Technocratic Decision Making in Economic Policy

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1. INTRODUCTION

Indonesia is often mentioned as an excellent example of a country which has a good economic performance because of its consistent practice of sound macroeconomic policies. Of course there are other countries in East and Southeast Asia progressing equally well or better. But since its independence, Indonesia has gone through two decades of politically turbulent times and missed opportunities for effective economic development. In 1966, however, there was a radical turnaround in politics and economic policy. A new regime took over and since then economic growth proceeded at adequate levels of six percent per annum. It is now cruising at a better than seven and a half percent per annum, due to the impact of a series of deregulations and the fruition of investments in infrastructure and in human resources development.

Economic policy making in the government of Indonesia was at times called technocratic, and a number of economic ministers called technocrats. Whether or not this system is repeatable in other developing countries is hard to say. The Indonesian situation which produced this system was historically unique. It came with a radical and traumatic change in the political system in 1966, with the rise to power of General Soeharto replacing the regime of President Soekarno. And for this reason it is not advisable to be emulated literally.

Since the independence in 1945 the country has known only two presidents. President Soekarno was the founding father of the Republic and the first president. But the first period of independence, from 1945 to

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1966, was marked by frequent political turbulence, a socialistically inclined management of the economy with a very strong role of the state and a weak private sector. Foreign direct investment was ideologically rejected because of the country was busy eliminating the vestiges of a colonial system. At one time President Soekarno even took the country out of the UN system, withdrawing also from the IMF and World Bank. At the end of his reign he practically took side of the Eastern camp in the cold war in his obsession against colonialism and imperialism. But this regime orientation only produced economic stagnation and in the end a hyperinflation. Finally, the regime collapsed.

2. THE NEW REGIME

The new government had a good opportunity of starting on a completely new basis. But the question that could be posed was: why could it do so and why did it want to do so?

First, the political make up of the new regime was radically different. The military dominated the new situation. The Indonesia military was non-ideological in the sense that it was not attracted by the then current and fashionable ideologies or "isms", like socialism, communism, nationalism or religious fundamentalism. It was patriotic but not "nationalistic" in the more ideological sense of the word. For instance, it had no hang-ups against foreign investment and international aid. It was more systematic in its outlook and results-oriented, unlike previous political parties which were more matter-of-principle in their outlook.

This military, actually the Army rather than the other armed forces, had previous links with the professors of the major national universities, i.e., the University of Indonesia in Jakarta and Gadjah Mada University in Yogyakarta, who provided the instructors of social science courses at the Bandung Army Staff and Command School (Seskoad) at the time. From the middle 1950s, the leadership in the army saw the need to educate the higher officers in social sciences because of their belief that army officers in their duties would graduate from military leaders to leaders of the society. And for that role they had better be prepared in the staff colleges.

3. THE "TECHNOCRATS"

The so-called economic technocrats in the government of President Soeharto were instructors of economic subjects at the Bandung Army Staff and Command School of the 1950s and 1960s, and have therefore
become known and trusted by the generals of the middle and late 1960s. It was a fortunate occurrence of productive civil-military relationship in a newly-independent country still engaged in nation-building and experimentation in establishing functioning political systems.

Those economic ministers, who started in 1966 as a team of economic advisors to the then Acting President Soeharto, regarded themselves neither as bureaucrats nor as politicians. They are often called (by outsiders, not by themselves) "technocrats", that is, top government officials, guided in their preparations for economic policy making, not by the rule of precedence, like bureaucrats, but by rational considerations, having the interest of the whole country at heart, and observing major principles of economics, such as the principle of opportunity cost and the recognition that resources are scarce and should be used in a thrifty manner. They had great sense of urgency and priority. Technocrats are not blind to politics because they know they have to exercise the art of the possible in a political environment.

Instead of ideological "isms", their preferred guideline is pragmatism, that is, the principle that what is good is what works. For instance, when they realized that domestic savings and resources were very deficient in 1966 and in the foreseeable future, they had no qualms about: (a) attracting foreign investments; (b) courting the western powers and the multilateral financial institutions that is, the IMF and the World Bank; (c) advising the government on economic stabilization and reconstruction. Foreign investment was spurned by the previous regime while the Fund and the Bank were regarded as part of an imperialistic plot. These technocrats moved to see that the country join the Fund and the Bank again.

But it still needs some explanation why the technocratic policy formulas were readily accepted by the political leadership and the public at large. Political leadership was in the hands of the military; and General or President Soeharto was the supreme commander. Why the military had (in 1966-7) such a great trust in a small group of economic technocrats is a bit hard to explain. It might be due to the respect given by the staff of command school to their former teachers or due to the quick results of the new policies. However, it could not be denied that at that time Soeharto himself was convinced that there was no better alternative available.
4. THE POLICY PRINCIPLES

The Package was also simple. First, the runaway inflation must be halted. The main policy instrument was a balanced budget, that is, the principle that the government should not resort to the printing press to finance its deficits. To make the policy more realistic, the balanced budget includes revenues from foreign aid. But it still meant heroic cutting of expenditures because the first flows of foreign aid were a few hundred millions of US dollars on an annual basis. But it also meant that there was an urgent need for the rescheduling of the large foreign debt that the previous government accumulated and which became unserviceable. This rescheduling with an exiting provision came in 1970.

To get an immediate greater national product, new capital inflows from outside was needed, hence the necessity to attract foreign investment. But the promotion of foreign investments was also seen as a bait to attract back the domestic capital parked outside the country in the previous period, mainly from the ethnic Chinese minority which has always been dominant in business and commerce.

The first legislation of the new regime was a law giving foreign direct investments guarantees and incentives. This was followed a year later by a corresponding law on domestic, that is, rupiah based investments. Whatever incentives were granted to the foreign investor must be made available to the domestic investor as well. Actually, those domestic investors received more incentives; for instance, no questions were asked about legitimacy or origin of the money, i.e., no back taxes were demanded. This whitewash policy was effective. Domestic investors could get access to government bank credits, something denied to foreign investors who had to bring all of their capital in foreign exchange. Government banks' rupiah funds should be reserved for domestics.

Giving strong encouragement and incentives to domestic capital owners who are potential investors, but who are mainly ethnic Chinese, should be regarded a political initiative not without risk - given the political and nationalistic inclinations of the previous regime who had tried to expulse the Chinese who did not want to adopt Indonesian citizenship. The role of such alien minorities as potential investors in a new policy regime is also crucial in a number of sub-Saharan (West) African countries nowadays. If a new regime cannot adequately convince would-be investors of a genuinely change of heart, those potential investors will remain a shy lot.
At times, difficult and painful decisions had to be made, such as handling a devaluation, substantially raising the prices of fuel to reduce deficits or limiting the military budget to basic routine expenditures and foregoing the urge to buy new equipment, at least in the first difficult years of economic stabilization and extreme scarcity of financial resources.

The top sectoral priority was to repair infrastructure connected with food production and distribution, while the agricultural sector, i.e., food production, received greater priority than industry. New investments in industry and mining were very welcome, but only those without the aid of government budget. The investment laws should provide the incentives and guarantees for private capital.

For some fifteen years state support for education was concentrated in primary education, not secondary and certainly not in tertiary education.

Establishing stringent priorities for allocation of meager government resources and sticking to id doggedly became the hallmark of the new regime, again, at least when resources were still very scarce. When in the 1970s oil revenues swelled, it was harder for the technocrats to do their job. The Indonesian economic technocracy was at its best in times of resources stringency and in overcoming financial crises. In times of relative abundance, it became much more difficult to keep political influences for greater spending at bay.

Highlights of technocratic policy making were, first, the institution of a balanced budget right from the start in 1966/7 to stem inflation of 600% at its high point. This inflation was brought under control in a few years to double digit levels and then to single digit. Second, was the complete abolishment of the foreign exchange controls as a regime and bureaucracy inherited from war time and colonial days. This abolishment was not done in a single stroke, but drastically enough in a few years. In 1970 the whole system was discarded and the rupiah made completely convertible, inclusive of capital account. The reasoning was that if part of the system is left intact the bureaucracy will fight back and eventually win again.

The latter can be seen when in the mid 1980s the government, again at the technocrats' initiative, engaged a Swiss surveyor company to do the pre-inspection of imports at the point of shipment, that is, outside the country, and instruct the national customs inspectors to accept and not to repeat the procedure. This policy not only reduced very much the
notorious corruption in harbors but also speeded up the flow of goods and even increased custom revenues. This policy became popular abroad and was emulated in several developing countries. But in Indonesia it could not be maintained forever because institutional vested interests fought a rear guard action making use of nationalistic public sentiments and the argument of sovereignty. The customs service could never be scrapped in the process, and leaving a state responsibility in foreign, or private, hands became politically vulnerable over time. The contract with the international firm is now terminated and the old system reinstated. The test now is whether the old weaknesses were inherent parts of the system or that after ten years something new has come up, like electronic interactions reducing the need for face-to-face contact between importers and custom official; a new and better educated breed of custom officials, etc.

Between 1983 and 1985 the technocrat ministers were able to convince the President to switch trade and industrial policy from inward looking and too protectionist policies to an export oriented stance. Again, the impulse for this policy reform came from a threatening current account deficit caused by dwindling oil revenues and expanding import requirements. There was little resistance from the lobby of domestic industries since the textile industry, the main pillar, was straddled with an oversupply of production unable to sell at home because of market saturation and unable to sell abroad because of lack of competitiveness. Domestic industry, led by textiles, was mentally ready to make the switch.

This reorientation was facilitated by a two time devaluation, in 1983 and in 1986. Since the devaluation of 1986, the policy of adjusting the rate of exchange to the domestic inflation, the government being unable to control the latter to lower single digit levels – shifted from fixed rate to floating rate system.

The devaluation of 1978 was a beautiful but rare instance of technocratic policy making because it was not done on the basis of acute urgency. But anticipative policy making of a non-incremental nature is very hard to repeat every time.

5. FIRST SOLUTIONS ARE SELDOM THE BEST
The question might be posed of why the policy style has been one of undergoing frequent policy changes and adjustments. Why was there no greater policy stability in macroeconomic management? I would not be
able to defend this by producing a compelling logic. Malaysia and Thailand which are not controlled by technocrats in a systematic way, have been able to achieve greater macroeconomic stability and high economic growth. Hence, the Indonesian technocratic system may really not be something to brag about.

We do not know. Malaysia and Thailand, during the post World War II, did not experience an extreme political and social instability that Indonesia did. The two countries, in their formative years of independence and nation building, did not radically reform the institutions left behind by a previous regime, while Indonesia did. It has also been proven by the Sub-Saharan African countries, where often a new national regime radically changes colonial policies and institutions, that such changes are not conductive to any sustained economic development. Becoming revolutionary does not always pay, for the whole country and in the longer term. This must be a sobering thought for many of us in young independent developing countries.

6. LESSON FOR OTHER DEVELOPING COUNTRIES

Does technocratic decision making hold a lesson for young developing countries where the economic growth rate has been sluggish? Well, perhaps, but with a lot of qualifications.

First of all, the influence of technocrats in governments is never all pervasive. In Indonesia the technocrats were very influential in the field of macroeconomics, but they influenced the sectoral deregulation (e.g. traded and industrial policies) as well. They had much less influence on the sub-sector (i.e., related to certain industries), enterprise or project level. If a developing country needs, first of all, good and steady macroeconomic policies to provide the conducive environment for investment, production and growth, it should try to get a team of technocrats with political influence and supported by the political system or leadership of the country.

But sometimes, the ‘supply response’ in the economy may be lacking or late in coming, even with proper macroeconomic policies, such as in the case of a number of sub-Saharan African countries. Then, sectoral or institutional policies should be scrutinized. Very often the weakness is the difference between stated policies and implementation. Implementation of policies is in the realm of institutional economic, institution building, politics, etc.
If a country does not have the political preconditions, how does one "engineer" them? Probably it cannot be done they way it happened in Indonesia as the historical process was unique. It was, first of all, built on productive "civil-military relations". If the military is a dominant political force in the country, such relations are very important. But how do you build them up? Well, it takes two to tango. In the Indonesian case there was the fortunate coincidence that part of the military leadership, i.e., in the staff and command school, had the idea and saw the necessity of weaving a synergetic relationship between the staff and command school and the senior faculty of the prime national universities. And later the country was lucky to be able to have General Soeharto willing to use this facility in his government and stick to it for a very long time. Probably, apart from a personal decision of President Soeharto to leave economic policy preparation to his technocratic team (yes, it was a team), under him the cooperation and alliance became an institution. And by and by it became part of the institutions of the regime, meaning that the relationship will survive after the Soeharto presidency.

If in other countries, perhaps the majority of them, the political system is a normal multiparty parliamentary setup, like the one in Thailand, can the government be persuaded to engage in some kind of technocratic decision making or to include the involvement of technocrats in policy formulation? Probably, but normative generalizations are speculative.

It should, however, be possible that policy options are discussed in public, and in this respect the media has a very important role to play. Moreover, economic research institutes, think tanks, individual and reputable scholars, and other actors (for instance international agencies like the World Bank, IMF, well known foreign scholars), all share some 'potential' influence.

For such an open system (the Indonesian technocratic system is more closed rather than open and transparent) to be effective, the quality of economic analysis should be available; in developing countries this needs time to mature. It may be worth while to nurse the development of such a system as part of an emerging civil society so that vigorous but healthy public discourses and policy debates become part of the new governance.
7. EX-POST REFLECTIONS

After thirty years of the New Order government one can presently hear a few remarks or even criticism from foreigners as well as natives.

One remark from outsiders or foreigners states that the political influence of the economic technocrats in the government is seen on the wane in favor of more ‘technological visions’ of Indonesian development. In the tug-of-war for the allocation of scarce financial resources more government (controlled) money has to be spent on large technological, or ‘high-tech’, projects. If the prudent macroeconomic policies of the technocrats have to give way to other objectives, will this not erode the foundations of economic stability?

The macroeconomic performance record does not prove this. After the deregulations of the mid-1980s, the overall record of economic growth and rate of inflation have improved. Economic growth is inching towards 8% per annum and inflation towards 6% per annum. Income per capita, in conventional terms, has crossed the USD1000 per annum, making Indonesia a middle-income country, albeit still at the bottom end.

Are economic distortions now greater than before, say in the 1970s and early 1980s? Probably not, because the net effect from the deregulation and liberalization measures (particularly in trade and industrial policy, and in banking) may still be greater than the effects of some backsliding. Such backsliding is seen related to the extra-protection and part-financing of large capital or technology intensive projects. On the other hand, it should be appreciated that military spending, e.g., for expensive hardware, has not gone up significantly, and neither were government salaries raised to more adequate levels. The biggest drag on the government budget is still the large (about USD8 billion) debt-service-payments of external debt, only partially offset by new gross consortium aid of over USD5 billion a year.

Of course it would be more ‘ideal’ if resource allocation can be done in a more thrifty way. But economic dynamism is often not a product of very conventional (and stingy) resource allocations. The private sector, practically beyond control of the government because of its free access to the international market, has for the past years indulged in aggressive investments in property and real estate. The commercial banking system in Indonesia is in serious trouble. Are such developments also not contrary to ‘prudent resource allocation’? But East and Southeast Asian economies were growing very buoyantly in spite of, or perhaps because of, aggressive entrepreneurial and often speculative behavior. If the
Indonesian economy will go through a financial crisis, who should be blamed: the (government) ‘technologists’, the (Chinese) conglomerates, or the (technocratic) monetary authorities?

It is true that the overall clout of the economic technocrats now is less than what they had in the seventies and eighties. But practically they still control the ministry of finance and the central bank. That is good enough a basis for maintenance of prudent macroeconomic (i.e. mainly fiscal and monetary) policies. And they have a new mission, not engaging any more in a balance-budget, but creating a budget surplus and educate the political elite and the general public that this is a very essential part of the new macroeconomic prudence. Government domestic revenue still can go up by at least 2% of GDP, whereas foreign aid is expected to dwindle.

Another currently often heard domestic criticism is that the economic policies were too liberal and that these have produced the conglomerates (like the chaebols in South Korea) in one decade and other distortions because of imperfections of the market. Hence the fast overall growth of the economy was accompanied by worsening distribution of income and wealth. Because the latter is socially and politically unacceptable, the longer term viability of the economic policy framework become questionable.

There are several ways to measure distribution of income. One is the Gini coefficient. It is not clear at all whether the number is worse for Indonesia than, say, Malaysia or Thailand. But some domestic social critics maintain that this coefficient has worsened in the past period of high GDP growth. Another yardstick is the size of the population living in absolute poverty, i.e., under the poverty line. This is improving for Indonesia because of the fast and long time growth. This is not disputed by the social critics, although some say that the poverty line should be raised over time. If you do this you can always create a scenario where the number of people under this threshold is increasing.

The charge of worsening income and wealth gap used by the social critics relates to relative poverty as distinct from absolute. It relates to the scenery one can easily see in Jakarta where palatial houses and glittering tall office buildings are often the neighbors of slum areas, and where the gap between wealthy Chinese businessmen and ‘poor and struggling’ indigenous entrepreneurs is for everybody to see. Has such ‘widening gap’ been the results of government economic policies, and could the government have prevented that?
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The economic technocrats are ill at ease answering these allegations. They were and are not the only actors in the process of economic policy making, and even much less in the execution. But they are all part of a larger system, including the political and the legal system. They cannot disassociate themselves and blame the ill effects to the other actors or because of execution of policies by a less than perfect government bureaucracy.

At first they can say that if the government was less interventionist, there will less distortions too. But nobody believes that the ideal system for a developing country like Indonesia is a laissez faire government stance. There is still a strong belief in a, or the, role of the state, guiding developments in a basically market economy. What such a role should be is very hard to identify in an operational sense, and it has more dimensions than formulating (economic) policies alone. Political development is also very important, because the same social distribution of income and wealth will be felt as less offending in a different political setting, e.g. if people can criticize it more openly and the government seen to be more sensitive and responsive to it.

Related to the issue of widening social gap is the issue of corruption. European or western NGOs concerned about 'governance', and lack of good-governance, alias corruption, such as Transparency International, has put Indonesia high on its list, together with countries such as China and Vietnam. Corruption in Indonesia is also often perceived by internationals (read: western business) as increasing in intensity, compared to say the decade of the seventies or eighties. On the other hand, the rate of economic growth, has been improving. China and Vietnam are also high growth countries but apparently there is more 'corruption' with an effective market mechanism rather than in a tightly state controlled system. Western observers lightly make the remark that economic performance will be better with less corruption (e.g., see small article of Paolo Mauro, "Why Worry About Corruption?", IMF Economic Issues Series, February 1997). Are the economic technocrats in Indonesia also co-responsible for the state of affair? What are the relationship between (macro) economic policies at one hand and the rise of corruption on the other hand?

It is equally easy to maintain that there is little connection. Corruption now surfaces and enters the international media in many developing countries, also in several industrialized countries. There is a lot of corruption in African countries, such like Zaire and Nigeria, without economic growth. There is corruption in South Asia with low
economic growth, and is East and Southeast Asia the disease coexist with high economic growth.

High economic growth in East and Southeast Asia goes together with high domestic savings, higher investments, foreign capital inflow, economic and political stability. Corruption is more related to power, the seat and balance of powers, and perhaps the quality of governance and civil society. Can one say that with less corruption the distribution of income and the social equity problem is better solved or resolved? Perhaps. But once could probably make the remark that in a well-established democratic society, such as the United States and Australia, the social gap between the rich whites on the one hand, and the poor black, (American) Indians and (Australian) aborigines are as wide as ever. Surely, (good) macroeconomic polices cannot take care of all social and economic problems. Hence, in Indonesia today, a policy package to alleviate poverty and eradicate extreme poverty, is an important policy matter by itself. What has to be resolved is the interaction between macro-economic policies for growth, at one hand, and distribution oriented policies at the other hand. They should work in synergy. The Indonesian technocrats were not blind for this. Since 1974 there is a distribution oriented policy package, leading to the ‘seven avenues for equitable distribution’ of the fruits of growth. Government spending should have this dimension, e.g., for (primary) education, health, low-cost housing, for grassroots development (the so called Inpres programs), for infrastructure building (e.g., feeder roads). Reducing absolute poverty was given higher priority than reducing relative poverty. Poverty alleviation should be the result of employment expansion and the creation of new wealth, not the result of distribution of existing wealth. With respect to small credits it is more productive to improve access rather than to give low interest rates. Such are some of the principles underlying the policy packages.