699
ASEAN	1,285	12,015	13,130	26,367	34,908	41,748

Source : UNCTAD, Handbook of International Trade and Development Statistics, 1994 : 34

The ASEAN PTAs was introduced to bolster ASEAN industries and provide them with an assured market. It is true that intra-ASEAN trade has generally expanded, but as a share of total ASEAN trade it has by and large declined during the last 5 years. The value of Indonesia's trade with ASEAN increased from US$ 4,194.6 million in 1989 to US$ 8,041.3 million in 1993. Indonesia's exports to ASEAN grew annually by 24.41% and her imports increased by 11.8% during the period 1989-1993. However, these Indonesia-ASEAN trade growth reached only 11.2% of Indonesia's total trade annually for the corresponding period, as Table 3.2 indicates.

TABLE 3.2 Indonesian Trade with ASEAN Countries
(US$ million)

Description	1989	1990	1991	1992	1993	Trend 1989-93
Export	2,429.3	2,768.2	3,585.8	4,908.0	5,437.2	24.41
Import	1,765.3	1,835.8	2,463.9	2,592.9	2,604.1	11.88
Total ASEAN	4,194.6	4,604.0	6,049.7	7,500.9	8,041.3	19.60
% Indonesian Trade	10.8	9.7	11.0	12.2	12.3	

Source : Central Bureau of Statistics, Statistical Year Book, various years

Luhulima observed that Indonesia's manufactured goods exports increased from US$ 1 billion in 1981 to US$ 10 billion in 1990. Also, Malaysia significantly raised its exports to ASEAN (her overall export rose from US$ 3.6 billion in 1980 to US$ 16.8 billion in 1990), but as a percentage of total exports, ASEAN's share in Malaysia's total export somewhat decreased from 26.6 % to 25.5 %. Thailand has the same experience. It more than doubled its exports to ASEAN (the overall export grew from US$ 2.3 billion in 1984 to US$ 13.7 billion in 1990), and again as a percentage of total exports it went down from 13.9 % to 11.5 % (*Luhulima*, 1994 : 15). This occurred despite the existence of the ASEAN PTAs. Therefore, it can be said that the magnitude of intra-regional trade of ASEAN-5 (excluding Brunei), in spite of many years of regional economic, has remained small, given the ASEAN countries are the only countries in Asia which give each other trade preferences. It stood at 20 % in exports and 15.6 % in imports in 1989: it has remained well beneath 20 % since 1970. In fact, the level has been boosted simply because of high intra-trade of Singapore (as Table 3.3 below shows).

TABLE 3.3

Intra-Regional Trade for Asean-5, and without Singapore (Asean-4), 1970-89 (Percentages)

ASEAN-5	Intra-Regional Exports	Intra-Regional Imports
1970	19.8	14.7
1980	17.8	16.9
1985	18.7	18.6
1989	18.0	15.6
ASEAN-4		
1970	3.9	4.6
1980	3.2	4.0
1985	4.8	6.0
1989	4.1	4.4

Source : IMF, Direction of Trade Statistics (various issues)

It is often said that the development of the ASEAN economies was the result of the dual role played by the US and Japan in the region, that is, as suppliers of capital goods and other factors of production which are not in the possession of ASEAN member states, and as the buyers of goods produced by ASEAN states (*Leonen and Santiago*, 1993 : 167). Compared to the volume and value of the US and Japan's trade with and investment in the southeast Asia region, intra ASEAN trade and investment levels might be considered insignificant. For example, in the case of the Philippines, its top imports from Indonesia, Malaysia and Thailand have been composed of non-manufactured goods, while its principal imports from Japan have consisted of heavy and chemical industrial products. As in Table 3.4, the combined value of the Philippines top imports from the three ASEAN countries in 1991 amounted to $219,362,930, which was less than the value of the Philippines' top import (machinery) from Japan which totaled $1,683,833,000.

TABLE 3.4
Top Philippine Imports from Indonesia, Malaysia, Thailand and Japan, as of 1991

Country of Origin	Products	Value
Indonesia	Petroleum oils, and oils obtained from bituminous minerals, crude (barrel)	$30,017,600.00
Malaysia	Petroleum oils and oils obtained from bituminous minerals, crude (barrel)	$164,373,650.00
Thailand	Other materials and accessories imported on consignment basis for the manufacture of semi-conductor devices	$24,981,680.00
Japan	Machinery (of which the largest component is electrical machinery)	$1,683,833,000.00 ($702,276,000.00)

Source : JETRO Monitor XIII, No.2 , February 1993

However, it is important to mention that total exports (especially Indonesia's, Malaysia's and Thailand's manufacturing exports mainly to Japan, US, Asian NICs, and EC nations), have grown dramatically in the ASEAN region since 1975 as the country members as a whole have moved towards a greater and more open industrialization strategy. There was a definite shift in the import and export structure of the member countries in the 1980s. Rapid industrialization processess have taken place in the entire economic structure of the members resulting in the changed import and export structures.

B. THE ASEAN-4 AS THE NEXT NICs

Measured in terms of total and per capita rates of growth the region underwent reasonably good economic growth during 1980s, in spite of two severe oil shocks,decreasing prices of primary commodities, and a slowing down of the global output and trade. It is believed that the larger ASEAN countries are about to reach

NICs level associated with their accelerated economic growth as shown in the Table 3.5 below.

TABLE 3.5
GDP and Per Capita Income Growth Rates, 1960-91

Country/ Region	Total Real GDP Growth Rates (%)			Per Capita Real GDP Growth Rates (%)		
	1960-70	1970-80	1980-91	1960-70	1970-80	1980-91
Indonesia	3.4	7.6	5.2	1.1	5.4	3.1
Malaysia	5.9	7.9	5.3	2.9	5.4	2.5
Philippines	5.2	6.3	0.9	2.0	3.6	-1.6
Singapore	9.4	8.4	6.4	6.9	6.8	5.2
Thailand	8.3	7.1	7.5	5.1	4.3	5.9
ASEAN Region	5.2	7.4	5.0	2.6	4.9	2.9
Developed Countries	5.1	3.1	3.0	4.0	2.2	2.3
USA	4.4	2.8	3.0	3.1	1.7	2.1
Japan	10.3	4.3	4.1	9.1	3.1	3.5
Developing countries	6.0	5.6	3.0	3.4	3.1	0.7

Source : UNCTAD, Handbook of International Trade and Development Statistics, 1993 : 436-37.

These rates, with the exception of the Philippines, ranged between 5 to 7.5 per cent in the countries of the region. The rate of per capita domestic product, on the other hand, expanded at an average rate of 2.5 per cent. Though that was comparable to the rate of developed market economies, it was far higher compared to those of developing countries, in spite of a relatively high population growth rate at about 2.3 per cent for the region and 2.2 per cent and more for the rest of the countries except Singapore that was 1.4%.

It is to say that ASEAN has made much progress regarding both government and private cooperation in many areas. Yet, despite the fact that their cooperative efforts in the trade and investment have continually improved since they were initiated in 1976, it is generally acknowledged that these efforts have had little impact on their growth or structure. It has always been criticised that the speed of developing economic cooperation has been far too slow. Even now, after twenty-six years of ASEAN's presence, it has not yet reached the goal of becoming a free trade area which is the first step of economic cooperation leading to regional integration. Therefore, the prospect of reaching a higher level of cooperation like the Europe Economic Community remains uncertain. Many have been questioning how to achieve faster growth within the cooperation. Such a question might be raised since each member state has tended to act on its own in the international trade and economic arena, and it has been exacerbated by giving priority to national interest, rather than regional cooperation.

The ASEAN group as a whole has now moved from import substitution industrialization strategies into a more open and trade based strategy. Exchange rate policies have played a decisive role in the growth of ASEAN exports during the 1980s. Since 1985 the ASEAN states have steadily depreciated their currencies in real terms by taking advantage of the decline of the US dollar in foreign exchange markets. Real effective exchange rates have declined in each of the major ASEAN countries, with the largest depreciation took place in Indonesia and the Philippines, both of which had sizable devaluations in the late 1980s. This, in itself, has favoured a shift in the allocation of resources from the non-tradable to the tradable sectors of the economy. Large currency depreciations in real terms have left governments room to rationalise tariff structures and reduce effective rates of protection.

The adoption by the ASEAN economies of outward-looking trade strategies and pragmatic exchange rate policies, coupled with a rapid expansion in exports, replicates the path taken by East Asian NICs in the 1960s and early 1970s. Outward-looking policies associated with East Asian NICs are able to overcome the limitations of domestic market, the increase of unemployment, and the deficiencies in financial stability (*Adams*, 1994 : 13). The question to be meaningfully posed is : can the larger ASEAN states be expected to follow the same development trajectory and become the new generation of Asian NICs?

There is no single, commonly accepted definition of the term 'newly industrializing country'. Countries as diverse as South Korea, Singapore, Portugal, Yugoslavia, Brazil, Mexico and Argentina are often included in this category. Most analysis identified three features of economic performance as crucial characteristics of the NICs, namely : 1). rapid economic growth, 2). the development of manufacturing industry, and 3). trade in manufactures. Growth in the four main non-NIC ASEAN economies - Indonesia, the Philippines, Thailand and Malaysia - was, as shown in Table 3.5, rapid during the second half of the 1980s. It is worth noting, however, that recent ASEAN growth rates are significantly lower than those recorded by the four Asian NICs during the early phase of their development : between 1964 and 1973, the four Asian NICs (South Korea, Taiwan, Singapore and Hongkong), registered annual growth rates of 10%, or slightly higher (while ASEAN-4 was about 6% on average).

The growth in ASEAN exports of manufactures, and the development of the industrial sector has transpired, with the partial exception of the Philippines where special circumstances have prevailed for much of the 1980s, since 1975. In 1979 the share of manufactures in ASEAN exports was only about 15 %. It jumped up four times, up to 49 % in 1989. In consequence, exports account for an increasing share of all these countries'GDP and the main component of these increase in exports has been in manufacturing, which is mainly natural-based and labour-intensive exports whose share of total exports has multiplied many times over within the period of a decade.

The three indicators of NIC status mentioned earlier together provide a measure of the countries' growing industrialization and integration within the world economy. They do not reveal, however, the major differences in the character of the industrialization process of the NICs. South Korea and Singapore, for example, are at the extreme ends of a comparison with regard to the sources of industrial capital : the industrial expansion of South Korea has been due largely to the efforts of indigenous enterprises, but in the case of Singapore the main factor has been a massive influx of foreign investment by multinational companies.

To assess the likelihood of the ASEAN countries achieving NIC status, it is necessary therefore to identify the strength of each country's indigenous firms and the significance of direct investment in each economy, as well as their capacity to mobilize capital in other forms, both domestically and internationally (*C. Kirkpatrick*, 1989 : 10). The strength of domestic companies in the developing ASEAN economies is not great in the sense that there are few major ASEAN enterprises comparable in size with those from the Asian NICs. This is not to say that ASEAN firms cannot develop their competitive strengths, but a South Korea style development strategy based on large indigenous industrial conglomerates is unlikely to take place. On the other hand, all ASEAN states are aware of the need to strengthen indigenous companies; and overseas Chinese capital is a major component of all these companies, which when appropriately utilized can enlarge the existing supply of indigenous capital.

By means of profoundly self-reliant efforts and cooperation with Japanese enterprises, South Korea and Taiwan can bolster significant involvement in regional mature and higher technology trade, with further deepening industrialization. Such outward-oriented achievement however is not becoming practicable for the larger ASEAN states. The insufficiencies in ASEAN-4 industrial policies, which are not being counteracted by progress in political development, are prone to carry through their participation in lower-technology regional commerce and their dependence on exports of primary products (*Boyd*, 1994 : 41). Nevertheless, the external reach of Japanese industrial policy has increasingly crucial effects on the evolution of indigenous-national firms in the ASEAN-4, simply because of opportunities which incoming Japanese enterprises provide for subcontracting and for more active association with the integrated Japanese East Asian international production system. The expanding Japanese corporate involvement in ASEAN, together with increasing Japanese influence at the policy level, on the basis of that involvement, is to a considerable extent a result of competition against American firms, but it is also a consequence of rivalry with enterprises in South Korea and Taiwan (*ibid.*, : 41).

The experience of the NICs reveals that human capital formation (through education and training) has been a relevant factor in these countries' growth. At present, low labour costs and sufficient labour supply are considered to be major temptations to foreign investors locating in the ASEAN region. However, if these states are finally to move from assembly and processing manufacturing into more skill- and technology-intensive production, human resource development is going to come to the surface as an increasingly significant determinant of economic achievement. Significant differences in educational achievements between the NICs and the ASEAN groups are perceived. Measures to enhance the general level of education and skill formation will assume critical importance in the future if the ASEAN states are to make the transition to NICs status. However, improved human capital has to be followed by effective economic management in the arrangement of the various factors that uphold economic growth and structural change. An important feature of the Asian NICs has been the crucial role of the state in promoting growth. The administrative capacity of the state to control the tools of economic management, and more generally, to regulate effectively the socio-political environment have been critical factors in their success. There are some instances of the state playing such a role in the ASEAN countries (in particular in Indonesia, Malaysia, and Thailand), but it will take time before they can reach the quality of administrative and regulatory process gained by the northeast Asian NICs.

The influence of US firms in the Asian region has been overtaken by the Japanese enterprises' involvement. This is simply because the trade barriers of the industrializing East Asian states and ASEAN members hinder US firms more open than Japanese enterprises. Moreover, American corporations tend to acquire less consideration from administration in those states because US direct investment in the area is decreasing relative to Japan's, is not matched by similar volumes of economic aid, and has less long-term significance. The integrated pattern of Japanese international production in East Asia moreover is based on a dispersal of specializations that results in much intrafirms trade at transfer prices that reduce the significance of tariffs.

Only the ASEAN states in Asia have some capacity for collective bargaining position on trade and foreign direct investment issues, but as perceived they have indicated little political will to cooperate with each other. As their economic links with Japan become more integrated they compete against each other to attract Japanese direct investment and official aid. Opportunities for industrial cooperation within ASEAN and between ASEAN, South Korea and Taiwan, are not being related mutually to each other. This laxity to some extent brings about failures to arrive at urgently needed collective improvements in structural competitiveness. Meanwhile a progressive decline in national bargaining strength continues, because of the lack of political will to work together on a closer regional trade issues, and the continuing expansion of the integrated Japanese-East Asian production system.

C. ASEAN FREE TRADE AREA (AFTA) : A NEW POLICY

One of the recent agreements, entered into by the six Asean members at the Singapore Summit in 1992, has been the arrangement on the Commonly Effective Preferential Tariff (CEPT) Scheme , replacing the ASEAN PTAs, for the Asean Free Trade Area (AFTA). Unlike the former ASEAN PTAs, the CEPT Scheme is intended to gradually cover all of ASEAN products, though some members are still reluctant to liberalize various subsectors. Through this agreement, the six ASEAN members expect to reduce significantly both tariff and non-tariff barriers imposed against ASEAN products exchanged within the region and thereby lead to an Asean free trade area. The CEPT Scheme calls for a two-phase reduction of tariffs beginning 1 January 1993. For products which are currently subjected to tariff rates over 20 %, there should be a reduction of these rates to 20 % in the next eight years, after which the 20 % rate should further be reduced to a zero to 5 % cluster within seven years. For goods on which are currently imposed tariff rates of 20 % or below, the same shall be reduced to the zero to 5 % band within a period to be determined individually by the member countries. The period for both phases shall not exceed 15 years; however, the reduction process may take place within a shorter period of time. In order to prevent trade deflection schemes by non-Asean businesses that might seek to benefit from AFTA through entry in a low-tariff ASEAN country and a subsequent penetration of the region under the same conditions imposed on Asean products, rules of origin are included in the AFTA arrangement. Consequently, for a product to be considered as originating from an ASEAN member country, at least 40 % of the product's contents must have derived from any ASEAN member country. AFTA's ultimate objective of setting up a regional market with low effective tariffs of maximally 5 % and devoid of non-tariff barriers were primarily also meant to meet the challenges posed by the formation of the European Single Market (EC) and the NAFTA. Asean countries were afraid of being pushed out of these markets. Many in the region feared that the formation of such regional economic blocs would replace part of their trade with that of Mexico in the case of NAFTA and Greece and Portugal in the case of EC. Hence, the move to create an AFTA in the next 15 to 20 years depicts an emotional move to join forces in protecting national economic interests collectively against a perceived threat rather than from a need to really share markets. As a consequence, the achievement of an AFTA prior to 2008 is still debatable.

What is expected from the AFTA exercise is that with the creation of a bigger market in Asean, it will attract foreign investments as well as investments from Asean member countries. This is quite significant since competition for foreign investments is getting tougher, in particular from the industrial countries themselves, from India, and China, and from countries in central and eastern Europe, inclusive of Russia.

D. PROBLEMS AND POSSIBILITIES WITHIN COOPERATION

The organization has established a strong spirit of cooperation and has made considerable progress in establishing a framework for consultations and development cooperation. In addition to the foreign ministers, regular meetings of other ministers (economic matters, labour, energy, agriculture ,etc.) take place, but many of the decisions they take cannot be implemented until the foreign ministers have signed the agreements. There have been complaints that too many detailed decisions are required to be taken at the apex of ASEAN decision making, with the result that action is delayed.

With the intention to form AFTA, the trade preference system goes into a new era. The interesting question in this context is whether AFTA is conducive to be a good policy from the regional development point of view. The importance of intra-

ASEAN trade is not great, especially when Singapore is excluded. An obvious reason for the small trade volumes is the similar structure of the larger ASEAN economies, Brunei and Singapore being special cases. Therefore, benefits based upon specialization will relatively be restricted. They produce similar agricultural and manufacturing goods, except Singapore and Brunei, and will compete with themselves in the international marketplace. This is to say that the economies of the member countries are competitive rather than complementary.

In population and income levels as well as level of development, the ASEAN members are very diverse, including one large, but relatively poor state (Indonesia), three intermediate states in population and income, tiny, highly-developed Singapore and oil-rich Brunei (*Frost*, 1990 : 11). Under such conditions, it is extremely difficult to design and implement schemes for regional economic cooperation that will benefit each country equally. The members' perspective towards international trade also vary : Singapore and Brunei are more open and outward-looking, while the others have been slightly protectionist to some extent and have higher tariffs to trade. The ASEAN-4 in effect discriminate against each other's exports of manufactures and agricultures and have not been willing to reduce this discrimination substantially. In general, East Asia's trade regimes still appear to hold more elements of protection than do those of its industrial trading partners, partly because they rely on tariffs for government revenue to a much greater extend than advanced-industrialised countries. Besides, trade policy instruments have traditionally been used as a supplement to industrialisation strategies. Some of them still have substantial tariff rates, even after considering the multilateral trade agreements of the Uruguay

Round. As Table 3.6 shows, the effective rates of protection in manufacturing sector have been relatively high in some East Asian countries.

TABLE 3.6. Trade Protection in Five East Asian Economies

Countries	Unweighted average nominal tariff (%)	Import items subject to import restrictions	Effective protection rate in Manufacturing
Indonesia (1992)	20	< 5	52
South Korea (1992)	10	< 5	28 a)
Malaysia (1990)	< 10	< 5	23 a)
Philippines (1992)	24	3	32
Thailand (1992)	28 b)	< 5	51 c)

Source : World Bank country reports; GATT; Government of Australia, cited in The World Bank, 1994 : 33, East Asia's Trade and Investment.

Note :
a). This estimate is for 1988
b). Trade-weighted. An earlier, unweighted estimate for 1989 was 39%.
c). This estimate is for 1988; it excludes agroprocessing and is weighted by value added in world prices. Using the more standard weighting of value added at domestic prices yields a rate of 61 in 1988. Reforms since then are considered to have lowered this estimate significantly.

The persistence of this discrimination reflects the relatively weak influence of technocrats in the ASEAN-4 (compared with their counterparts in South Korea), due to strong elements of personal rule, which appear to be responsible for forms of 'crony capitalism'. While they have adopted a more outward trade orientation, the tendency of prolonging the phase of import substituting industrialization and dependence on foreign investment in assembly type manufacturing in the ASEAN-4 has hindered efforts to develop a common industrial policy. All of these contribute to the reason why neither western-oriented classical economics, nor dependency or world system theory is fully applicable to Southeast Asian developments (*Evers*, 1989 : 7). The emphasis on economic nationalism (economic freedom and self-reliance), is the most noticeable obstacle to regional economic cooperation, and is embodied clearly in policy guidelines of all the ASEAN countries; not only in economic but also in political and social matters (*Sukrasep*, 1989 : 50). The emphasis on the sovereignty of each member results in the limitation of power and authority of outside organizations such as the ASEAN Secretariat, and in the lack of determination by the member countries to wholly support ASEAN activities.

In spite of the rules of origin, there is no probability that AFTA will create a closed ASEAN. In other words, AFTA does not possess the tendency to be inward-looking because of certain significant features which characterize both intra- and extra ASEAN trade. The most of which are the dependence of the ASEAN-4 on non-ASEAN nations, especially USA and Japan, for the supply of capital goods and funds to fuel their development as well as for their simultaneous reliance on the markets of these two economies the capital goods.

- Political Problems

Even though the best attempts have been given to push down the potential conflicts by their governments and news media, various potentially dangerous disputes and clashes of interest still exist between ASEAN members. For instance, the dispute over Sabah between Malaysia and the Philippines has remained unresolved up until now. It has ruined the relationship of both countries twice and affect the regional cooperation to some degree.

Anti-Chinese sentiments of Malaysians, whose overseas Chinese were 35.5% of total population in 1986, remain questionable for Singapore whose majority population is Chinese (72% of total population in 1986). It results in a relationship of distrust between the two countries. In sum, some conflicts of interests between the ASEAN countries have their roots in historical events long passed, and others in processes of colonisation and decolonisation. It goes without saying that insecurity feeling towards neighbouring states and political conflicts among the members place certain obstacles in the way of the development of economic cooperation.

E. CONCLUSION

The economy of the South (developing countries) has been much more sensitive towards the changes in the international economy than that of the North (industrialised-capitalist countries), since most countries of the South have had little to sell other than primary products and frequently tended to rely on a small number of low quality exports; moreover, they have had to import machinery equipments from the North and pay licence fees for industrialization. In line with such an international system, they, the South, posed jointly some proposals on how the structures and management of international economic mechanism ought to be changed and how international organizations and the more advanced economies of the North should support them in overcoming poverty and encouraging economic progress. The Asian-African Conference in Bandung (Indonesia) in 1955 was the first self-awareness and attempt of the South to enter into international arena. It was then followed by the foundation of the Non-Aligned Movement in 1961 and the

Group-77 in 1964, which marked the beginning of collective action by the South to promote its common interests.

It is widely accepted that establishing regional economic cooperation among neighbouring countries in the South is a plausible way to enhance their collective economic competitiveness in international political economic environment, which is frequently full of the politics of market protectionism and uncertainty about the world's financial stability. To sum up, South-South economic links have come to be established - at bilateral, subregional and regional levels - as developing countries have looked at each other for mutual sustenance in a bid to terminate their narrow orientation towards the North. As a consequence, it is easily perceived that a few framework of the South-South economic cooperation schemes and integration groupings have been widespread. The phenomenon of the proliferation of regional cooperation in the South indicates a growing need to protect the interests of the developing countries in an increasingly competitive international system that has not been successful to safeguard them. Regional cooperation will be an advantage to all parties concerned, as acting together is more effective than performing alone. They might utilize any type of regionalism or groupings as an alternative way of pursuing their economic growth and of strengthening their bargaining power suitable to deal with other external groups.

With the formation of NAFTA, the northeast Asian NICs and ASEAN members have become more important in the external dimension of Japan's industrial policy. The larger ASEAN economies have all registered impressive economic growth since the mid-1980s, and might suffer less than the northeast

Asian NICs. This is partly because the major ASEAN states depend less heavily on trade than the Asian NICs, partly because they can expect to gain continuing flows of capital from foreign investors seeking alternatives to the increasingly high cost northeast Asian NICs. Therefore, the pattern formed in the 1980s when international trade acted as a powerful engine of growth and exports increased their share of GDP is likely to persist throughout this decade.

When ASEAN was formed, there were political conflicts among member countries, which have not been solved until now. This regional disputes should be overcome soon in order to improve the socio-economic regional cooperation. For the sake of ASEAN economic development cooperation and creating a strong and influential association, each member nation, therefore, needs to indicate a political will towards a greater economic cooperation in order to gain respectable leverage in the New International Economic Order. And at present, what is lacking of ASEAN development is the political will to transform the institution from its hitherto deliberately decentralized state into more sharply focused and centralized entity with some of the organizational attributes of the European Community.

Trade liberalization in the Asia-Pacific region will seemingly not proceed as rapidly as outside interests might hope for. Most East Asian and Southeast Asian economies remain more highly protected than developed western ones. In some of them, visible trade barriers are being reduced gradually. The effect of this policy on openness to foreign trade has been a subject of much controversy, and any clear conclusions are beyond the scope of this thesis. However, it can be said that there is a trade-off between exchange rate adjustments and quantitative restrictions. Should the large trade surpluses of some of the southeast and northeast countries persist, there will be a tension for their currencies to appreciate, hurting exports and income growth. Moreover, with regard to trade liberalisation, although visible trade barriers are declining, informal ones affecting public procurement, quality and testing standards, customs procedures, administrative guidance and distribution systems prevail in widespread use. Few of these informal barriers are covered under the Uruguay Round. In theory, they are covered under APEC (Asia-Pacific Economic Cooperation). Nevertheless, the stipulations of the APEC treaty are voluntary and it seems unlikely that all East Asian members will follow them.

Although the establishment of ASEAN is aimed at accelerating regional economic growth, it appears to be in the spheres of political and security cooperation that the association has achieved the most. However, after Vietnam withdrew from Cambodia and joined the association last year, ASEAN will have to find a new motivation to maintain its close solidarity and cooperation in the absence of the former common communist threat. It is therefore the intensified economic cooperation that needs to be maintained. As the political and economic relations between ASEAN members and Indochina states have improved, there is a possibility that ASEAN may expand its membership to include Cambodia, Laos, and Burma.

IV. THE POLITICAL ECONOMY OF TRADE AND INDUSTRIALISATION IN INDONESIA

A. A HISTORICAL OVERVIEW OF INDONESIA'S FOREIGN TRADE

Indonesia is endowed with rich natural resources, apart from oil and gas, crops products in particular such as pepper, rubber, aromatic plants, rice, coffee and spices, produced specifically by many Indonesian islands. No wonder if the richness and islands' specification of such material factor endowments, coupled with an area geographically intersected by important trade routes, had encouraged not only inter-island trade within Indonesia, but also foreign trade with Chinese, Indians, Gujaratis, Persians, Arabs and other Asian merchants long before the Dutch's occupation, leading to the country's involvement in a considerable amount of commercial traffic in southeast Asia waters. This pre-colonial trading pattern through maritime trade was based essentially upon the import of cloth from Indian and Arab world in exchange for the cloves, mace, nutmeg, pepper, and some precious woods and gold of Indonesia (*Missen*, 1972 : 111).

The spices of the islands were important to the Indian and Arab traders and became increasingly important to the Europeans at a later date; and Indian cloth was the main incentive for the Moluccans, Javanese, and other Indonesians to participate in trade. Added to this basic trade flow was a wide variety of goods which were imported and exported by the Indonesian islands and early Indonesian states. For instances, carpets, incense, seeds and grains, metals, and even foodstuffs arrived in Indonesian waters from Indian and Arab world; in return, Indonesia offered (apart from spices, woods and gold) champor, tin, plumage, and *batik* fabrics. Indo-China, the Philippines, Japan, and especially China also entered this trade (*Missen*, *ibid.*, : 112). Accordingly, trading ships plied across the whole archipelago to obtain spices and other primary goods and to tap intermediate areas for gold, benzoin, champor, pepper, foodstuffs and other items.

Early in the sixteenth century, the Europeans - initiated by Portuguese and the Spanish, British, and Dutch soon followed - showed up in the Mollucas, in search of spices for European markets. Early in the seventeenth century, Dutch traders appeared to be the most dominant in some Indonesia's main islands. As a matter of fact, the Dutch first came to Indonesia in the form of the Dutch East India Company - a state-chartered but mostly autonomous syndicate and called the *Vereenigde Oost-Indische Compagnie* (VOC) in Dutch. The main objective and task of this syndicate was obviously to compete against Asian and other European traders in the Far East. In conducting its task, the VOC established a monopoly of the most important crops (a monopolistic merchant capitalism) - pepper, spices, and coffee for the most part, so that it could enact fixed prices and quotas.

The Dutch government interest in commercial profit was then accompanied by the gradually military territorial expansion all over Indonesia, ultimately dominating the import-export sector of the economy. The result was that the trading system changed the economic geography of classical Indonesia. Other ports arose, notably Ambon, and Batavia (later Jakarta) as the headquarter of the Company. New crops and plantations were introduced in the mid-nineteenth century to the farmers in places in order to produce profitable export commodities (particularly coffee in west Java, and sugar in central and east Java), and old crops became important in new areas or islands, such as pepper along Sumatra's west coast and in Lampung. Deliveries of these commodities were, in effect, a form of land taxation due to the government as owner of all land. Villagers were forced to allocate 20% of village lands to production of specified commercial crops for delivery to the state and to provide sixty-six days of labour per year to work on these state plantations (*Robison*, 1986 : 6). All at once, the Dutch introduced new and variable techniques for gathering Indonesia's goods into the international trading channels, especially for the European markets.

Under such circumstances, a dual economic structure of Indonesia - as common in other colonial economies - was inevitably established. The capital-intensive and export sector on one side was managed and capitalised by the Dutch who determined prices, wages and output of the labour-intensive side - indigenous agricultural units, small domestic trading. One of the most persistent themes developed by economic historians of Dutch colonialism in Indonesia has been that the penetration of capitalism failed to generate an indigenous capitalist economy or an indigenous bourgeoisie (*Robison*, 1986 : 3). The existence of a dual economic division - capitalist and non-capitalist sector - provides one possible explanation of the capitalist failure to induce the emergence of indigenous entrepreneurships since capitalist enterprises which entered Indonesia in the late nineteenth and early twentieth centuries was believed to be highly inaccessible for a weakly developed indigenous merchant class. What is more, the expansion of agricultural production on state plantations in the mid-nineteenth century was deemed to entrench pre-capitalist social structures in Javanese villages, obstructing the expansion of private land-ownership and native capitalist class. This destruction of the peasant agricultural system was accompanied by the destruction of peasant industry; the thriving Javanese (batik) textile industry and other peasant handicrafts industries were restricted by government policies and undercut by imported Dutch goods (*Taylor*, 1974 : 13). At the same time, most of the export surplus from the increased agricultural production were transferred overseas (Holland in particular) - where it provided the capital for industrial investment - as profits, interests, and dividends (*Mangkusuwondo*, 1967 : 89), leading to a hindrance of Indonesian capital formation.

Therefore, Indonesian smallholders, as an aftermath of being in the labour-intensive agricultural unit and non-capitalist side, lost relative importance as exporters and correspondingly were in a state of being constrained to improve their economic status, not to mention the peasant and labours. It was estimated that per head income received by European, Chinese, and Indonesian communities in 1939 was distributed in the ratio of 61 : 18 : 1 (*Anspach*, 1969 : 117). From export standpoint, the following Table 4.1 shows that the value of smallholder's exports were found to be about only one-fourth of plantations' export in the period of 1890-1909.

TABLE 4.1
Estate Agriculture and Smallholders' Export in Indonesia (1870-1909)

Yearly Averages	1870-1879	1880-1889	1890-1899	1900-1909
Output of main crops (1,000 metric tons)				
- Sugar	209.5	374.9	553.5	1,024.6
- Coffee	83.9	81.8	53.2	40.1
- Tea	2.1	2.8	4.3	10.5
- Tobacco, incl. smallholders's	13.4	45.6	68.1	94.3
- Cinchona bark	n.a	0.8	3.6	7.4
Exports (in Fl. 1,000,000)				
- All goods	156.0	187.3	208.1	321.7
- Vegetable products	142.4	172.1	184.0	262.6
Main crops	127.1	140.0	152.3	191.6
Other crop	15.3	32.1	31.7	71.0
Exports (in Fl. 1,000,000)				
- Estates	n.a	n.a	137.5	157.5
- Smallholders	n.a	n.a	16.0	40.0

Source : Mansvelt, W.M.F. 1975 : 21, Changing Economy in Indonesia : Indonesia's Export Crips 1816-1940

Note : Fl. = the Florin or the Gulden (monetary unit of the Netherlands).

As in the Table above shows, during the late nineteenth and early twentieth centuries of the colonial time both Indonesia's foreign trade and agricultural production increased significantly and more indigenous engaged in them, as foreign capital was invested and private enterprises began to develop. However, as *Missen* argues (1972 : 136), the Indonesian peasant, with some Outer Islands exceptions, did not produce for the external market in his own right and had very little incentive to do so by expanding production or developing new techniques. Under the Dutch he was a commercial producer only in the sense that some of his crops found their way into commercial markets; but he himself remained outside that market, oriented to subsistence living.

As a colony, Indonesia was predominantly an exporting economy. In 1925, for example, exports was valued around 36% of the domestic product. Attached to this, the colonial balance of trade appeared to experience an annual export surplus of 247.75 million gulden on average during the period of 1876-1939.

TABLE 4.2 THE INDONESIA'S BALANCE OF TRADE (1876-1939)
(in million gulden)

Period	Imports	Exports	Export Surplus
1876-1880	129	180	51
1881-1885	142	189	47
1886-1890	130	185	55
1891-1895	162	206	44
1896-1900	170	227	57
1901-1905	197	275	78
1906-1910	258	414	156
1911-1915	407	643	236
1916-1920	685	1,339	654
1921-1925	817	1,417	600
1926-1930	994	1,501	507
1931-1935	375	540	165
1936	287	631	344
1937	516	1,012	496
1938	497	714	217
1939	530	787	257

Source: Boeke, J.H., Economics and Economic Policy of Dual Societies, 1953 : 199

Note: The figures of 1940 onward during the colonization are not included by Boeke since for that years the import figures are incomplete, imports of war materials being kept secret.

The economically successful colonialism and colonial policy, however, continued to be the subject of critical discussion in the Netherlands (*Glassbumer, B.*, 1971 : 2). Liberals argued that economic liberalism alone was insufficient, as it failed to lead to recognizable improvement in the quality of life of the indigeneous Indonesians. As a result, the so-called 'Ethical Policy' was initiated in 1901 to be oriented towards the welfare of Indonesians - in the areas of agriculture, education, health, and public works. The reorientation of colonial policy did not change economic trends in any drastic way. The rate of inflow of various forms of the Dutch, other European, and Chinese capital and industrial firms remained to grow, in particular from 1920 until 1941 (. *Segers, W.A.I.M.,* 1987 : 26 and 32), while the Java's growth rate of the indigeneous population accelerated. Before the 1930s, perhaps the most significant transformation in the pattern of economic development was the shift of the growth motive from Java to Sumatra, as Java - the island best endowed with fertile soil - became increasingly heavily populated and less capable of producing export surpluses (*Glassburner*, 1971 : 3).

Compared to the agricultural development which was very impressive, Indonesia's modern industrial sector by 1920s was very small and largely foreign owned. Even though a growing number of factories were established during the 1920s, producing especially for the domestic market, there were only two large industrial establishments in the entire country namely, a General Motors car assembly plant and a cigarette manufacturing plant of British-American Tobacco. What little manufacturing there was consisted almost entirely of seasonal cottage activities (rice milling, textiles, and so forth), and estate-based activities. However, when the Great Depression had a catastrophic effect on the economy with the colony's exports declining from 1,488 million gulden in 1929 to 505 million gulden in 1935, while plantation employment over the same period more than halved (*Hill*, 1988 : 1), the colonial government had little alternative but to encourage industrialisation. *Hill* points to the dismantling of some restrictions on establishing plants and the introduction of limited protection against import competition as the main spurs to industrial growth and foreign direct investment flow in the 1930s.

From indigenous population standpoint, however, the Dutch did next to nothing to develop domestic industry; the only industry that did thrive was the very one that the Dutch had failed to destroy, the indigenous smallholder rubber industry, confined mainly to the Outer Islands (*Taylor*, 1974 : 14). That is to say that the Dutch and other European countries' investment was restricted to the export sector, which whilst it provided lucrative returns for foreign companies (and occasionally for the small domestic economic groups that were involved in this sector), was of little value to Indonesian masses.

Right up until the end of the colonial period, village subsistence production continued to co-exist with the modern plantation sector, and elements of pre-capitalist political authority operated side by side with the Dutch colonial administration (*Robison*, 1986 : 4). By the end of over 300 years of the colonial era, the Indonesian bourgeoisie along with manufacturing industrial production was still relatively weakly developed and concentrated in the sector of trade. Direct Dutch influence did not go beyond the elite classes of native society. Its weakness was magnified by the fact that its most significant element, the Chinese merchants, were not able to assume a position of legitimate, public, social or political leadership. Nonetheless, Dutch colonialism did result in fundamental changes to the pre-capitalist economic and social structures of the Indies which have provided a framework for the intensification of the capitalist revolution in the post-colonial period (*ibid.*, : 5).

B. THE POLITICAL ECONOMY AFTER LIBERATION

After struggling for full sovereignty for four years after her independence, Indonesia ultimately started to be managed by the national government under the late President Sukarno. The economy which Indonesians inherited in 1949 was still of a dualistic economic structure, dominated by export-oriented foreign enterprises in the modern sector and peasant agricultural unit in the traditional sector. As a natural corollary of this, she had to depend on the Western countries as markets for her commodity exports, which not only made her vulnerable to the economic fluctuations of the West but also economically unstable *(Bandyopadhyaya*, 1990 : 12). In this regard, the Dutch legacy of an export plantation economy along with its corresponding consequences of resources exploitation and profit repatriation, was considered to be anti economic prosperity. The plausible response of the post-colonial administration was that economic nationalism which was translated into policy in the form of high trade barriers to cushion the development of a manufacturing sector. It is therefore understandable that economic nationalism in post-colonial period took the form of state support for industrialisation programs and intolerance toward foreign ownership of capital. Thus, economic nationalism meant lowering the country's concentration of aid and trade dependency on major foreign powers.

To this purpose, the creation of an indigenous middle class entrepreneurship was encouraged through various government subsidies. Simultaneously, some prohibitive measures was attempted to limit the growth of foreign capital. Although these measures were partially successful in reducing the Dutch economic dominance, nonetheless, the years 1950-1957 witnessed on the whole, a fruitless perspective in economic nationalism or the so-called *socialism ala Indonesia*. Even, in 1957, about half of all estate acreage remained under Dutch ownership, about 60% of the country's foreign trade was still controlled by the Dutch, and substantial portion of the total bank credit was still controlled by the Dutch banks (*Bandyopadhyaya,* ibid., : 26). To this end, as *Wong* says, the various development programmes in the 1950s and through the greater part of the 1960s did not meet with success, not only because of shortage of capital, technology and foreign exchange, but due also to pernicious, chronic inflation, caused mainly by persistent government deficits to meet rising military expenditures. Indonesia's development efforts was further thwarted by constant political upheavals, corruption, bureaucratic obstacles, social-economic conflicts and the like (*Wong,* 1979 : 58).

Actually, the Dutch left an Indonesia which had a set of very complex socio-economic problems, such as physical infrastucture deficiencies, urban population increase, jobless growth, and a decline in its ability to be self-sufficient in basic food coupled with an economy that had already been seriously disrupted by four years of Japanese wartime occupation. This economic situation even worsened in the twenty years following the proclamation of independence in 1945. In the 1950s, the post-independence period, Indonesia seemed to head for economic stagnation. The old order government wished to make progress in economic development, but in this decade :

> both rural and industrial production steadily decreased, to a large extent because the rate of investment was not maintained. Inflation increased, annual price rose averaging between 8 and 12% between 1951 and 1956. The pressure which this placed on government to implement price control and foreign exchange policies tended to be to the disadvantage of the export communities of the Outer Islands and to foster disenchantment with the central government (*Missen, 1972 : 237*).

One main factor which brought about this economic deterioration was the too-rapid turnover of cabinets within the parliamentary democratic system, leading to discontinued policies of the policy making elite of the entire 1949-1957 post-colonial period. Formal political power went through a series of parliamentary cabinets, depicting various degrees of fluctuating influence and interests of the major political parties. None of these parties could be said to represent or constitute the specific interests of any class in a cohesive way (*Robison*, 1986 : 37). This was largely because, according to *Robison*, the pre-capitalist structures of social class and political power had been eroded by the money economy, commodity production and the colonial state without being replaced by well-defined or politically organised classes of landlords, wage labourers or capitalist.

The specific policies for a national economy varied considerably among the parties of the post independence period. Although as many as twenty four political parties, surrounded by various groups of interests, contested in the general elections of 1955-1956, the political system and the decision making process were dominated by four major parties. The Communist Party, PKI, emphasized s[illegible] ownership; groups within the Nationalist party, PNI, envisaged cooperatives playing a dominant role; while Masyumi and the other Islamic parties, naturally strongly anti communist in its attitude, favoured private capital provided it was in Indonesian hands; and the Socialist Party, PSI, which was closely associated with Western-trained intellectuals and represented another nationalist force, was interested in a minimal role of the state in the economy. Therefore, in the course of 1949-1957 period, Indonesia's domestic politics and foreign policy perspectives were a function of the interplay of these four major political parties with their diverse ideologies and different in attitude on important national and international issues. The rightist and leftist groups of the small elite leadership coupled with anti-colonialism, nationalism, and belief in national religion, i.e. Islam, bound them together.

The reasons of the diverse schemes of these parties were broadly threefold (*Missen*, 1972 : 234). First, there was little in the way of established theory upon which to base reconstruction. While socialism was voiced in some form or another by nearly all major parties, socialism meant little more than Indonesianisation. Marx's principles of struggle between classes distinguished on the basis of property ownership were not really appropriate, since all Indonesians, irrespective of property ownership, had become pauper under the particular colonialism the Dutch practised. In the second place, there remained the thorny problem of securing a national economy without disrupting the assets which the foreign capitalist sector had established. In order for economic growth to be launched, especially after wartime devastation and depreciation of assets, Indonesia required the levels of productivity and the foreign reserves associated with this capital sector. Thus, while foreign capital and enterprises were generally antithetic to the nation's post-revolutionary mood, they were nevertheless often recognised as important for the the economy, at least for the moment. Even the Communist Party (PKI) seeing the need for capital assets and the problems posed by Indonesia's deficiencies in skill and management, was transitionary in its approach. To a large extent, therefore, economic policies tended to compromise between foreign capital needs and indigenous pressures, and all were qualified by pragmatism (*ibid.*,: 235). On that account, there was a dilemma of independence versus economic needs (requiring aid, investment, and trade) in the process of restructuring the economy according to their desired national goal.

As the political disparities of Indonesia became more obviously unworkable and frustration arose out of the failure to promote economic nationalism, a form of political system other than parliamentary democracy was inevitably put in use. The result was Guided Democracy (Guided Economy) by which the role of the parties was curtailed by bringing non-party bodies into the machinery of government. A parliamentary democratic system was replaced with an authoritarian regime, loosely built around two centers of authority : the President and the Army (*Robison*, 1986 : 69). This to say that the most important development in the relationships between power and capital in Indonesia during 1957-1965 was the rise of the military as the most powerful politico-bureaucratic force. With the advent of Guided Democracy in 1957, a radically new economic policy began to emerge with an anti-Western course in foreign policy. Foreign enterprises were nationalised, and this introduced a period of much more direct and broader-based state intervention in the economy (*Taylor*, 1974 :15). Not only were these foreign enterprises nationalised, but the state also took over control of the various economic functions, such as banking and transportation. Unfortunately, the nationalisation of Dutch commercial interests, and those of the British in 1957, contributed little to the general welfare of the Indonesian people. The confiscation of British interest which occurred in the period of confrontation with Malaysia (1963-1965) provided Indonesian army officers with a windfall of profitable undertakings (*Payne*, 1974 : 60).

The surplus generated in the raw material sector and the foreign owned agricultural (almost totally plantation) sector was now no longer to be appropriated by foreign concerns, but would be used directly to finance indigenous industrialisation, which would be further assisted by the introduction of a complex system of multiple exchange rates, by which selected domestic industries would be protected from undercutting by imported commodities (*Taylor*, opcit. : 16). The expropriations were a major blow to foreign capital in Indonesia and fundamentally transformed the structure of the economy. They involved the transfer of ownership of 90% of plantation output, 60% of foreign trade, some 246 factories and mining enterprises, plus banks, shipping and a variety of service industry (*Robison*, 1986 : 72). In April 1958 alone, the confiscated Dutch trading houses were incorporated into several new state trading corporations and were given a monopoly on the import of thirteen basic commodities, including rice and textile (*Taylor*, opcit., : 16). All these indicated a clear picture that the private sector, indigenous or Chinese, was to be excluded from the most profitable of trading monopolies. Thus the intention of Guided Economy was to put together a national industrial economy around state-owned capital, ending the experiment in state financing of a domestic capitalist class. There were several arguments for this excessive state control. Indigenous capitalists had in general proven themselves to weak to assume ownership of such a massive slab of the colonial economy, consuming state credit and concessions throughout 1950s without providing any serious evidence that they were able to establish the basis for a national industrial economy. At the same time it was clearly out of the question, in political terms at least, to hand the confiscated assets to Indonesian Chinese capitalists (*Robison*, opcit. : 73).

The economic programme of Guided Democracy obviously emphasised national preoccupation and other political objectives rather than rational management of the economy. The nationalisation of foreign enterprises in late 1957 and the subsequent suppression of the business activities of the private sector of ethnic Chinese made it virtually impossible for foreign participation in development - with the exceptions of oil and minerals. Consequently, the economy's performance during Guided Democracy deteriorated while inflation became rampant and the government proved unable to replace a declining estate export sector with some kind of national industrial capitalism. Declining foreign exchange earnings through exports, combined with growing foreign borrowings and imports, induced severe balance of payment crises. It was estimated over 60% the debt of the old regime was owed to the former Communist bloc. A considerable amount of it was used for the purchase of military hardware. On 31 December 1965 foreign debt amounted to a total of US$ 2,358 million, of which the former Soviet Union led with $ 990 million, followed by Japan with $ 231 million and the United States with $ 179 million (*Mody*, 1987 : 2).

In fact some Western observers suggested that by the 1950s per capita income had returned roughly to pre-war levels, while aggregate economic growth for the Guided Economy was probably below the population growth (*Wong*, 1979 : 58). From the mid-1950s to 1965, exports in general were not able to reach as much as 10% of GDP, perhaps falling as low as 5% (*Glassburner*, 1971 : 14). The bulk of this decline was in smallholders' production of exportable agricultural commodities. The failure to develop domestic production and to increase exports, coupled with the restrictions placed on foreign capital investment and imported goods, produced a situation in which domestic economic stagnation was virtually inevitable (*Taylor*, opcit. : 17). Microeconomic distortions were myriad, and extremely high levels of over-bureaucratisation and the corrupt administrative structure in the government sector created serious economic disarray. Domestic capitalist were subjected to a variety of political and economic controls by state agencies largely based upon the power of the state to allocate raw materials and other imports.

Right before the downfall of Sukarno's regime, the extent of macroeconomic imbalance was also unbelievably high, making it impossible for even the most productive economic sector, i.e., export industries, to grow. Exports declined rapidly during the sixties, and they stood at a total value of $648 million in 1964 and $450 million in 1965, as compared with $840 million in 1960; again, agricultural productivity failed to meet domestic needs during this period - in fact, rice was the biggest single item on the imports bill during the sixties (*ibid.*, : 16). Some indication of the severity of the decline in the postwar years may be associated with the dollar value of exports. At the height of the Korean War boom, Indonesia exported nearly $ 1.30 billion worth of goods (*Glassburner*, 1971 : 3). It was in this economic mismanagement situation that a communist-motivated coup was attempted in

September 1965. Abrupt suppression of the coup by the army established General Soeharto as a rival to Sukarno.

C. THE POLITICS OF THE NEW ORDER'S ECONOMIC REFORM

As the country closed to bankcruptcy with debt service obligation in 1966 exceeded export earnings and the economy was obstructed by overregulation and a-three digit inflation (almost 650%), the Suharto's administration placed economic stability as a principal goal. The priority was depicted in the appointment of a number of US-educated economists to senior ministerial post. Hand in hand with the IMF and other aid donors, a new generation of foreign-educated technocrats arranged a comprehensive programme for the rapid restoration of economic stability, and the recovery of the country's growth performance. The measures adopted by these policy-makers included a fiscal and monetary discipline to lessen the high rate of inflation, which involved a commitment to balance budget principle and strict controls on the expansion of credit through the imposition of high interest rates.

This policy proved to be successful in a decrease in the rate of inflation to approximately 10% by 1969. In the period before the first oil boom (1969-73), the economy grew at an average growth rate of 8.4% per year. This growth was largely attributable to the process of recovery of the economy from a period of stagnation and hyperinflation as a result of system reform (*Tjiptoherijanto*, 1993 : 320). The extensive system of direct control which stifled production and invesment was dismantled. The exchange rate devaluation was implemented and the economy was reopened for foreign investment. The import licensing system was thoroughly terminated, and while there were some upward adjustment in tariffs in 1968 to push domestic production, notably in textiles, import protection was considerably reduced (*Pangestu*, 1991 : 255).

The measures taken in the period of 1966-70 under the New Order administration clearly shows, in contrast to Sukarno's attitude against foreign aid and trade, that the basic elements of the new political economy - foreign aid, investment, trade, technology - were necessary for development. This approach was obviously reflected by the influence of the economic team of Suharto's New Order government with neo-classical orientation. The key figures in the team have continued to be in the government sector, and this continuity has proved valuable when Indonesia faced economic crisis and needed reforms.

To understand the politics of Indonesia's economic policy under the new order government, it is here necessary to look at two significant *forces of influence* that have contended to form economic policy. Three groupings in economic policy debates can be broadly delineated : old-style economic nationalists, interventionists generally supported by the nationalists, and free marketers (*Mackie and MacIntyre*, 1994 : 35). Another significant part of the interventionists since the mid-1970s, although it can be said a separate part of the group, has been the Ministry of Research and Technology , which supervises ten capital-intensive state industries and wants Indonesia to enter high-tech industries (*Bhattacharya and Pangestu*, 1993 : 39). The technocrats favour market reforms and a limited role for the government in the economy. In contrast, economic nationalists and interventionists argue that trade protection and direct government investment and regulation are necessary to contain foreign influence while sufficient resources are mobilized to modernize the economy. The balance of power between the economic technocrats and the economic nationalists appears to be mediated by Suharto, who has skilfully channeled the energies of both groups into separate arenas. To a large extent this might serve as an explanation of policies pursue under the new order has often been characterised by a contradictory mix of liberalizing and protectionist perspective.

By the same token, government policy has also changed over time, partly as a result and in response to the changes in the external environment, especially the oil boom and the decline of oil and primary goods prices (*Pangestu*, 1991 : 256). This is to say that when it came to the difficult times towards the end of the 1970s and the beginning of the 1980s, the country quickly realised that she could not rely on her domestic market to provide for adequate outlets if she wanted to maintain the growth of her emerging industrial sector. The rise and decline in interventionist policies in Indonesia as a response to changes in international condition are summarised in the following Table 4.3 in order to provide a more clear illustration of the policies adopted.

TABLE 4.3 Changes in Policy Direction and External Condition

Period	Changes in External Environment	Policy Direction		
		Macroeconomic Policy	Trade and Industrial Policy	Ownership and Government Regulation
1958-65 Guided Economy		Growing Instability Ending with hyper-inflation; Foreign Exchange Control	Strongly Inward Oriented	Nationalisation; state dominated economy; Strict control over private domestic and foreign investment
1967-73 New Order Rehabilitation & Stabilisation		Successful stabilisation; open capital account	Moderately Outward Oriented (beginning of Import Substitution Policy)	Liberalisation of domestic and foreign investment; some rationalisation of state owned enterprises (SOE)
1974-81 Oil Boom	Sharp increase in oil prices 1973; and non oil commodity boom 1975-79; second oil price increase 1979	Maintenance of macroeconomic stability, although some inflation from lack of sterilisation of oil revenue	Growing inward orientation (increasing ISI)	Increasing share of public investment and SOE. Growing restrictions on foreign and domestic investment
1982-85 First External Shock	Decline in oil prices. Decline in Primary Commodity Prices	Macroeconomic Stabilisation; fiscal austerity, devaluation and tight monet. pol.	Strongly Inward Oriented; proliferation of non-tariff barriers	Continued reliance on SOE and regulation of market economy
1986-88 Second External Shock	Sharp decline in oil prices and continued decline in primary product prices. Yen Appreciation; shock on external debt	Continued Macroeconomic stabilisation; Devaluation, tight monetary policy and balanced budget	Shift to Outward Oriented Economy	Deregulation of customs and imports; relaxation of foreign and domestic investment regulations; Reduced reliance on SOE and public investment
1988-now Non Oil Led Recovery	Stable oil prices. Further decline in primary commodity prices	Maintenance of macroeconomic stability	Further shift to Outward Oriented Economy	Deregulation extended to investment, finance, maritime and other areas; Initial steps towards SOE reforms

Source : Pangestu, M., 1991 : 254, *'The Role of the State and Economic Development in Indonesia'*, in the Indonesian Quarterly Vol. XXI No.1, Third Quarter.

The economist technocrats have managed the Ministry of Finance, the National Development Planning Agency (*Bappenas*), the Central Bank, while the interventionists (engineers) have controlled the Ministry of Industry, the Ministry of Trade, and the National Investment Coordinating Board (*BKPM*). The technocrats' acceptance of the comparative advantage principle has led them to emphasize the development of non-oil export industries, particularly agricultural commodities and labour-intensive manufactured goods. This has meant favourable treatment for the agricultural sector, which supplied 82% of Indonesia's non-oil exports in 1970 and 75% in 1980. Exchange rate devaluation rather than the removal of trade barriers on imported inputs has been used to promote exports because the technocrats have conrolled the ministries in charge of macroeconomic policies but not the ministries that have the authority to set quotas and grant import licenses. However, the technocrats are not free-market ideologues and have not been averse to state intervention to promote other objectives besides economic efficiency (*Woo* et. al, 1991 : 40). In *Woo's* view, they practice neoclassical economics in the sense that they believe that some methods of intervention (especially those that are market-compatible) yield better results than others.

On the other hand, the interventionists include technicians-turned-managers, military advisers, and economists with structuralist inclinations, united by their belief in the general validity of the infant industry argument and a dislike of foreign ownership of capital (*ibid.*, : 41). The interventionists have generally been associated with members of the intellegentsia who have viewed state enterprises as the way to balance Chinese domination of the private sector. Their existence in the Ministry of Industry and Trade, and *BKPM* has provided them with a chance to encourage domestic production of manufactured goods, including aircrafts. Furthermore, according to *Woo*, their support for import-substituting industrialisation won them the support of the rent-seeking coalition composed of indigenous capitalist, army officials, and civilian bureaucrats (*ibid.*, : 44). In Southeast Asia countries, there has been increased recognition of different forms of resistance to economic reform - not simply or even primarily from bureaucrats, but more significantly from important segments of the private sector. The principal focus of this inquiry has been on the influence of 'rent seeking' groups, the argument being that those who benefit from policies that distort the economy will resist any effort to change these policies (*Koppel*, 1992 : 118). However, there are other possible explanations, including that patterns of capitalism in Southeast Asia do not distinguish clearly between public and private interests or between political and economic competition.

The influence of the technocrats in Indonesia has been noticeable in the periods of harsh economic conditions, especially right after post-Sukarno years and the period from 1983 to now. During the intervening years their influence was heavily circumscribed. The resurgence in nationalist and interventionist ideas in the early 1970s manifested itself in a number of ways. Foreign investment regulations were once again tightened. Trade and industrial policy was redirected as the country set off on a state-led drive for import substituting industrialisation. Armed with the revenue from oil taxes, the government began financing and investing heavily in upstream import substitution and strategic government projects (e.g.: steel, fertilisers, and cement) and other basic infrastructure in a bid to develop an integrated industrial base (*Mackie and MacIntyre*, 1994 : 37). Trade barriers were erected to protect domestic producers from excessive foreign competition. As an aftermath, almost all Indonesia's industrial production was sold on domestic markets, leaving exports dominated by oil and agricultural products. Selective intervention proliferated and was intensified through the early 1980s. The typical pattern was to induce domestic producers to invest in a selected sector, designed by the Ministry of Industry, that could substitute domestic production for products previously imported.

It was common to offer incentive to the domestic investor often included sole license to import the product, and thus created restrictions on other potential domestic producers.

In the period of 1973-81, the economy continued to grow at a high rate, averaging 7.9% per annum, but this growth followed an import substitution path with rapidly expanding investments in infrastructure and directly productive capacity reflecting the dominant role of the government sector (*Tjiptoherijanto*, 1993 : 320). However, the private sector became dominated by large conglomerate corporations, often Chinese minority-owned, which had sufficient wealth and know-how to assist the government in large-scale modernization projects. *Robison* estimated that Chinese Indonesian capital accounted for 70-75% of private-sector investment in the 1970s (*Robison*, 1986 : 276). The two most prominent conglomerates, the Astra Groups and the Liem Group, had substantial holdings in dozens of private firms ranging from automobile assembly to banking. The growth of these conglomerates usually depended on close ties to government (*William*, 1993 : 145). Because Indonesia lacked an indigeneous class of entrepreneurs, large-scale enterprises were organised either through the action of the state, by ethnic Chinese capitalists, or quite often, a cooperative relationship of the two (*ibid.*, :61). In exchange for monopoly priveleges on production and imports of key industrial products, conglomerates would undertake large-scale investment projects to help implement government industrialisation goals. Political patronage became a vital component of business success in the early 1980s as government restrictions were extended to curtail imports when oil revenues began to decline.

Prior to 1985, there were about 1,700 items, representing 35% of the value of imports, that were either imported by licensed importers or controlled through a quota system (decided by the Ministry of Trade). Such non-tariff barriers affected almost all manufactured imports. No wonder if corporations in these sectors, as a result of restrictions on imports, were effectively protected from foreign competition or in the position to sell their products at a higher cost. Corporations that acquired import licenses were also extremely lucrative, but costs were borne by the entire economy because imports were often key inputs for many manufacturers.

Due to the uncertainty and sharp decline in oil and primary commodity revenues in the mid-1980s, leading to a sharp decline in the external terms of trade, Indonesia adopted an alternative industrial strategy to overcome the economic condition. Indonesia was heavily dependent upon oil as a critical export, and this important export accounted for more than 70 per cent of the total export revenues of Indonesia. As oil was no longer seen as the main source of export earning potential, the government promoted a program of export diversification. The policy pendulum swung back towards a more liberal regime, as economic growth during the first half of 1980s (below 5%) and investor interest declined (*Hill, 1994* : 68).

Major trade policy reforms, introduced in the mid-1980s, went a long way toward disentangling the government from the market. Despite the many public statements regarding the importance of improved efficiency in the state sector (by the late 1980s it contributed around 30% of GDP, and almost 40% of non-agricultural GDP), the reform process has moved much more slowly than in the case of foreign investment or trade policy. State corporations continued to control a tremendous amount of economic activity, much larger than that in most developing countries.

TABLE 4.4 Estimates of Ownership Shares by Sector, 1988

	Domestic	Foreign	Government	Share of Sector Out of GDP
Agriculture				21
-Food Crops, Smallholders and Livestock	100	0	0	18
-Fisheries, Forestry, and Plantations	80	5	15	3
Mining				16
-Oil and gas	0	50	50	15
-Other	30	30	40	1
Manufacturing				18
-Oil and Gas	0	0	100	4
-Other	59	17	24	14
Construction	90	5	5	5
Utilities	0	0	100	1
Transport and Communications	50	0	50	5
Trade and Tourism	90	5	5	16
Banking and Finance	30	5	65	4
Government	0	0	100	8
Accomodation	90	0	10	4
Other Services	100	0	0	4
Total	*57*	*12*	*31*	*100*
(Excluding Oil and Gas)	*71*	*5*	*29*	

Source : Hall Hill, 1992, cited in Pangestu, M, 1991 : 262.

A major reason for the slow progress in state enterprises reform, apart from bureaucratic resistance, is the continuing commercial dominance of the non-indigenous (mainly ethnic Chinese, less than 3% of the population) (*Hill*, 1994 : 69). Another government policy initiated in 1989 suggested that at least some state-owned industries would be protected from possible privatization. A Council for the Development of Strategic Industries was established, headed by Minister of State for Research and Technology. The council gained control on ten major state enterprises, including several munitions plants, shipbuilding industry, the state aircraft corporation (*IPTN*), and *Krakatau Steel*. This policy, viewed as a concession to the economic nationalists in the midst of government cutbacks, assured a major role for state-owned industries in Indonesia's most technologically sophisticated sectors (*William*, 1993 : 154).

Still, the large conglomerates that had emerged under the heavy regulations also had the resources to benefit most in the more competitive environment. By the early 1990s, the government still confronted widespread popular concern over the distribution of gains from economic development. There has been much public commentary arguing that rather than leading to improved economic circumstances for the great majority of Indonesians, the government's shift towards more market-oriented policies during the 1980s has served principally to make the very wealthy even wealthier still (*Mackie and MacIntyre*, 1994 :39). Resentment has been sharpened by the perception that many of the most successful of the conglomerates have prospered primarily because of cronyism. Therefore, Indonesia's business landscape can be roughly divided into three separate interests. First, there is a group of powerfully connected indigenously owned conglomerates which have mostly made their way to enormous success through the political patronage and government protection. The second category is made of ethnic Chinese Indonesians who have amassed tremendous wealth through, again, political patronage and government largesse. Last, and most certainly least in terms of power, is the huge number of small and middle-scale businesses which have for years pressed for economic reform.

TABLE 4.5 Ranking of Indonesia's largest conglomerates
(Assets estimated in trillion Rupiah)

Rank	Conglomerate	Main Owners	Assets	Main Line of Business
1	Salim Group	Sudono Salim (c) (Liem Sioe Liong)	24.50	Cement, Wheat, Food, Automotive, Finance, Steel, Agrobusiness, Property, Textile
2	Barito Pacific	Prajogo Pangestu (c)	14.50	Integrated Wood-Based Industry, Bank, Chemicals, Agrobusiness, Pulp and Paper, Property
3	Sinar Mas	Eka Tjipta Widjaja (c)	13.00	Finance, Pulp and Paper, Agrobusiness, Property
4	Danamon	Usman Admadjaja (c)	7.20	Finance
5	Gajah Tungal	Sjamsul Nursalim (c)	6.60	Tyre, Pipe, Cables, Finance, Property
6	Astra	Prajogo Pangestu (c)	5.50	Automotive, Electronics, Finance, Agrobusiness
7	Lippo	Mochtar Riady (c)	5.30	Finance, Property, Electronics
8	Bimantara	Bambang Trihatmodjo and Indra Rukmana (i)	3.70	Finance, Automotive, Animal Feeds, Property, Textile
9	Indrapura	Julius Tahija (c)	3.70	Finance, Mining Industry Processing
10	Raja Garuda Mas	Sukanto Tanoto (c)	3.60	Pulp and Paper, Integrated Wood-Based Industry, Bank
11	Gudang Garam	The Rahman Halims (c)	3.50	Cigarettes and Supporting Industries, Property
12	Panin	Mu'min Ali Gunawan (c)	3.40	Finance and Property
13	Argo Manunggal	The Nien King (c)	3.30	Textile, Chemicals, Finance, Steel, Property
14	Dharmala	Soehargo Gondo Kusumo (c)	2.90	Property, Agrobusiness, Finance, Electronics
15	Roda Mas	Tan Siong Kie (c)	2.80	Property, Finance, Chemicals
16	Pasopati/Nusamba	Mohamad Hasan (c)	2.60	Integrated Wood-Based Industry, Finance, Property, Agrobusiness
17	Nugra Santana	H. Ibnu Sutowo (i)	2.60	Finance, Property, Shipping
18	Jaya	Pemda DKI and Ciputra (I & c)	2.40	Property, Finance, Various Industries
19	Arya Upaya	Kaharudin Ongko (c)	2.30	Property, Ceramics, Finance
20	Humpuss	Hutomo Mandala Putera (i)	2.30	Transportation, Automotive, Oil, Finance, Chemicals
21	Mulia	Eka Tjandra - negara (c)	2.00	Property, Ceramics, Glass
22	Sinar Sahabat/ Kanisatex	Sukanta Tanudjaja (c)	1.80	Textile, Property, Finance
23	BHS	Hendra Rahardja (c)	1.70	Finance, Motorcycle, Property
24	Arseto	Sigit Harjojudanto (i)	1.70	Finance, Chemicals, Oil, Transportation
25	Djarum	The Michael B Hartonos (c)	1.60	Kretek Cigarettes, Electronics, Agrobusiness
26	Bakrie	The Aburizal Bakries (c)	1.60	Steel, Agrobusiness, Property, Finance
27	Ometraco	Ferry T. Santoso (c)	1.60	Finance, Industry, Trade, Property
28	Modern	The Samadikun Hartonos (c)	1.60	Film Industry, Finance, Trade, Property
29	Gunung Sewu	Dasuki A. Subroto (c)	1.50	Agrobusiness, Foodstuff, Property
30	Citra Caraka	Murdaya Widyamarta (c)	1.45	Footwear Industry, Construction, Computer, Property
31	Ratu Sayang	Henry Onggo (c)	1.40	Property, Textile
32	Bank Bali	Djaja Ramli (c)	1.40	Finance, Property
33	Texmaco	Marimutu Sinivasan (c)	1.40	Textile, Engineering

Source: Adapted from Economic & Business Review Indonesia, Sept. 23, 1995 : 2

Note : i (indigenous) ; c (chinese Indonesian)

Most of the substantial reforms that began in the mid-1980s and continued through the first half of 1990s reflected a new orientation to market-led economic development. In some cases, however, important new policies reflected the longstanding government concern that the private sector could not be trusted to ensure politically desirable outcomes. This was particularly true of policies concerning the processing of Indonesia's valuable natural resources and the sensitive area of indigenous business development (*William*, 1993 : 152).

V. TRADE AND GROWTH

A. THE ROLE OF TRADE IN THE ECONOMY

Indonesia lost time and various opportunities in catching up with the more industrialised countries in the almost thirty five years after its liberation. These lost and impediments, as reviewed in Chapter IV, were to some extent caused by : first, the poor performance of the economy throughout the first half of 1960s as a result of the economic mismanagement, which was exacerbated by increasingly cutting itself off from international commerce ; second, the country experienced a major external shock during the first half of 1980s. The main source of the shock was a sharp decline in the external terms of trade accompanied by slow growth (even with negative growth 0.3% in 1982-83), largely due to the collapse of oil prices in the international market in the 1980s and to a lesser extent the decline in the primary commodity prices, both of which used to be the main sources of the country's foreign exchange earnings.

However, despite the obstacles above, Indonesia has succeeded to regain her growth, although it remains slightly lower than peak levels of well over 8% recorded in the first half of 1970s, and began to place great reliance on a foreign trade diversification and deregulation to boost export-led growth in manufactures as well as encourage an increased role for the private sector. The growth in non-oil exports, which exceeded that of oil exports in 1988, helped Indonesia maintain a positive trade balance throughout the 1980s in spite of the oil market collapse. Using the UNCTAD's 1994 data, Indonesia's participation in world's total value of import and export trade in 1993 is US$ 64.9 billion, that is an increase of about 46 times over the value of 1960, US$ 1.4 billion (*UNCTAD*, 1994 : 6 & 7). As a comparison, the world trade value in 1993 amounted to US$ 7,488.8 billion, that is only a 28 times expansion over that of 1960 (US$ 266.4 billion).

Table 5.1 World and Indonesia Trade Value (billions of dollars)

Year	1960	1970	1975	1980	1985	1990	1992	1993
World	266.4	642.0	1,784.7	4,083.1	3,974.7	7,074.6	7,570.1	7,488.8
Indonesia	1.4	2.1	11.9	32.7	28.9	47.5	61.1	64.9

Source: UNCTAD, Handbook of International Trade and Development Statistic, 1994 : 2 and 6
Figures have been rounded.

As in the following Table 5.2, export grew more than double, from US$ 14.8 billion in 1986 to US$ 33.8 billion in 1992; import increased more than double from US$ 10,7 billion 1986 to US$ 27.3 billion in 1992 as well. Domestic output also gained its momentum with an increase from US$ 70 billion to US$ 101.3 during the same period. These figures show that the growth of Indonesia's foreign trade, close to 19% on average, is faster than that of domestic output, which is about 7% yearly.

It is, therefore, necessary to notice how the role of two-way trade has affected Indonesia's macroeconomic performance since a more diversified outward-looking development strategy was in effect. For the purpose of determining the contribution of Indonesia's foreign trade to the national economy, we have to compare export dependency ratios (exports/GDP ratio), import dependency ratios (imports/GDP ratio), and the degree of openness (the ratio of the total external trade to GDP). As can be seen in Table 5.2, the average value of exports and imports during the period 1986-1992 was US$24.0 billion and US$19.2 billion, respectively. It means that about 128% of Indonesia's imports were able to be financed by exports. Exports as percentage of GDP (export dependency ratio) increased from 21.1% in 1986 to 33.4% in 1992, averaging about 27.4% of GDP. At the same time, the import dependency ratio rose from 15.3% in 1986 to 26.9% in 1992, averaging 21.7% of GDP. As a comparison, the corresponding ratios for South Korea in 1965, when her manufacturing export industries began to take off economically, were only 5% and 16%, respectively (*World Bank*, 1991). This suggests that a good potential for the Indonesian economy exist because of her high foreign trade dependency and the large size of the country.

TABLE 5.2. Indicators on Indonesia's Foreign Trade and GDP (1986 - 1992)
(in billion US$ and %)

	1986	1988	1989	1990	1991	1992	Average
Exports	14.8	18.9	21.8	25.6	29.0	33.8	24.0
Imports	10.7	13.2	16.3	21.8	25.9	27.3	19.2
Total Trade	25.5	32.1	38.1	47.4	54.9	61.1	43.2
GDP	70.0	77.7	83.4	89.3	95.2	101.3	86.2
Exports/Imports(%)	138.3	143.2	133.7	117.4	112.0	123.8	128.1
Exports/GDP (%)	21.1	24.3	26.1	28.7	30.5	33.4	27.4
Imports/GDP (%)	15.3	17.0	19.5	24.4	27.2	26.9	21.7
TotalTrade/GDP (%)	36.4	41.3	45.7	53.1	57.7	60.3	49.1

Source : Calculated from World Bank, World Tables, 1994 : 349 and 351, Figures are rounded

Note : Estimated using 1987 average exchange rate at constant 1987 prices

Meanwhile, the degree of openness of the economy (the ratio of total trade to GDP) also grew from 36.4% in 1986 to 60.3% in 1992, averaging 49.1% of GDP, compared with the Philippines' 39% in 1988, and much lower ratio of

12% in Myanmar. Based on data from the *World Bank* 1991, Indonesia, like most Southeast Asian nations, is not far behind East Asian NICs. As for the year 1988, Thailand's total trade/GDP ratio was 58.8%, and Vietnam's was 31.0%. In 1992 Indonesia's trade to GDP ratio reached 60.3%, comparable to the level of South Korea, although still below figures for Taiwan or Singapore and Hongkong.

Among non-oil exports, the crucial development was the very strong growth of manufactured industrial exports, whose value in 1994 (US$ 22.36 billion) was higher 7.12 times than that in 1986 (US$ 3.14 billion). As in Table 5.3, nearly 45% of the exports during the period (1986 - 1994) consisted of miscellaneous light-manufactured goods. Much of the early growth was actually in wood processing, following the enforced export substitution, notably the log export ban of the early 1980s. But by the late 1980s the base had broadened considerably to include garments, textiles, paper products, footwear, fertiliser, furniture and many other industrial products. In other words, there was a steady diversification towards a wide range of labour-intensive manufactures for which actual comparative advantage factors were the crucial means of commercial success. For much of this period, however, reflecting Indonesia's factor endowments, natural-resource-based products comprised a relatively large share of manufactured exports.

The expansion of such low-skilled labour-intensive exportables in a typical labour-surplus economy could generate real income. Foreign exchange earned by exports might facilitate material and equipment imports necessary to industrialization. What is more, because 128% of imports during this period were financed by exports, imports have provided technology. machinery, equipment, and intermediate goods, that would otherwise not have been available in the country. Besides, trade contributes to technology transfer by drawing in foreign investment and by exposing domestic firms to the world market. Considering Indonesia's situation, foreign investment is obviously critical for the economy. At this point, the country is attractive to the foreign investors due to its domestic market of almost 200 million people, cheap and well-disciplined labour, and abundance of natural resources. Recently, the Asian NICs have become the major source of investment in Indonesia's manufacturing export industries (mostly concentrated on Java), as firms have shifted their labour-intensive industries into the newly competitive low-wage countries. This appears to be a force for the stronger economic complementarities between a low-wage but resource-rich Indonesia alongside the resource-poor, high-wage economies of the east Asian NICs and Japan.

Table 5.3. Indonesia's Export Structure by Main and Selected Commodities, 1986-94

(Billions US $)

No	Description of Goods	1986	%	1988	%	1989	%	1990	%
I	Oil and Gas	8.27	56	7.68	40	8.67	39	11.07	43
II	Primary Commodities/Agri.	3.39	22	4.85	26	5.11	23	4.65	18
III	Industrial Products	3.14	21	6.68	35	8.36	38	9,94	39
	- Plywood	1.13	8	2.30	12	2.54	11	3.06	12
	-Textile and garment	0.82	6	1.48	8	2.01	9	2.89	11
	-Base metals not containing of iron	0.34	2	0.54	3	0.68	3	0.45	2
	-Vegetable oil and fat	0.12	0	0.46	2	0.41	2	0.33	1
	-Iron and steel	0.07	0	0.27	1	0.41	2	0.24	0
	-Glass and glassware	0.01	0	0.09	0	0.08	0	0.08	0
	-Paper and paper products	0.03	0	0.14	0	0.17	0	0.15	0
	-Other industrial products	0.58	4	1.40	7	2.08	9	2,74	11
IV.	Non -oil and gas (II and III)	6,53	44	11.53	60	13.47	61	14,59	57
V.	Total Export	14.80	100	19.21	100	22,14	100	25,66	100

No	Description of Goods	1991	%	1992	%	1993	%	1994	%
I.	Oil and Gas	10.89	37	10.67	31	9.74	26	9.69	24
II.	Primary Commodities/Agri.	5.43	19	6.00	18	6.45	17	7.4	20
III.	Industrial Products	12.81	44	17.28	51	20.62	56	22.36	56
	-Plywood	3.29	11	3.82	11	5.13	14	4.83	12
	-Textile and garment	4.02	14	6.00	18	6.14	17	5.70	14
	-Base metals not containing of iron	0.38	1	0.41	1	0.29	0	0.41	1
	-Vegetable oil and fat	0.47	2	0.67	2	0.71	2	1.13	3
	-Iron and steel	0.29	0	0.27	0	0.31	0	0.31	0
	-Glass and glassware	0.09	0	0.10	0	0.13	0	0.13	0
	-Paper and paper products	0.26	0	0.34	1	0.49	1	0.59	1
	-Other industrial products	4.01	14	5.67	17	7.42	20	9.25	23
IV	Non oil and gas (II and III)	18,24	63	23.28	69	27,07	74	29.76	76
V.	Total Export	29.13	100	33.95	100	36.81	100	39.45	100

Source: The Ministry of Trade, Trade Statistics, No. 79/BL, 1990 : 55, and No. 134/BL1995 : 50, Figures have been rounded.

Thus, the surge of the Indonesian economy - like that of the northeast and southeast Asian nations - can be attributed to their outward-oriented trade and other related strategies. However, the success of those policies would have been dubious, if markets in the North could have not expanded and not absorbed large quantitities of exports from Indonesia. In particular, the huge market of the US, Japan, and to a lesser degree of the EC, provided necessary outlets for increased trade exports, especially exports of manufacturing during the crucial periods of the first half of the 1980s. Even when protectionist schemes intensified in the US and Western Europe, exports from the country continued to grow impressively, thereby enabled Indonesia to sustain her strong growth.

Due to an attempt to revitalize the expansion and diversification of manufactured exports, the share of manufactured goods in Indonesia's imports, as Table 5.4, remained above 73% of imports on average between 1970 and 1993, with machinery and equipment absorbing slightly above 38% of imports. It may be inferred that foreign trade, in particular imports, has played a very significant role in Indonesia's economy. In other words, a decline in exports can lead to a reduction in foreign earnings which in turn may cause a scaling down of imports. A decline of imports can influence the supply of raw materials, fuels, capital goods and spare parts needed for domestic production so that there will be also a decline in domestic production. At the same time, a reduction in exports and economic growth will generate the vicious cycle of general decline for the economy as a whole. This suggests that the contribution of foreign trade to the Indonesian economy is critical.

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structure of the economy has changed, with declining significance of agriculture and petroleum as the contributors to the total GDP. Structural transformation in Indonesia's exports, as epitomised below in Figure 1, shows that the share of industrial products exports expanded from 21% of total export in 1986 to 51% in 1992, and even reached 56% in 1994, while that of primary and oil-gas products exports shrank to 18% and 31% in 1992 from 23% and 56%, respectively in 1986.

Indonesian Export Share1986

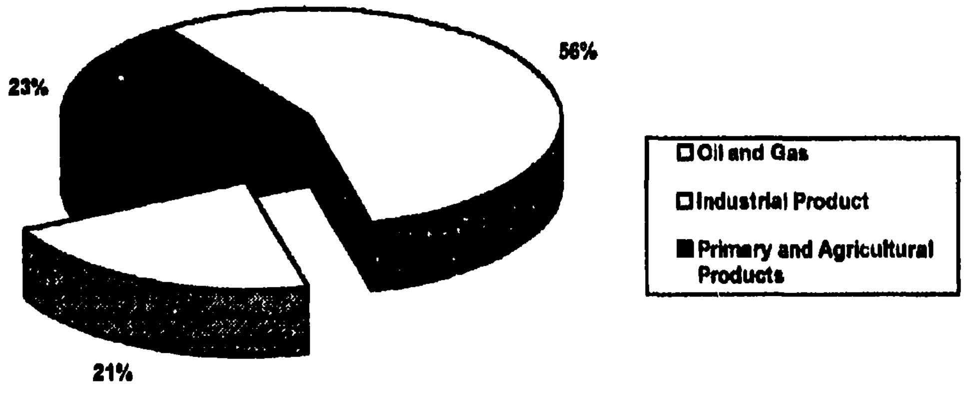
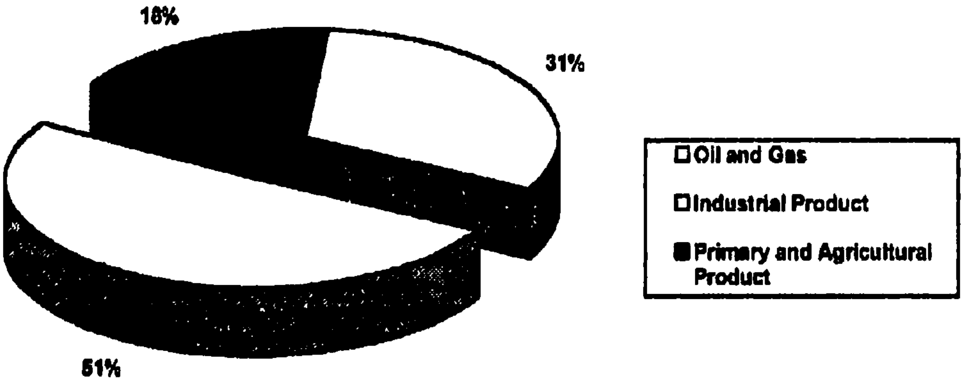


Figure : 1

Data source : Ministry of Trade, Trade Statistics 1995 (see Table 5.3)

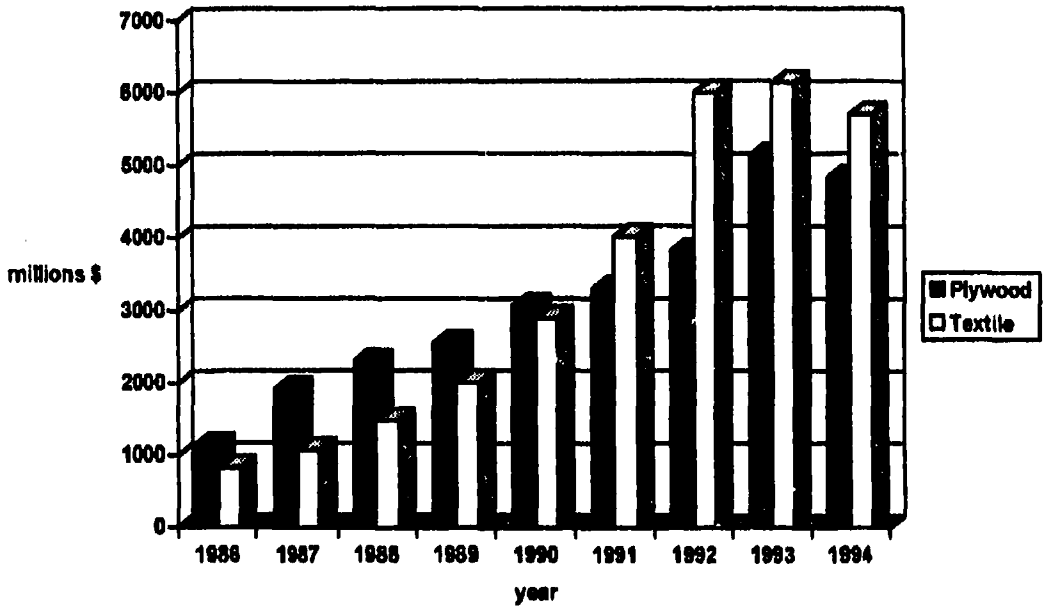
Indonesian Export Share 1992



Non-oil exports, which are seen as the engine for future growth, grew annually by 21.5%. This is stimulated to a large extent by the growth of manufacturing exports of 28.4% a year in 1986-1994, a record comparable to the East Asian NICs. Although this growth took place from an exceptionally low base, Indonesia's industry has nevertheless been transformed. However, despite the impressive growth and diversification of trade, some worrying signs are coming to the surface. Textile and garments, and wood products/plywood has dominated non-oil manufactured exports since 1990, accounting for one-third of total non-oil exports (see Table 5.3) and for more than 50% of the growth in such exports between 1986 and 1993. Growth in these two products exports, however, fell from 31% in 1993 to 26% in 1994, and has fallen further recently. This decline can be associated mainly with weakening world prices for such products, as well as with reduced growth in volume because of intensified international competition.

Figure : 2

The Development of Plywood and Textile Indonesian Export



Data Source : Ministry of Trade, Trade Statistics 1995 (see Table 5.3)

Indonesia was the world's leading exporter of tropical logs in 1979, accounting for 41% of the world market. Concerns about environmental degradation and the lack of domestic log processing capacity led to restrictions on log exports beginning in 1980, culminating in a complete ban on log exports in 1985. The intent was primarily to foster the basic plywood and sawmill industry, which could in turn export its output and expand employment and industry within the country. By 1988 the country supplied almost 30% of world exports of plywood (*William*, 1993 : 153). The success of this policy led to other similar initiatives, including a ban on raw rattan exports in 1988 to foster the domestic rattan furniture industry and a substantial export tax on sawn timber in 1990 to promote the domestic wood furniture industry.

Plywood production has increased rapidly following the introduction of log export ban in the mid-1980s, to become Indonesia's second most important export after textile and garments. The industry has clearly benefited from access to cheaper logs, at prices estimated to be approximately half those prevailing on world markets, as well as requirements that logging concessionaires establish local wood-processing mills (*GATT*, 1995 : xviii). However, *Far Eastern Economic Review* (FEER) reported that plywood, which accounts for about 12% of total exports, experienced a fall of 5% in the January-July 1994 period compared with the same period in 1993, following phenomenal growth in 1992 and 1993 due to a boom in sales to China (*FEER*, Yearbook 1994 : 138). The slowdown, it was reported, was mostly due to a fall in plywood prices and some decline in demand. At the same time, according to *FEER's* 1994 report, there has also been a continued decline in the growth of exports of textiles and clothings, accounting for 15% of exports. It grew only at only 2% in 1993 compared with more than 30% in previous years, and fell by 8.5% in the January-July 1994 period compared with the year-earlier period. In 1994, the decline was mainly caused by a fall in the value of fabrics exports, caused by a sharp decline in polyester yarn prices (*FEER*, ibid., : 138).

B. DIRECTION OF TRADE

The direction of Indonesia's foreign trade include dozens of countries throughout the world. Imported goods come from markets as near as Singapore and as far as Europe and North America. And the country's non-oil exports have continued to be diversified to various countries, around 90% are directed to her 20 main trading partners. The fact that non-oil exports continued to perform well - despite depressed economic conditions in North America, Europe and Japan - points to the success of Indonesian producers in augmenting their market share in the advanced industrial countries as well as in diversifying their markets.

Although trade flows have remained relatively stable and expanded in recent years, there has been a decline in the Japan's and US's dominance in Indonesian foreign trade. As can be seen in Table 5.5 and 5.6, Indonesia's trade has heavily been dependent on and biased towards Japan, the USA and Singapore, which together accounted for approximately 60% of exports and 47% of imports during the period 1986-1994. Of these, Japan is the most important trading partner, purchasing 36.5% of Indonesia's exports and supplying about 25% of imports in the period (1986-1994). The USA accounted for 14.6% of Indonesia's exports and 15.4% of its imports in the same period, while Singapore took close to 9% of Indonesia's exports and supplied 6.7% of its imports. However, on the basis of statistics enlisted in the Table 5.5 and 5.6, several visible characteristics can be outlined, as follows :

1). The bulk of trade continued to be conducted with other Asian countries, in particular northeast Asian economies, which were markets for about two thirds of her exports and suppliers of about half of her imports. Japan remained the single most important trading partner because it was the main purchaser of Indonesia's oil and gas export, and was an important supplier of intermediate and capital goods for Indonesia's growing manufacturing sector. But, Japan's dominant position in Indonesian trade is in the process of declining, especially as an export destination, in line with the country's diversification away from oil and gas. Japan's share of Indonesian exports fell from 44,9% in 1986 to 27.3% in 1994, while Indonesian imports from Japan declined from 29% to 24.2%. South Korea, Taiwan, and Hongkong appeared to absorb the lost of Japan in Indonesian trade, all together increased their exports to Indonesia from 6.5% in 1986 to 12.5% in 1994, on the other hands, their imports of Indonesian goods grew from 6.9% to close to 12%.

2). After Japan, the most important trading entity was the EC (West Europe), its share of Indonesian trade having recently overtaken that of the United States, Indonesia's second largest single trading country. The EC share of Indonesian exports rose from 9.5% in 1986 to little above 15% in 1994, while Indonesian imports share from West Europe increased over the same period from 20% to 22%. The most important EC markets are the United Kingdom, the Netherlands, and Germany, which together absorbed 7% of Indonesian exports and supplied about 10% of Indonesian imports.

3). Non-traditional markets for Indonesian exports recording relatively high growth rates i.e. above 30%, are the countries of West Asia, in particular the Union oı Arab Emirates and Saudi Arabia, Spain, Malaysia, and Canada. For example, trade relation between Indonesia and Canada, although it is not as great as that between Indonesia and the USA, has expanded quickly. Two way trade in 1986 was only US$ 258 million. It rose to US$ 818.6 million in 1994, with Canada exporting around US$ 175 million more than it imported.

4). While the rate of expansion of both exports to and imports from the other economies in the ASEAN grouping, apart from Singapore, although it grew, has been dissapointing. This is surprising, given the proximity of the ASEAN nations, their outward orientations and the fact that ASEAN is the only free trade area in the Asian region. As reviewed in Chapter III, furthermore, the most obvious bilateral intra-ASEAN flows - exports from Indonesia and Malaysia to Singapore, and from Singapore to Indonesia, and from Singapore to Malaysia - all involve Singapore.

5). Indonesian exports to the United States, as in the case of Japan, declined from 19.6% to 14.5%, while the United State's share of Indonesian imports fell from 16.04 % to 11.2%. To a large extent, Indonesia has so far remained dependent on two major markets - Japan and the USA - for the sale of over 70% of her oil and gas exports and one third of her non-oil exports, although there has been a decline of both economies in Indonesian trade. Thus, when either of these economies is in recession, Indonesian exports suffer. Exports to the USA performed slow growth in 1991, when the USA dipped into recession; the effect was most pronounced on oil and gas exports, which slumped by 22% (*Business Monitor International*, 1993 : 51). And the slowdown in Japan in 1992-93 affected Indonesian exports there; again the effect was most marked on oil and gas exports.

6). Indonesian exports have grown rapidly - even more than the world average - partly because her exports have been concentrated in countries whose imports have grown relatively rapidly; Indonesia has increased her share of imports of commodities in individual country markets; and partly because her exports have been more concentrated in commodties for which the world trade has grown relatively rapidly.

TABEL 5.5. Indonesia's Export Stucture by Main Regions and Destinations
(in Millions of Dollars)

Countries Of Destination	1986	Share (%)	1988	1990	1992	1994	Share (%)
WORLD	14,805	100.00	19,218	25,675	33,967	40,053	100.00
East Asia, of which:	7,804	52.72	10,396	14,625	16,419	17,813	44.47
-Japan	6,644	44.88	8,018	10,923	10,761	10,929	27.29
-Hongkong	345	2.33	554	617	881	1,322	3.30
-South Korea	356	2.40	840	1,363	2,083	2,593	6.47
-Taiwan	316.6	2.14	478	849	1,279	1,635	4.08
- China	139	0.94	491.8	834	1,396	1,322	3.30
South and Southeast Asia, of which:	1,672	11.29	2290	2,768	4,908	6,601	16.48
-Thailand	83	0.56	151	189	353	401	1.00
-Singapore	1,239	8.37	1,643	1,902	3,314	4,150	10.36
-Malaysia	82	0.56	184	253	487	739	1.84
West Asia	195	1.32	377	698.7	1,243	1,241	3.10
Africa	223.4	1.51	270	199	419	583	1.46
Australia and Oceania	241.7	1.63	324.3	487.4	798.8	772.3	1.93
North America, of which :	2961	20.00	3,174.6	3,503	4,708	6,150	15.36
-USA	2,902	19.60	3,074	3,364	4,419	5,829	14.55
-Canada	59.9	0.40	100.6	138.5	289.2	321.8	0.80
Central & South America	181.8	1.22	47	101.9	328	560.6	1.40
West Europe, of which:	1,416	9.56	2,207	3,138	4,987	6,055	15.12
-U. Kingdom	196.6	1.33	348.8	516.8	843.8	1,038	2.59
-Netherlands	452.5	3.06	646.3	723.1	1,100	1,324	3.30
-German	339.8	2.26	467.3	750.7	977.8	1,263	3.15
-Italy	151.8	1.03	220.5	276.1	582.8	660.7	1.65
East Europe	241	1.63	167	154.2	156.5	276.3	0.69

Source: Data selected from The Ministry of Trade. Trade Statistics, No. 79/BL, 1990 :. 66-69
No. 134/BL, 1995 : 67, Figures have been rounded

TABEL 5.6. Indonesia's Import Stucture by Main Regions and Origins
(in Millions of Dollars)

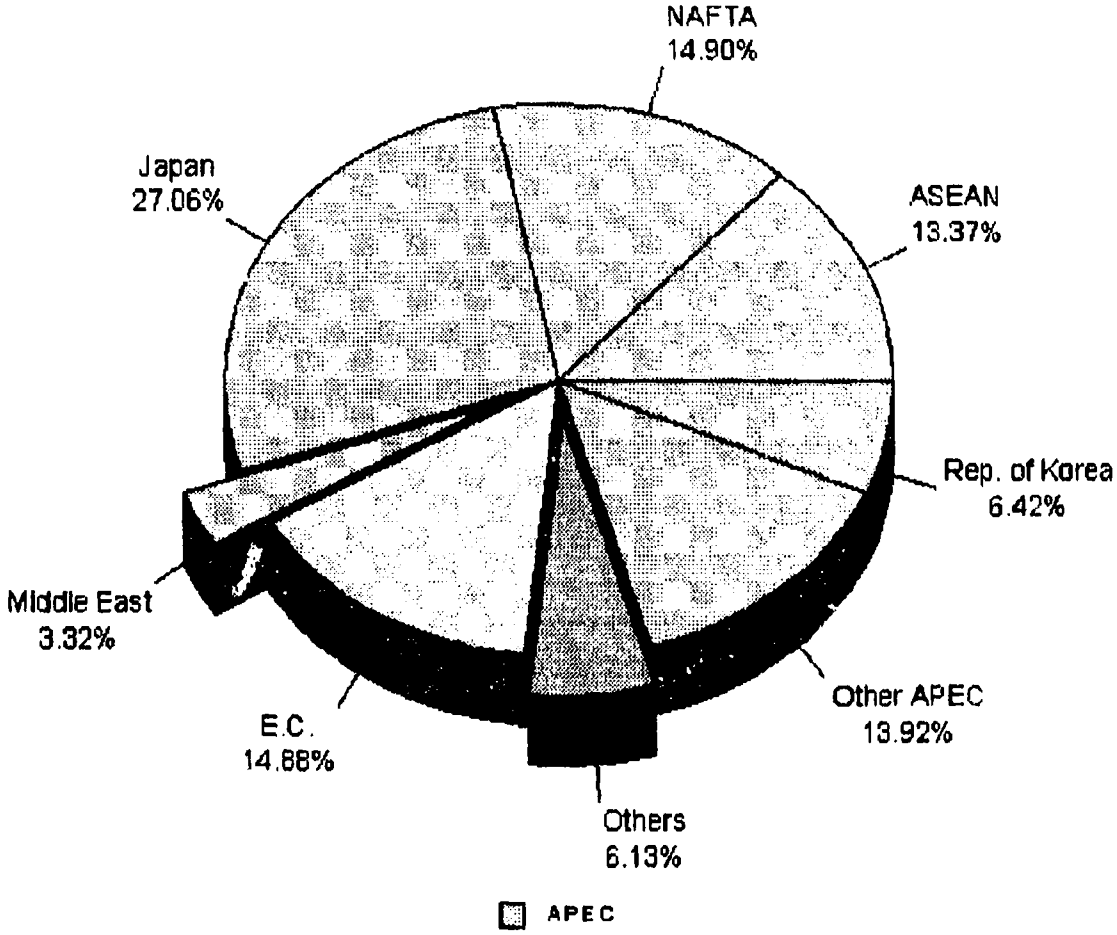
Countries of Origin	1986	Share (%)	1988	1990	1992	1994	Share (%)
WORLD	10,718	100.00	13,249	21,837	27,279	31,984	100.00
East Asia, of which :	4,132	38.55	4,967	8,605	10,205	12,989	40.61
-Japan	3,128	29.18	3,386	5,300	6,014	7,740	24.20
-Hongkong	94.3	0.88	6.1	273.3	229.0	240.5	0.75
-South Korea	159	1.48	376	985	1,894	2,166	6.77
-Taiwan	409	3.82	625	1,341	1,292	1,448	4.53
-China	337	3.14	439	652.3	751.5	1,369	4.28
South and Southeast Asia :	1,213	11.31	1,439	2,171	3,030	3,460	10.82
-Thailand	72.2	0.67	96.1	183.4	344.7	406.2	1.27
-Singapore	968.8	9.04	894.5	1,272	1,671	1,877	5.87
-Malaysia	50.4	0.47	276.1	325.6	524.6	578.8	1.81
West Asia	678	6.32	682	1,266.5	1,097	1,326	4.15
Africa	103	0.96	200	170.3	213.3	331.5	1.04
Australia & Oceania	413	3.85	579	1,301	1,549	1,726	5.40
North America :	1,918	17.89	2,010	2,927	4,282	4,085	12.77
-USA	1,720	16.04	1,736	2,520	3,822	3,588	11.22
-Canada	198	1.85	274	406.7	459.3	496.8	1.55
Central & South America	174	1.62	223	518.6	488	755	2.36
West Europe :	2,159	20.14	2,932	4,706	6,275	6,956	21.75
-United Kingdom	300.4	2.93	339.8	439.8	719.4	710.1	2.22
-Netherlands	215.1	2.10	258.4	550.2	506.5	563.7	1.76
-German*)	683.6	6.38	891.6	1,515	2,141	2,473	7.73
-Italy	101.4	0.95	247.6	409.6	558.2	667.8	2.09
East Europe	34	0.31	115	172	141	355	1.11

Source: The Ministry of Trade. Trade Statistics, No. 79/BL, 1990 :121-124, and No. 134/BL, 1995 : 162-165, Figures have been rounded

Note: *) 1986 and 1988 only the former West Germany, began in 1990 German united.

1. Distribution of Indonesia's Export Value by Economic Country Groups in 1995

Figure : 3



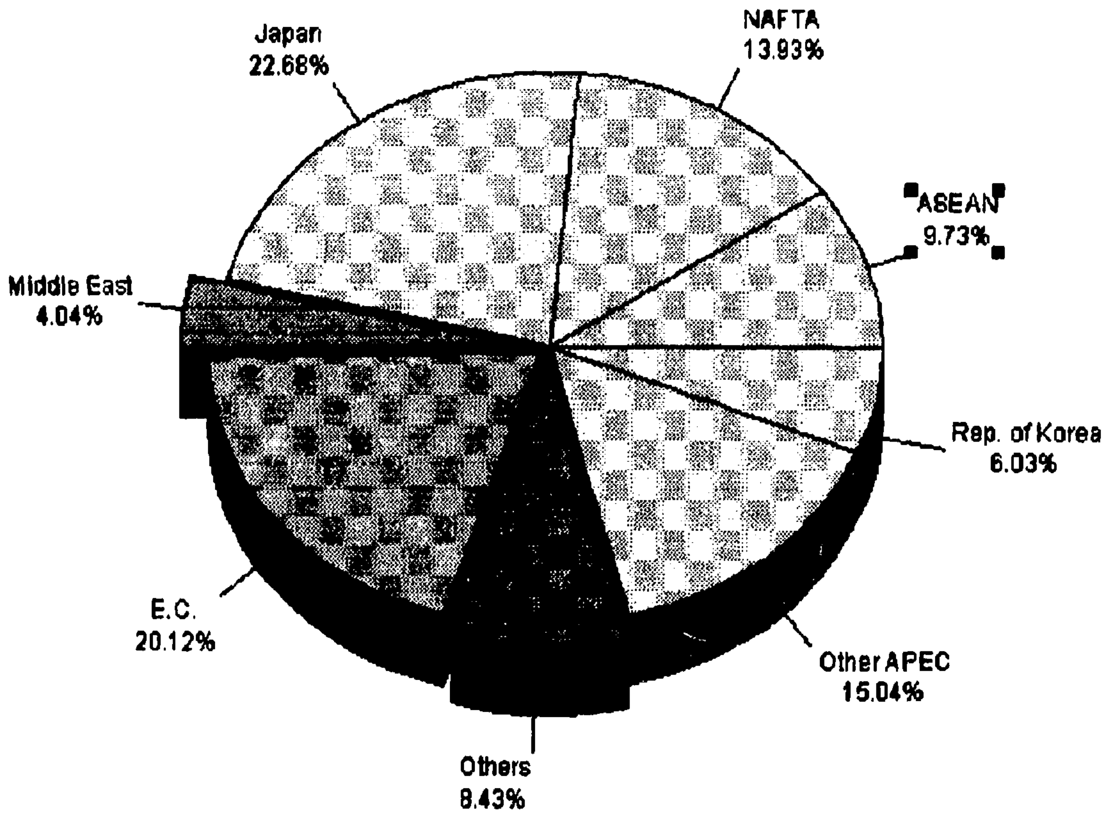
Source : Central Bureau of Statistics, Monthly Summary of the Indonesian Macroeconomic Statistics, March 1996 : 3

Last year, the biggest exports value was sent to the APEC-member countries with US$ 34.37 billion (75.67%), consisted of US$ 6.07 billion (13.37%) to the ASEAN-member countries; US$ 6.77 billion to NAFTA-member countries; and US$ 12.29 billion (27.06%) to Japan. Exports to the European Community (EC) was valued at US$ 6.76 billion (14.88%), and the Middle-East at US$ 1.51 billion (3.32%). If compared to the same period 1994 (see Table 5.5), the percentage sent to the APEC-member countries decreased from approximately

78%, to the EC countries decreased from 15.12%, and to the Middle East (West Asia) increased from 3.10%. The exports value to the APEC countries increased around 10% compared to 1994, to EC countries increased 11.55%, to the Middle East increased 21.77%, and to other countries increased 25%.

2. Percentage of Indonesian Import Values by Economic Country Group, 1995

Figure : 4



Source : Central Bureau of Statistics (BPS), Monthly Summary of the Indonesian Macroeconomic Statistics, March 1996 : 5.

Indonesia's imports during January - December 1995 experienced growth at about US$ 8.64 billion or 27.05% growth compared to the same period in 1994 (see Table 5.6). Indonesia's import January - December 1995 is valued at US$ 40.63 billion, of which 67.41% (US$ 27.39 billion) came from APEC-member countries, 20.12% (US$ 8.17 billion) came from EC, and 4.04% (US$ 1.64 billion) derived from the Middle East.

Among the APEC-member countries, Indonesia's import from Japan is the biggest at 22.68% (US$ 9.22 billion), followed by the NAFTA-member countries at 13.39% (US$ 5.66 billion), ASEAN countries 9.73% (US$ 3.95 billion), and South Korea at 6.03% (US$ 2.45 billion US$). Indonesia experienced a trade surplus, valued at US$ 6.98 billion, with the APEC-member countries. With the EC and the Middle East, Indonesia experienced a negative trade balance at US$ 1.41 billion, and US$ 0.13 billion, respectively.

C. THE TRICKLE DOWN EFFECT OF GROWTH AND TRADE

To understand the politics of trade, it is necessary to look at the effects of trade, not just on a country as a whole but on the distribution of income within that country. While trade may benefit a nation as a whole, it often hurts significant groups within the country, at least in the short run. In the course of new order administration, despite growth rates and foreign trade expansion which can be considered to be high when compared to other developing countries, the gap between the rich and the poor has become worse as the *Gini* ratio is prone to rise. A study conducted by *Hasibuan* provides an evidence of growing income inequality during 1961-1980.

TABLE 5.7. Income Distribution in Indonesia

Year	Gini Coefficient of Income Distribution	% of Income Received by the Lowest 40%
1961	0.30	25.3
1964	0.22	25.5
1971	0.30	26.8
1976	0.34	12.7
1980	0.46	10.4

Source : Hasibuan 1984, cited in Budiman, 1988 : 125

While in the mid 1960s, shortly before the change of Government, the percentage of income gained by the bottom 40 percent of the population was 25.5% of the national income, in 1980 it went down to 10.4%. However, it is also true that the national and per head income have become much bigger. It was estimated that the economy grew from 7.48% in 1994 to 8.07% in 1995, and per head income rose to US$ 978 in 1995 (*Kompas*, 20 April 1996). Thus, people who live under the poverty line are reported to have decreased, from about 60% of the population in 1970 to about 15% in 1990 (*World Bank*, 1993 : 235).

1. Poverty and Growth

If the World Bank's estimate above can be taken as reliable and accurate, it could be argued that in terms of growth with equity as well as the alleviation of poverty incidence, in fact, has not been that successful. It is true that success in reducing poverty is partly attributable to the policies adopted before the external shocks of the 1980s, particularly development of widespread social and economic infrastructure and emphasis on rural development. By the same token, it is also attributable to government economic adjustment measures that generated broad-based growth in employment and avoided substantial cutbacks in development expenditures in sectors - such as agriculture and human resource development - that are critical for poverty alleviation (*World Bank*, ibid., : 235). However, people that still live in absolute poverty are 28.5 million out of 190 million, and there are still many Indonesians have incomes only slightly above the poverty line who may drop below it any time. These people, the "near poor", are, therefore, vulnerable to changes in their economic circumstances, such as increases in the price of an important staple, or a downturn in economic growth. Moreover, it is an unfortunate yet timely reminder that many Indonesians, especially in rural areas, still live close to or in poverty and, because of dependence on agriculture, are extremely vulnerable to changes in weather conditions (*Manning*, 1992 : 23).

They have no savings nor insurance to save them from potential misfortunes. Also, the government made little progress in reducing the absolute number of urban poor. In 1984, some 9.3 million urban dwellers were categorised as poor; in 1990 the number of urban poor was about 9.4 million, representing little or no change (*Wardhana*, 1993 : 435). It is estimated that by the year 2000, over 40% of the country's population and approximately half of its poor will live in urban areas (*ibid.* : 454). It is important that we recognized that in the not too distant future, poverty in Indonesia will become largely an urban phenomena.

Other indicators of improving living standards for the poor as a result of economic growth are reported to include significant increases in caloric intake, falling infant mortality, universal primary education, and rapidly expanding secondary and tertiary enrollments (*World Bank*, 1993 : 235). At the same time, since the rate of unemployment is always relatively high, the government concentrates more on labour-intensive industries rather than capital- and technology- intensive industries. It points to a much more rapid rate of labour absorption in manufacturing industries. They took up approximately 4.9 million workers in 1979 and then 8.6 million in 1993 (*Central Bureau of Statistics*, 1995). Nevertheless, while certain indicators are improving, the healthy growth of non-oil exports is masking some significant structural flaws in the economy. The worst of these, as reviewed in Chapter IV, lies in the small number of large conglomerates which dominate the domestic economy and which exhibited remarkable growth in the past 10 years (*FEER*, Yearbook 1993 : 140). We notice that the source of high growth derives mainly from manufactured industries. It means the highest proportion of growth takes place only in the circle of capital owners (or large conglomerates and foreign investors). The more Indonesian large conglomerates develop, the higher the growth rate, and the wider the income gap. According to *the Central Bank of Indonesia* 1995 Report, the number of Indonesian entrepreneurs is 34.65 million people, of which 99.4% (34.45 millions) engages in a small-scale business and the rest, 0.6% (200 thousands), is a middle and large-scale businessman (*Republika*, Jan. 1996). Therefore, it is perhaps no exaggeration to say that only 0.1% of the population who actually benefit from the growth. More specific, only about 35 people (the roughly estimated number of Indonesian largest conglomerates - see Table 4.5) out of almost 200 million of the population have taken pleasure from the rapid growth.

2. Labour Wages and Manufacturing Value Added

The distribution of national income is determined by the amounts paid to the factors of production - the wage workers earn and the rent the owners of capital collect (*Mankiw and Scarth*, 1995 : 49). The situation in Indonesia demonstrates that the real income of labour remains to be in the subsistence or "near poor" level, while the owners of capital in manufacturing industries experience a high growth as value added increases rapidly. It is reckoned that large and medium scale manufacturing industries' value added rose from Rp. 5091.04 billion in 1984 to Rp. 49,821.48 billion in 1993, which is virtually, a 10 times jump.

TABLE 5.8
Large and Medium Scale Manufacturing Industries' Value Added by Subsector
(billion rupiahs)

	Year			Growth	(%)
Subsector	1984	1989	1993	1984-89	1989-94
Food	1 746.18	5 079.57	12098.73	23.81	24.23
Textile	689.26	2 828.45	9 810.57	32.63	36.47
Wood	327.24	2 292.61	4 628.66	47.60	19.20
Paper	104.07	720.52	2 097.79	47.26	30.63
Chemical	758.92	2 643.89	6 516.78	28.35	25.30
Non Metallic	259.57	585.76	2 143.87	17.68	38.32
Basic Metal	495.17	1 577.15	3 414.08	26.07	21.30
Metallic Product	693.00	3 218.57	8 665.13	35.95	28.09
Other	17.63	101.74	445.69	41.99	44.67
INDONESIA	5 091.04	19 048.26	49 821.48	30.20	27.17

Source : Central Bureau of Statistics, Statistical Year Book, 1995 : 23

Note : Rp. is the rupiah, Indonesian currency

Similarly, the worker productivity of the large-medium scale manufacturing industries has increased by a factor of 7.4 (from Rp. 7199 thousand in 1979 to Rp. 53,084 thousand in 1993). When it comes to dividing the wage data by worker productivity (value added per employee) in Table 5.9 below, the resulting crude indicator of real labour costs suggests that Indonesian labour - although one might argue that it is competitive internationally - is paid only 3.17% (below US$2 per day) of the amount that it actually produces. This is to say, even though the country's cheap labour has mostly been employed to develop new light manufacturing industries that made Indonesia's export grew significantly and contributed to increasing national income, the ratio of labour earning to worker productivity has decreased. And again, it reveals that rapid economic growth as a result of trade expansion does not necessarily lead to increased equity. Table 5.9 indicates that labour earning in textile, Indonesia's main export, was 6.25% of worker productivity in 1993, although *Hill's* survey puts it at 7.41 % in 1984 (*Hill*, 1992 : 14).

The importance of textiles and garments as sources of employment generation is underlined by the fact that these are the largest and most labour-intensive of Indonesia's emerging manufactured exports.Therefore, it is safe to say that Indonesia after the oil boom has been facing the decrease of labour income in real terms. In other words, wages appear to have stagnated, a surprising development given the rapid growth of non-oil exports and the decline in poverty since the mid-1980s. However, although wage rates do not appear to have risen in real terms in the centers of manufacturing exports (mostly in Java), the earnings of labourers are likely to have increased as a consequence of more intensive use of capital-technology and longer working hours.

TABLE 5.9 Labour Costs in Large-Medium Scale Manufacturing Industries, 1993
(Thousand Rupiahs)

Subsector	Wage a)	Value Added per Worker (1993) b)
Food	1348.8	49,764
Textile	1411.2	22,587
Wood	1516.8	27,013
Paper	1732.8	45,124
Chemical	1636.8	46,260
Non Metal	1550.4	32,812
Basic Metal	2846.4	180,681
Metallic Products	1809.4	58,018
Others	1281.6	15,499
Average	1681.6	53,084.22

Source : Calculated from Statistical Yearbook, 1995, Central Bureau of Statistics, BPS

Note : a) Annual labour costs per employee up to June 1994.
b) Annual labour costs per employee as percentage of value added per employee

That Indonesia's labour wages are very low, especially when compared to other Asian countries' labour wage levels, is illustrated by *Hill's* study. *Hill* observed that the ratio of wage to worker productivity (value added per employee) in textile industry in 1984 was 0.74 in Japan, 0.33 in Singapore, 0.29 in South Korea, 0.27 in Hongkong, 0.19 in Malaysia, 0.13 in the Philippines, 0.074 in Indonesia, and 0.049 in India (*H. hill*, ibid., : 14). Indonesian labour wage in textile industry was far below those of the industrialised economies and of the NICs and near NICs such as Malaysia, and were on a par with Indonesia's direct competitors in international markets, such as the Philippines and India. No wonder if the poorly-paid Indonesian workers - getting paid below the minimum wage in particular - have induced many strikes occurred in Java's and North Sumatra's export-oriented zones, where foreign capital plays a major role (*FEER*, Yearbook 1994 : 135). For instance, the low wages paid in the South Korean-managed *Nike* products and by other domestic and foreign firms received some national and international coverage as the result of an unpublished study financed by the American Free Labour Institute in Jakarta in mid-1991 (*Boston Globe*, 30 Dec. 1991). Likewise, the failure of wages to keep up with increases in the cost of living and the public listing of company profits through the stock exchange have been the factors contributing to worker unrest (*Manning*, 1992 : 35). Apparently, unlike in 1980s when dismissals were a main reason for labour disputes, concern with wages and working conditions has been the fundamental motive of the1990s unrest.

3. Regional Disparity

Another issue, deserving comments and questioning of the success of Indonesia's economic development, is associated with the problem of uneven development, which is now more between the country's east and west than the older dichotomy of Java and the outer islands. Indonesia is the third most populous developing country and the world's largest archipelago. It has a strong natural resource endowment, but the geographic distribution of these resources and of the population is most uneven. For instance, the central island of Java has over 100 million inhabitants, about 60% of the total population, on only 7% of the land area. Java's population density of around 750 persons per square km. is one of the highest in the world, and about 21 times that of the rest of the country. Table 5.10. further provides an overview of regional performance and structure. The increasingly prosperous and dynamic provinces are found mostly in the central-west regions of Indonesia (predominantly Java, Bali, Sumatra, and parts of Kalimantan), as opposed to the lagging east (column 1-2). In terms of per head income, Jakarta, the booming tourist economy of Bali, the resource-rich provinces of East and Central Kalimantan, Aceh and South and North Sumatra - all of which have better infrastructure - are at least above the national average. In general, the Java provinces present the least critical problems - contrary to the gloomy conditions that prevailed in the 1960s - partly because they are close to the national average and partly because their social and physical infrastructure is superior.

On the other hand, eastern provinces and most parts of Sulawesi steadily register incomes that are far below the national average. The Sulawesi region as a whole has consistently lagged behind the rest of the country and lacked a dynamic leading sector which can detain this trend. The two Nusa Tenggara and East Timor provinces pose the most serious problems. Limited natural resources, distance and neglect have together resulted in serious problems of poverty and underdevelopment. The poverty estimates (column 9), which are high for the eastern part of the country, ubiquitously confirm these regional income inequalities. If in the 1960s researchers found despair and poverty in parts of Central and East Java, in the 1990s they are more likely to locate it in Nusa Tenggara (Sumba and Flores territories), East Timor and rural Irian Jaya.

TABLE 5. 10. Indicators of Regional Structure in Indonesia

Region/Provinces	GRP 1990 Rp. billion	GRP per head 1990 Rp'000	Manu-facturing as % of GRP, 1990 a)	Agricul-ture as % of GRP, 1990	Net Export as % of GRP, 1989 b)	% of Export c) 1976	1991	% of foreign invest-ment d) 1967-91	% of popu-lation in poverty 1987
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
Sumatra :									
- Aceh	8290	2448		66	66.8	0.2	10.7	2.3	12.50
excl. oil	2897	737	11.1						
- North Sumatra	10833	1063	17.7	61	10.3	7.1	6.1	7.5	na
- West Sumatra	3297	829	12.1	60	19.9	0.7	0.7	0.1	7.0
- Riau	13231	4493		58	48.8	43.2	17.3	5.6	7.9
excl. oil	2672	907	7.7						
- Jambi	1414	709	17.0	70	20.0	0.8	0.9	0.1	6.5
- South Sumatra	6266	1304	20.3	65	9.5	4.4	2.4	2.7	15.0
- Bengkulu	795	684	3.0	71	-13.8	x	x	0.1	8.8
- Lampung	3217	540	11.1	70	19.8	1.5	1.2	1.3	34.4
Java and Bali :									
- Jakarta	22855	2481	26.4	1	71.2	11.2	26.1	24.1	na
- West Java	31358	917	23.2	37	18.6	1.8	0.9	29.3	23.0
- Central Java	21689	763	16.7	48	9.6	0.7	2.5	6.1	41.0
- Yogyakarta	1901	654	10.3	46	-26.1	x	x	0.1	25.2
- East Java	29161	769	21.0	39	2.7	1.6	7.9	7.0	38.8
- Bali	3018	1090	5.3	44	-1.1	0.1	0.6	3.9	40.0
Kalimantan (Borneo):									
- West Kalimantan	2743	860	18.7	73	-5.6	1.2	1.9	0.3	27.7
- Central Kalimantan	1376	998	10.2	62	-8.0	1.0	0.4	0.6	17.7
- South Kalimantan	2326	887	17.2	54	32.0	1.1	2.1	0.5	15.4
- East Kalimantan	10770	5821		43	55.4	17.6	12.5	3.3	8.2
excl. oil	4410	2383	20.2						
Sulawesi (Celebes) :									
- North Sulawesi	1507	593	5.7	56	-6.6	0.2	0.2	0.7	27.7
- Central Sulawesi	982	581	5.8	68	9.2	0.2	0.1	0.1	29.8
- South Sulawesi	4241	610	6.9	58	3.9	0.3	1.6	2.8	42.0
- Southeast Sul.	821	616	2.3	68	4.7	0.4	0.2	0.1	55.8
Eastern Indonesia									
- West Nusa Tenggara	1290	383	2.9	54	-5.8	x	x	0.1	47.1
- East Nusa Tenggara	737	361	2.3	75	-16.5	0.1	x	0.1	53.0
- East Timor	269	364	1.7	74	-14.4	x	x	0.0	45.3
- Maluku	1463	809	14.0	62	33.3	0.6	1.3	0.2	25.0
- Irian Jaya	2047	1247		72	52.5	4.0	2.5	2.2	41.0
excl. mining	1217	742	4.3						
Indonesia	196919	1098		50		100	100	100	

Sources : Data selected from : 1. Central Bureau of Statistics (BPS), Regional Income of Provinces in Indonesia by Industrial Origin, various years; 2. BPS, Statistical Yearbook Indonesia, various years; 3. Republic of Indonesia, Nota Keuangan, various years;

Note :
a). Non-oil manufacturing as % of non-oil GRP (Gross Domestic Regional Product)
b). Net exports of goods and services as % of GRP
c). % of merchandise exports
d). Approved foreign investment, excluding oil and financial service
x = less than 1% and negligible

Column 6 - 7 of the Table, regional export patterns, also highlights huge interprovincial diversities in economic structure. At the height of the oil boom in

1976, Riau and East Kalimantan provided the country with 61% of total exports. Jakarta, the centre of government with its better port facilities, mineral-rich South Sumatra and Irian Jaya, and the traditionally strong North Sumatra cash-crop province generated another 27%. The nine provinces of Sulawesi and eastern Indonesia presented less than 2%. The role of infrastructure, particularly that related to transport and communication, is likely to be significant in explaining this phenomenon. It is, therefore, clear that if the eastern provinces are to be realistically treated as an important target territory for the sake of either export expansion or reduction of interregional disparity in the future, serious efforts need to be made to improve infrastructure and thus raise the competitiveness of those provinces.

The most important change since the mid-1980s has been the resurrection of Java as a significant source of foreign exchange earnings, reflecting the spectacular growth of manufacturing exports and falling energy prices. Again, this indicates the benefits of reforms have disproportionately accrued to Java. In 1991, Aceh, Riau and East Kalimantan, where massive oil and LNG (liquid natural gas) investments came on stream, still produced 41% of the total, but Java's share more than doubled from 15.4 % in 1976 to 38% in 1991. As the manufacturing boom gathers momentum, Java is regaining the position it held in the colonial time of being the country's predominant foreign exchange earner. Furthermore, Java's factories are providing the major increment to employment expansion, and its cities are the location of newly-emerging high value added service activities. Bali, if included as a part of 'inner islands', is also contributing most of the revenue from the Indonesia's other major new export growth industry - tourism.

Table 5.10 illustrates further this interprovincial variations. With the exception of Sulawesi and eastern Indonesia, agriculture supplies less than 50% of gross regional product (GRP) in most instances. For the industrialising provinces of West and East Java that share is beneath 40%; in both these provinces manufacturing accounts for over 20% of output, and these shares are higher than those of any other provinces except Jakarta. (column 3 - 4). The relatively high manufacturing shares for Kalimantan are slightly ambiguous. Apart from the special case of East Kalimantan, much of the non-agricultural activity has been related to the wood processing boom. There is almost no footloose industry in the outer islands, as would be expected given their distance from major markets, supply-side deficiencies (skilled labour and supporting infrastructure in particular), and the absence of any wage cost advantage. The Nusa Tenggara provinces continue the most agrarian of all, reflecting their poverty and lack of dynamism.

Additional data in Table 5.10 highlight various other aspects of the country's regional economic disparity. The large export surplus generated by the resource-rich provinces, and Jakarta owing to its port facilities, is presented in column 5, as is the negative in several poor regions. And again, the eastern part of the country has so far made the lowest contribution to the nation's export earnings. In this respect, the relatively low exports from the eastern provinces are likely more indicative of the fact that regional resources and other potentials are not yet fully utilized due to the spatially concentrated nature of development so far. Regional backwardness and disparities are also depicted in the allocation of capital investments. Column 8 shows that Western Indonesia has attracted much more foreign investment (excluding oil, gas and financial services) than the east. From 1967 to 1991, Jakarta and West Java alone absorbed over half the total, while Java - Bali as a whole take up 69.5%. It is clear from the data that regional disparities in conjunction with the distribution of capital investments have existed, and even more importantly, they are prone to worsen over time.

VI. CONCLUSION

Conspicuously, the decade of the 1990s remains to bring speedy economic growth and trade expansion to most East and Southeast Asian nations. In fact, in this part of the world, economic development has occurred in sequential waves since the second world war. The first wave of remarkable growth was launched by Japan in the 1950s and 1960s, accompanied by the second wave in the 1970s initiated by the east Asian NICs, and the third wave in the second half of the 1980s generated by the ASEAN-4 countries and China. By now people in these countries may have become accustomed to witnessing their economies grow year after year and consequently, tend to take economic expansion for granted. This view is of course too narrow and too short-sighted, since countries undergoing rapid growth over an extended time recently can be found only among a limited number of countries, particularly in east and southeast Asia. Many developing countries of the South, especially in Africa and Latin America, still have great difficulties to grow out of their depressed state. For most people in those countries stagnation has become a habitual experience, and many of them have to suffer from persistently declining levels of income.

This contrasting economic performance of the so called Asian NICs and "Near NICs", and China recently on the one hand and Africa along with Latin America on the other hand, has attracted a great deal of attention recently. A growing number of studies have been conducted to understand the underlying reasons for the diverse experience. The emerging consensus among theorists seem to opt for government policies as the most important factor explicating the different economic performance of the developing world. The countries of northeast and southeast Asia have succeeded in maintaining the momentum of their growth through the turbulent decade of the 1970s and throughout the recession of the early 1980s, to a large extent because they have adopted policies designed to harvest the maximum benefit from the gains from international trade. All these countries, but the Philippines, augmented their exports values in a range from 50 to 245 times from 1963 to 1993, and the main component of the increase was in manufacturing. That is to say, in general, their achievement appears to lie in their capability of establishing and diversifying their manufacturing industries for external markets at a time when the developed countries moved into technology intensive and services industries. When the world underwent economic downturns at the end of the 1970s and in particular early in the 1980s, almost simultaneously these nations decided that structural adjustments and policy reforms have to be made in the wake of the recession and the accompanying changes in the structure of international trade. For small countries like Singapore, Hongkong and Taiwan, this awareness came quite naturally, but even countries with larger population such as Indonesia, the Philippines, Thailand and Malaysia did not take long to follow suit.

All the above southeast Asia nations have previous experience with inward-looking protective trade policies, designed to stimulate domestic manufacturing industries. Now they decided that to ensure continued growth they must pervade the world market as their industrial outputs began to grow. One prerequisite for this is increased competitiveness of domestic industries. Therefore, changes in trade and industrial strategies were a must in order to induce a larger inflow of capital, know-how and technology, and to improve efficiency by injecting more competition in the domestic economy. However, as has been reviewed, the success of those strategies would have been impossible without the advanced industrial market capability of absorbing a significant quantity of manufacturing merchandise exports from the region. While recognizing the crucial role played by major industrial markets, one should also discern while their economies developed, the southeast Asian countries themselves also increased their imports substantially, thereby creating new expanding markets and larger volumes of world trade. The northeast and southeast Asian nations have managed to achieve high growth rates during difficult times by first, concentrating on exporting mostly manufactured products and second, concentrating on exporting to a selected number of countries in the Asia Pacific. This implies that interdependence has increased among these countries. Their trade has become more concentrated in the area. The rise of the northeast and southeast Asian nations has at least provided an example to other countries in the developing world faced with various economic dilemmas.

Whether manufactured exports will be persistent to act as a powerful engine and expediter of growth will largely depend on some significant comsiderations and challenges. First, the output increase of industrialised-advanced countries will have to be sufficient to expand the demand for imports and thus provide a growing market for the developing countries. Second, will industrialised-advanced country trade barriers arise in response to the export success of the developing countries? Especially in the protection of intellectual property rights (IPR), most developing countries of the South have been concerned about continued access to technology and wish that protection of IPR will not become a means to restrict the transfer of technology to the South. Thirdly, will the developing countries lessen their high trade barriers against one another? Failure on any of these three conditions, but especially the first two, would degrade the likelihood of development led by manufactured exports to a large extent. Added to these considerations, there is another issue, inconvenient but perhaps less serious in the long run, that technological change may cause comparative advantage to alter more rapidly than in the past, leading to a greater need for flexibility and willingness to adapt than in the past. Even so, developing countries can now generally be assured that comparative advantage lies in labour-intensive products and that this will continue as long as wage levels are relatively low *vis-a-vis* the more developed countries. This is particularly true for Indonesia which remains a labour surplus economy in which wages are likely to be held down by the excess labour supply for several years to come.

Prior to the pre-reform of 1980s, Indonesia' s foreign trade potentialities faced various impediments, that hampered its overall growth and as a consequence it failed to come level with the advanced industrialised world, which the Asian NICs were able to pursue. Full withdrawal from international division of labour, mistakes made in economic policies as a result of the fragmentation of the rightist, leftist and other interests in the national economy after liberation, economic mismanagement and rising military expenditure during the Guided Democracy era, shift into inward orientation in the second half of the 1970s, and a sharp decline in oil and primary commodity prices in the 1980s, all impeded the country to go into a steadfast and reasonable model of development. Delinking from the International community and increasing import substitution in the 1970s of course left no space for export promotion and totally blocked the country's comparative advantages of both its rich natural resources and low labour cost, and further delayed the role of foreign trade as the catalyst of output and growth.

The record of the past twenty-six years in Indonesia suggests that inward orientation and selective government interventions have generally not been successful in promoting industrial growth. In particular, in the 1970s the results were dissapointing. Even though a large number of industrial investments, which emphasized on heavy industries and large capital intensive projects, were made behind protective barriers and under state ownership, the productivity of these investments was in question and the investments were a burden on the rest of the economy. They have been concentrated in sectors that faced limited domestic or import competition. Consequently, their outputs were often negative value added (priced well above world prices), and again, putting a burden on the other segments of the economy.

In contrast, manufacturing grew rapidly during the two major liberalisations of the mid-1960s and the 1980s, when exports recovered and private investment surged. In the reforms of the 1980s, at a time when the industrial structure was more developed, much of the extra investment went to "new" labour-intensive export industries. This suggests that functional interventions, rather than selective interventions, are likely to be more effective in advancing industry and growth. The mid-1980s reforms proved very successful in promoting the growth of new export industries and an enormous force of production. An annual 18% foreign trade increase since the mid-1980s and steady speed growth in the economy have eventually divulged Indonesia's potential as an emerging market. The effect of these reform measures was that Indonesian non-oil exports rose from a third of total exports in the first half of 1985 to close to half in the first half of 1988, recording a dramatic increase in 1987-88. Moreover, the pace of economic growth quickened in 1989 led by strong growth in real terms of non-oil exports and private investment. In 1991 for the first time the output of industrial products exceeded the export of petroleum and gas and from then on industrial products lead in foreign exchange earning. In 1981, the petroleum and gas sector earned foreign exchange at ten times that of the industrial products sector. Petroleum and gas earned US$ 20,663.2 millions and it accounted for 82.11 percent of total export whereas industrial products earned only US$ 2,666.6 which accounts only 10.60 per cent. From 1981 onward the export earning potential from the oil sector drastically fell to (in US$ millions) 8,276.6; 8,556; and 7,681.6 for 1986, 1987, and 1988 respectively. On the other hand the industrial sector showed a continuous expansion to (in US$ millions) 3,139 ; 4,816.3 ; and 6,686.3 in 1986, 1987, and 1988 respectively (*The Ministry of Trade*, 1995 : 50). Such growth will continue to depend on maintaining the deregulation and debureaucratisation strategies as well as political stability.

Indonesia's foreign trade underwent various shifts and spinnings on its development path, but it has shown a strong and stable expansion as a result of various supportive factors since the mid-1980s. Foreign investment inflows, albeit unequally distributed, have obviously fixed miscellaneous bottlenecks such as backward infrastructure, scarcity of fund for urgently needed machinery equipments and technology. As far as foreign investment is concerned, the government faces a dilemma. On the one side, Indonesia needs capital inflows for exploring potential economies yet on the other side their existence is politically controversial and could lead to political protests. Therefore, the government will appear to remain to cautiously formulates which economic sectors the foreign investors can enter and which sectors cannot. Another decisive factor, which has basically brought about trade expansion, is imports. The direct imports of advanced technology has enabled many small- and medium-scale establishments to expand production and advance product quality. A large number of new value added goods have been emerged and shiped out of the country, which has directly contributed to the expansion of exports and the absorption of growing labour force. Likewise, it has to bear in mind that international financial institutions' assistances and trade aid granted by the developed countries through the GSP (Generalised System of Preference) have all together served as essential factors which allowed Indonesia to accelerate and sustain the pace of trade and growth.

Indonesia's foreign trade performance since its independence in 1945 has demonstrated that the significant role of foreign trade in the economy can only be effective if certain circumstances exist both domestically and internationally. As it has been argued, any trade policy adopted by a nation is not only a matter of economics, but it has a lot to do with international and domestic conditions, the political system, and social change conditions. All these conditions encourage and/or discourage policy, affecting trade achievement at different time. Indonesia under the old order administration could barely introduce the export promotion strategy, mainly because the domestic political situation favoured inward-looking economic nationalism, thus, the country cut itself off from international community. Like anywhere else, the political factor always bears an important role in determining the process and outcomes of the reform. Also, Indonesia did not adopt export promotion in the 1970s, because, in addition to considerable resistance to structural change, the government had abundant oil-gas revenues as a result of sharp increases of oil prices in international market. This resource enabled the government to invest strongly in capital-technology intensive projects for domestic market and in other basic infrastructure in order to develop an integrated industrial base. Therefore, there appears to be unuseful to debate which trade strategy presents a better outcome without pondering the political, economic and social conditions of a country as well as the international environment.

Indonesia's labour productivity, that is, manufacturing value added per worker, has risen. This is at least a crude indicator of rising industrial competence. Over the period 1979-93 it rose by approximately seven times as much for non-oil manufacturing industries. Some of these reflect fundamental transformations in the industry. Examples include basic metals, where new steel and alumunium facilities completely transformed the industrial landscape. In others, such as textiles, the increases reflected major technological innovation, in this instance the substitution of mechanised for hand technology and the introduction of new synthetic fibre manufacturing capacity. Productivity has risen more slowly in the chemicals and non-metallic mineral industries, at least during the 1980s. Much of the increase in these industries occurred in the 1970s under the impetus of state-led industrialisation. Therefore, it is no exaggeration to state that Indonesia's rapid industrialisation has been accompanied by equally rapid structural change. Yet the country's latecomer industrial status is reflected in its levels of technological development which, despite significant progress, are among the lowest in east Asia. In this regards, educating the new generation and training the existing labour force are of strategic importance to the country's structural competitiveness in the long run, because sustainable trade expansion relies ultimately on the development of productivity. Given its resources, govemment-funded research institutes will have a more important role to play in the process of education and training, broadly defined to include middle-level vocational programs, more intensive scientific effort at all level, and specialised industry-based training. However, it is doubtful whether ambitious 'high-tech' investment projects contribute significantly to efficient, broad-based technology development, particularly when the underlying research and education infrastructure is still rather weak. An element of selectivity is inevitable in this intervention, mainly because Indonesia, like most developing countries, calls for appropriate technologies which exemplify the leading edge in the development of the industries, enabling them to further increase productivity, improve the quality of products, and diversify the country's resources so that local advantages will be able to be acceptably ecologically brought to light and further developed.

To conclude, if the central purpose of development economics is to understand why and how growth rates vary across countries and over time, Indonesia definitely provides one of the best laboratories for such a study. The country's stable trade expansion and economic growth since the mid-1980s has further provided a model for economic development in other developing countries. By the mid-1960s there were a few observers despairing of any prospect of significant trade and economic advance. Gunnar Myrdal, for example, in his famous "Asian Drama" was pessimistic about growth in Indonesia. However, a decade afterward Indonesia was saluted as one of Asia's success stories; and prior to 1990, the country was categorised among the select group of developing countries destined shortly to become newly industrialised countries, following the successful path of east Asian outward looking trade countries. Many domestic and international organisations have commented, almost unanimously, that the reform in 1980s in particular, was a success, although few problems and challenges remained unresolved. Once the world's largest importer of rice, Indonesia achieved self-sufficiency in this crop in the mid-1980s. The country was further considered to be a model among the oil exporting countries in investing its oil revenue gains effectively and in adjusting quickly to weakening oil prices in the early 1980s. While other developing countries have also experienced economic reform, some with successful accomplishment and others produce a complete failure, the Indonesian case has been considered involving a few unique features. Despite all the achievements, it is possible to perceive all manner of mistakes, inapproriate interventions and scandals, and the like, and to point to other countries - though not many - which have done better. But, public administration and economic management of a poor, ethnically diverse archipelago state such as Indonesia is a daunting job, and the essential recipe is one in which the government has got its policies 'right' more often than it has not, and has displayed political will to take tough and unpopular decisions when necessary.

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