Crony Capitalism as a Variable for Growth: Chinese-Indonesian Conglomerates and their Role in Indonesia's Economic Development

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Introduction

Indonesia's remarkable economic performance during the Suharto era has been widely documented, with the country achieving an average 7% per annum growth from 1965-1997. By 1996, the poverty rate had dropped to around 11% compared with 40% in 1976, enormous oil revenues were enjoyed, foreign direct investment surged, and massive infrastructure projects were developed. Indonesia was seemingly a promising developing, industrial, resource-rich country – and Suharto was leading the way to sustained prosperity. However, Suharto's autocratic regime centralized power in the hands of Suharto and his family, with them controlling the flow of capital, labor, commodities, personnel, bureaucracy – and the society in general. This centralized authority spurred the growth of pervasive corruption – especially crony capitalism – as the society looked towards Suharto and his family for favors and access to government largess.

This problematic dichotomy between corruption and economic development in Indonesia debunks the prevailing assumption in poli-

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tical science literature that corruption impedes economic growth. This assumption lies in the theory that corruption involves rent-seeking activities that lead to inefficient economic outcomes: unproductiveness, increased transaction costs and uncertainty, hindered investment, misallocation of resources, undermined state legitimacy, among others. Nonetheless, Indonesia's rampant corruption did not impede economic growth during the Suharto era; instead Indonesia achieved sustained economic growth and macroeconomic stability.

This paper seeks to attribute this coexistence of economic development and corruption, more specifically, crony capitalism, to the dominance of Chinese-Indonesian capital during the Suharto era. This economic dominance was achieved through the customary clientelistic relationships between the Chinese-Indonesian business elite with government officials, particularly, Suharto. As said, Suharto maintained autocratic power over the country, and he utilized the Chinese-Indonesians conglomerates to achieve economic growth, as that they were major powers in respective markets. I argue that Suharto kept Chinese-Indonesian cronies and allowed the dominance of Chinese-Indonesian capital because of state-sanctioned political marginalization – confining the Chinese-Indonesian business elite to economic pursuits, unable to pose as political threats to Suharto. This paper will examine three case studies of Chinese-Indonesian conglomerate involvement in crony capitalism and subsequent contributions to economic development: Salim Group, Astra Group, and Sampoerna Group. These three conglomerate groups exhibit the existence of clientelism that contributed to economic growth, as they were co-opted as the Suharto regime's business clients.

In this paper, I aim to showcase three Chinese-Indonesian conglomerate groups (Sampoerna Group, Salim Group, and Astra Group) and their clientelistic relationship with the Suharto regime to answer two main questions: (1) Why can economic development coexist with corruption, and (2) How did crony capitalism contribute to this coexistence? As discussed, there is significant literature explaining the coexistence of crony capitalism and economic development. I will use the three hypotheses of this coexistence (Centralized Developmental State, Goldilocks Principle, and Bureaucratic Capitalist State), to provide a theoretical explanation of the clientelistic relationship between the three conglomerate groups and Suharto's regime that contributed to Indonesia's economic development during the 1967-1998 Suharto era.

However, this paper does not seek to address the hollow growth that was masked underneath the economic growth of the New Order era. Although growth was evident, the socio-economic conditions of the country suffered due to the uneven wealth distribution between the new wealthy elite and poor majority. Furthermore, such economic growth that was accompanied by crony capitalism was achieved under Indonesia's New Order-specific conditions. Suharto's authoritarian regime directly reduced transaction costs and provided state-sanctioned incentives for investment and production, due to Suharto's centralized power. The regime also marginalized the Chinese-Indonesians to the economic sphere, and allowed the burgeoning of Chinese-Indonesian conglomerates who capitalized on Suharto's economic patronage and favors. Nonetheless, this paper does not seek to champion autocratic regimes, or crony capitalism. It is particularly examining Indonesia's specific circumstances under Suharto's New Order era, in which an alliance for convenience between the government elite and the Chinese-Indonesian conglomerates allowed for economic growth.

This paper first discusses the historical background of crony capitalism in Indonesia, and the state-sanctioned discrimination of the Chinese-Indonesians, and the dominance of Chinese-Indonesian economic capital as a result of their confinement to the business arena. Then, it explores the case studies of the Sampoerna Group, Salim Group, and Astra Group, and the increased state-sanctioned incentives for the conglomerates' productivity, which contributed to Indonesian economic growth as a result of crony capitalism.

Reconciling the Coexistence of Economic Development and Crony Capitalism

Corruption, as commonly defined, is the use of public office for private gain. The problem arises in that the state has the responsibility and power to allocate resources, thereby creating opportunities for government officials to abuse their power, and spurring rent-seeking activities. As said by Peter Enderwick, "where governments enjoy the power of allocation and arbitration of such rights, they also have the ability to usurp those very rights"[1]. This usurpation could include "taxation of private economic rents, or the seizure of rent-creating assets" that may "discourage investment and hence growth"[2]. The dilemma thus lies in finding the balance between state and business interests as to not hinder economic growth. A possible solution is crony capitalism.

Crony capitalism lies within the corruption arena, as that it can be defined as the close relationship between the state and business sector that creates certain private gains for the elites in both sectors. David Kang classifies cronyism as "a blanket term that refers to a number of related concepts: family and personal relations, bribery and corruption, patron-client relations, and collusion"[3]. Business elites, or otherwise known as the "cronies", receive economic opportunities, whilst the state elites receive political support and shares of economic rents. This economic system dictates that the "profitability of business depends on political connections"[4], rather than the market. Thus, it is not surprising that academic literature remains conflicted on the benefits and costs of crony capitalism on economic growth. On one side of the spectrum, crony capitalism implies the distortion of business behavior by the misallocation of resources and reservation for the political connected "cronies", thereby encouraging rent-seeking behavior at the expense of wealth creation and economic growth. However, on the other side of the spectrum lies the notion that crony capitalism increases economic efficiency, centralization of rents, reduces transaction costs, and ultimately – strengthens economic growth.

Existing literature has supported the conflicted theoretical framework of crony capitalism and economic growth. Previous studies by Enderwick[5] and Kang[6] suggest that an economy characterized by crony capitalism increases rent-seeking behavior that may hinder economic

[1] Peter Enderwick, "What's Bad About Crony Capitalism?", *Asian Business & Management* 4 (2005): 117-32.
[2] Ibid, 118.
[3] David C. Kang, *Crony Capitalism: Corruption and Development in South Korea and the Philippines*, (Cambridge: Cambridge UP, 2002).
[4] Randall G. Holcombe, "Crony Capitalism: By-Product of Big Government," *The Independent Review* 17.4 (2013): 541-59.
[5] Enderwick, "What's Bad About Crony Capitalism?"
[6] Kang, *Crony Capitalism*.

growth, yet under certain conditions, crony capitalism may be beneficial. Particularly, in developing countries, conditions are ripe for crony capitalism due to weak institutional structures. Kang believes that "if there is a balance of power among a small and stable set of government and business elites, [crony capitalism] can actually reduce transaction costs and make long-term agreements and investments more efficient, even while enriching those fortunate few who collude together."[7] This increased efficiency and reduction of transaction costs contributes to incentives for investment that contributes to economic growth. The coexistence of crony capitalism and economic development can be further explained through the following frameworks.

Centralized Developmental State Hypothesis

As such, it is important to understand the state-business relationship to understand the relationship between the political and business elites in regards to crony capitalism. Kang looks at this relationship as a Prisoner's Dilemma situation.

Figure 1: Four Types of Corruption

		state coherent	**state** fractured
business	small-N (concentrated)	I: mutual hostages type: PD collusion amount: medium	II: rent seeking type: bottom-up amount: large
business	large-N (dispersed)	III: predatory state type: top-down amount: large	IV: laissez-faire type: residual amount: small

PD = Prisoner's Dilemma

Source: Kang, *Crony Capitalism*, 15.

[7] Ibid, 3.

When there is a small number of conglomerates and a strong coherent state, there is a "mutual hostages" situation in which the business sector and the state collude and reduce transaction costs. This can be seen in South Korea under Park Chung-Hee, when the conglomerates and the government were in collusion and achieved productivity and economic growth. Both state and business are equally powerful and have incentives to continue the relationship so that both can benefit and share economic rents. If the state were weak in this instance, the powerful business players would overpower the state and take advantage of their opportunities and attain more economic rents. If the business sector is weak but the state is strong, this would result in a "predatory state," with top-down corruption, such as in the Philippines under Ferdinand Marcos. This means the state collects most of the economic rents. However, if the business sector and the state are both weak, this would clear the political market and corruption would not occur, such that no businessman or official can take advantage of each other. Crony capitalism can occur in all four scenarios. I will explore later in the paper the Sampoerna Group-Indonesian state relationship as one of a hybrid between mutual hostages and predatory state corruption, which have both contributed to economic growth.

Furthermore, the state-business relationship is particularly different under a developmental state, such as Indonesia. A study by Dieleman & Sachs showcases that the "ubiquity of powerful and well-connected business actors, and weak domestic institutions are conditions that can facilitate a powerful two-way dynamic between the development of corporations and institutions."[8] A developmental state possesses weak institutions that can be controlled by a strong bureaucracy – especially under an authoritarian regime such as Suharto's. This means there are more ad hoc policy initiatives that are in the interests of the bureaucracy, for instance for rent-seeking purposes. As demonstrated in this paper, the Indonesian government enacted monopoly laws for state rent collection that benefited and disadvantaged certain groups in the economy.

[8] Marleen Dieleman and Wladimir M. Sachs, "Coevolution of Institutions and Corporations in Emerging Economies: How the Salim Group Morphed into an Institution of Suharto's Crony Regime." *Journal of Management Studies* 45.7 (2008): 1274-300.

"Goldilocks Principle" Hypothesis

Under an authoritarian regime, there is centralization around one important actor – the dictator. Kang suggests that this concentrated power can reduce transaction costs because of increased efficiency in decision-making.[9] This is because only one person – the dictator – holds power and makes decisions, thereby increasing the incentives for investors to make business decisions as that "it is easier to make agreements with one than to work through large numbers of...players."[10] Nonetheless, in such authoritarian regime, transaction costs are highly contingent on the dictator. If a political uprising displaces the dictator to whom the business elites have created strong relationships with, the business elites will no longer have access to opportunities. This would then increase transaction costs and economic uncertainty, such that new relationships have to be made with the new government and new contracts and enforcement means be constructed.

This situation is showcased in Indonesia's economic situation under the Suharto regime. Kang writes, "with power concentrated in Suharto, the state-dominated economy was permeated by patronage and corruption but was also decisive and flexible."[11] The business elites who receive patronage from Suharto were able to take advantage of the better information, opportunities, longer time horizons for side payments and reciprocity, reduced monitoring costs, and make easier enforcement of agreements.[12] Having such advantage of reduced transaction costs increases incentives for carrying out investment and production activities that would contribute to economic growth. I will showcase this hypothesis later in the paper using the example of the mutually beneficial relationship between the government, Suharto's family, and the Salim Group in Indonesia's food industry.

Bureaucratic Capitalist State Hypothesis

Paul Hutchcroft introduced a framework to categorize different capitalist states. Similar to Kang (2002), this framework demonstrates

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9 David C. Kang, "Transaction Costs and Crony Capitalism in East Asia." *Comparative Politics*". 35.4 (2003).

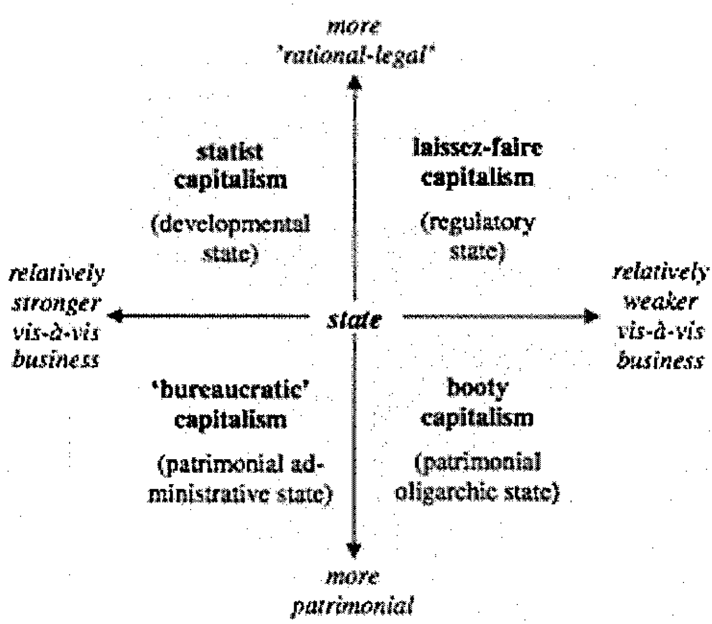
10 Ibid, 439-58.

11 Ibid, 451.

12 Ibid, 440.

state-business relations. However, Hutchcroft further classifies the stronger and weaker states managers in a Western or Southeast Asian context *vis-à-vis* business interests.[13]

Figure 2: Typology of Capitalist Systems



Source: Chua, *Chinese Big Business in Indonesia*, 37.

Hutchcroft classified Western States as being more rational-legal, meaning more law-abiding and thus as developmental or regulatory states. Southeast Asian states are classified as either patrimonial administrative (strong state managers) or patrimonial oligarchic (weak state managers). Chua explains this tendency for patrimonial Southeast Asian states using Weber's definition of patrimonialism: "Practically everything depends explicitly upon the personal considerations: upon the attitude toward the concrete applicant and his concrete request and

[13] As quoted in Christian Chua, *Chinese Big Business in Indonesia: The State of Capital.* Diss. National University of Singapore, 2006.

upon purely personal connections, favors, promises, and privileges."[14] In regards to Indonesia, Hutchcroft places Indonesia as a "bureaucratic capitalist" system, such that "rents are most commonly grabbed by a bureaucratic elite based *inside* the state."[15] This means that economic rents were not shared equally between the state elites and the business elites. Chua explains this as that the Indonesian bureaucrats "benefited disproportionately from the patrimonial administrative state, unhindered by an initially and marginalized capitalist class."[16]

During the Suharto era, such disproportionate benefits can be seen through the Chinese-Indonesian businesses that were run in tandem with Suharto's family and friends. Suharto's regime demanded a profit share in the businesses that they approved of, or gave licenses and opportunities to. Although this may seem like a discouraging feature to business elites in undertaking business activities, in fact it was a small price to pay for easing investment and reducing transaction costs.

Crony Capitalism in Indonesia

Indonesia is perceived to be a very corrupt country. At the end of Suharto's regime, Indonesia placed 80th out of 85 on Transparency International's 1998 Corruption Perception Index.[17] In 1997, Hong Kong-based Political and Economic Risk Consultancy perceived Indonesia as the most corrupt country in Asia.[18] Indonesia's corruption, and subsequent crony capitalism, can be attributed to two factors: the Javanese culture of corruption, and its status as a developing country.

Since early Dutch colonial times and independence in 1945, the core ethnic group and dominant culture has been the Javanese. It is also not surprising that the two dominant post-independence leaders, Sukarno and Suharto, were both Javanese. Thus, Indonesian culture has been heavily influenced by Javanese culture, which has strong customs that are related to corruption, collusion, and nepotism. For instance, a

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[14] Ibid, 36.
[15] Ibid, 37.
[16] Ibid.
[17] Fiona Robertson-Snape, "Corruption, Collusion, and Nepotism in Indonesia," *Third World Quality* 20.3 (1999): 589-602.
[18] Ibid, 597.

traditional Javanese custom is the offering of gifts by subjects to their rulers. This could explain the prevalence of bribery. Traditional culture also dictates strong family and community loyalties, primary to that of state loyalties, which contributes to nepotism and collusion since economic opportunities based on family or community are deemed legitimate in terms of the official's priorities.

Furthermore, high-level corruption can be explained through the hierarchical and patrimonial Javanese culture. Javanese culture was highly influenced by Indian culture, and Indian culture had a rigid caste system that exalted the ruler in a high position – allowing the ruler to "dispense personal favors to his people."[19] This is identical to a traditional Javanese king, who has the right to dispense favors, and for the subjects to benefit from such patronage, they must be "deferential and obedient." This strong tradition of patronage in Indonesian society has characterized Indonesia as a patrimonial state. It is thus not unlikely that crony capitalism is rampant, as that crony capitalism requires strong clientelistic relationships between individuals.

As a developing state, Indonesia faces systematic corruption due to the weak government capacity to regulate and control the country. In other words, Indonesia lacks formal and legal institutions that could hinder corruption. This results in the undersupply of institutions that should be providing regulation, supervision, transparency, and balance between growth and stability.[20] Other problems, such as the "strong motivation to earn income," which is "exacerbated by poverty and low and declining civil service salaries" further adds incentives for government officials to receive bribes, in exchange for the speeding up of a business permit, or information about a business opportunity, and so forth.[21] This could explain crony capitalism on the micro-level, as that it is important for both the businessman and the government official to build relationships for each other's private gain.

Crony capitalism was not a new concept to the Suharto regime. Even during the revolutionary war in the 1940s, "senior military and civilian officials cultivated covert relationships with business people,

[19] Ibid, 597.
[20] Enderwick, "What's Bad About Crony Capitalism?", 128.
[21] Daniel Kaufmann and Cheryl Grey, "Corruption and Development," *Finance & Development* (1998): 7-10.

with the resulting revenue being hidden and managed through various so-called social or charitable foundations and commercial joint ventures."[22] The first post-independence president, Sukarno, was also engaged in crony capitalism, as that business licenses were dependent upon the favor of friends and family of Sukarno.[23] Nonetheless, a priority of Suharto's New Order regime was financial stability and growth, and crony capitalism was vital to achieve this.

Gross domestic capital investment contributed greatly to Indonesia's economic growth. However, the regime placed policy-generated limits on domestic competition and trade, creating lucrative, rent-seeking opportunities in the form of monopolies. Such policies and exemptions included preferential access to credit from state-owned banks, cartels, price controls, entry and exit controls, exclusive licensing, tax and duty exemptions, protection against import competition, and other "ad hoc interventions by the government in favor of specific firms or sectors."[24] These monopolistic rents were distributed between the "politically well-connected businessmen and their political patrons", which correlates with the flurry of crony capitalism. This showcases that even though the government seemingly maintained fiscal discipline, there were corrupt practices that pervaded the economy in the form of the infamous "KKN" (*korupsi, kolusi, nepotisme*) – corruption, collusion, nepotism. Such practices encouraged rent-seeking and less entrepreneurial activity – leaving large conglomerates to partake in most economic activity, and thus attain great wealth. Boards of various enterprises, may it be state or non-state, had some sort of relationship with Suharto, or his family and friends – usually being run in tandem with them. Another example of these practices was the so-called "memo lending," which is when bank loans were made to cronies purely based from a letter from a close associate of Suharto, without credit risk assessment.[25]

[22] Andrew MacIntyre, "Funny Money: Fiscal Policy, Rent-seeking, and Economic Performance in Indonesia," *Rent-Seeking in Southeast Asia*. (Cambridge: Cambridge UP, 2000). 248-73.

[23] Terri Morrison and Wayne A. Conaway, *Kiss, Bow, or Shake Hands: The Bestselling Guide to Doing Business in More than 60 Countries*, (Adams Media, 2006).

[24] Wie, "Indonesia's Economic Performance under Soeharto's New Order," 278.

[25] J. Malcolm Dowling, and Chin-Fang Yap, "Indonesian Economic Development: Mirage or Miracle?" *Journal of Asian Economics* 19 (2008): 474-85.

State-Sanctioned Discrimination of Chinese

It is important to look at the historically rooted developments between the Chinese minority and the state to understand the political marginalization of the Chinese, and their subsequent confinement to the economic sphere. The Chinese arrived in Indonesia as early as the Tang period (618-907), yet the intensification of trade during the Ming Dynasty (1368-1644) led to increased migration from Southern provinces of China to Southeast Asia, such as Indonesia.[26] Their mission to trade resulted in their strong involvement in traditional markets, acting as intermediaries between local regents and the indigenous population, facilitating trade with China and monetizing on subsistence and cash crop economy. The regents chose the Chinese to be their intermediaries because they did not want the indigenous people to gain clout that may threaten their power. As a foreign minority, the regents believed the Chinese were not indigenous, nor were they considered to remain in Indonesia permanently. Thus, they were ideal, unthreatening intermediaries that acted in the economic interests of the regents.

During the Dutch colonial period, the Dutch built on the existing political structures and used the Chinese merchants and traders as intermediaries, much like the traditional regents before. The Chinese became tax collectors, officers, trading partners, and operators of opium farming, monopolies, gambling dens, and pawnshops. Later, other methods of private capital accumulation were in sugar production, tin mining, rice milling, retail and wholesale trade, shipping, and rubber cultivation or trading.[27] They were ideal intermediaries because of their already established "networks and infrastructure of commerce,"[28] nor did they pose as political threats either, as they were "positioned as 'outsiders at the center'."[29] This is in reference to the Chinese having very limited rights from the nineteenth century, as that even though they were important within the economic system, they were "restricted from owning land, or later on, joining the civil service,"[30] leaving them to be active in the economic arena instead. Chua argues: "To be

[26] Chua, *Chinese Big Business in Indonesia*, 43.
[27] Ibid, 47.
[28] Ibid, 45.
[29] Ibid, 45.
[30] Ibid, 47.

as close to power as possible gave a small group of Chinese *towkays* the much needed security and access to business opportunities."[31] Such synergy between the Chinese business and government elites set the patronage networks that can be seen in future crony capitalism during the Suharto era. Nonetheless, fear of growing Chinese economic power led the Dutch to marginalize the Chinese involvement in society, by enacting anti-Chinese regulations such as head taxes, deportations, and banning of agricultural land ownership. Ultimately, the Chinese became an important capitalist class within the colonial society, yet they were restraint to an economic role – a role that can also be seen during the Suharto era.

The revolutionary period called for another opportunity for collaboration between the political and Chinese business elites. Initially, the native Indonesian revolutionaries had to rely on illegal trade with Singapore and Penang to obtain financial resources, medicine, and weapons, however the collaboration with the Chinese-Indonesian businessmen who readily had resources proved to be a mutually beneficial relationship.[32] Chinese capitalists supplied goods, and also acted as middlemen and financiers for the revolutionaries, building relationships with army/political elites that were to be of use for the future.

Suharto's regime marked intense marginalization of the Chinese people, building on the historical ethnic notions of the indigenous Indonesian people categorizing the Chinese collectively as outsiders. This "us vs. them" dynamic was exacerbated with Suharto's assimilation policies in the 1960s and 1970s. The assimilation policies prohibited Chinese script, closure of Chinese language schools and educational institutions, banned of Chinese newspapers, limited educational opportunities (only 10% quota on Chinese students in medicine, engineering, law, science) in Indonesian universities, required the Chinese to adopt to "Indonesian-sounding" versions of their names, and stifled overall Chinese cultural expression.[33] Such state-sanctioned discrimination against the Chinese extinguished Chinese culture and margin-

[31] Ibid.

[32] Hong Liu, "The Chinese Business Elite in Indonesia and the Transition to Independence, 1940-1950 by Twang Peck Yang Book Review," *The China Quarterly* 160 (1999): 1078-079.

[33] Sarah Turner and Pamela Allen, "Chinese Indonesians in a Rapidly Changing Nation: Pressures of Ethnicity and Identity," *Asia Pacific Viewpoint* 48.1 (2007): 112-27.

alized the ethnic group in society – relegating them as second-class citizens and limiting their social radius.

Furthermore, the ethnic Chinese group as a whole was stigmatized as rich expropriators throughout history – such that they consisted of an estimated 4% of the Indonesian population, but controlled 70% of the economy. This is obviously problematic because Chinese-Indonesians only controlled 73% of listed firms in the Indonesian stock exchange by market capitalization, not the whole economy. State-owned companies such as Pertamina, and giant foreign companies like Freeport McMoran Copper & Gold or Coca Cola, were not included in this listing. Other corporations that were run in tandem, or directly, by Suharto's family and friends were also not included. Thus, the exaggerated image of the minority Chinese-Indonesians dominating the market is problematic, especially when there were socioeconomic differences within the ethnic group itself.[34]

Suharto wanted to be seen as a champion and defender for indigenous interests, and this is evident in the infamous ranch incident,[35] when Suharto called the heads of the thirty-one largest conglomerates in Indonesia, and only two were indigenous, the other twenty-nine were Chinese.

This theme of the Chinese being politically and socially marginalized, through discriminatory regulation throughout the colonial and Suharto regime showcases the state-sanctioned discrimination that has confined the Chinese to the economic sphere. Under such a marginalized position, the Chinese business elites had to turn to the ruling elite to defend and provide them with necessary functions and distributions of a state apparatus that was difficult for them to attain. As Christian Chua writes, "Chinese big businessmen were politically and socially handicapped, but economically they were given the special right to partake in the predatory networks that ultimately came to be centered on Suharto himself."[36] Furthermore, the pattern of an alliance of convenience –the Chinese business elites supplying capital and business expertise while the indigenous political elite provided protection and

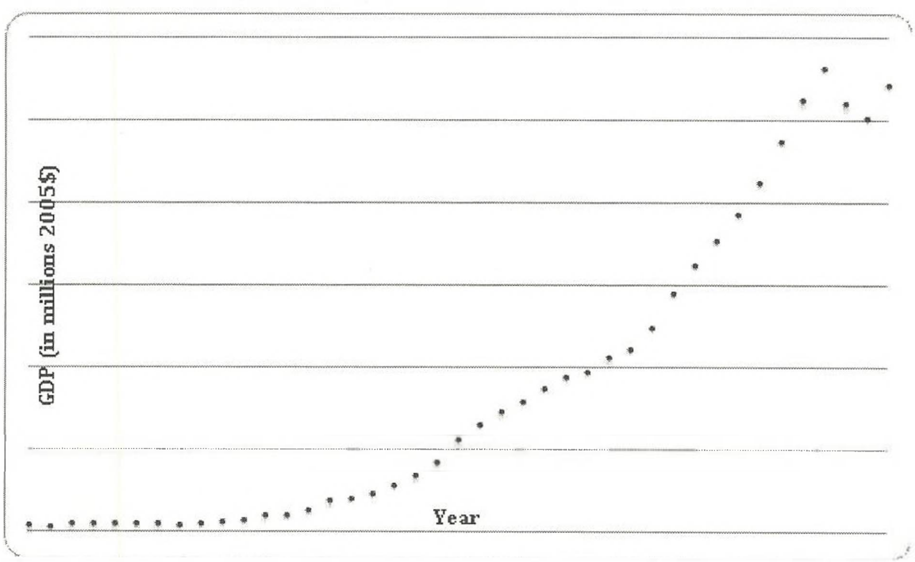
[34] George J. Aditjondro, "The Myth of Chinese Domination," *The Jakarta Post*, 14 August 1998.
[35] MacIntyre, "Funny Money," 258.
[36] Chua, *Chinese Big Business in Indonesia*, 63.

patronage– characterizes the state-business relations during the Suharto era that exacerbated crony capitalism.

Indonesia's Economic Performance and Dominance of Chinese-Indonesian Economic Capital

The Suharto New Order regime placed economic growth and financial stability as one of its primary goals. From being a 'chronic underperformer' in Southeast Asia during the early 1960s, Indonesia was able to achieve rapid and sustained growth through the regime's 'Balanced Budget Rule', vast foreign investment, high rates of domestic capital investment, and trade, allowing it to become a high-performing Asian economy by the early 1990s[37]. Figure 3 illustrates the immense GDP growth during the regime's era, which suffered a setback in 1998 due to the Asian financial crisis, and also marked Suharto's fall from power.

Figure 3: Indonesian GDP (in millions 2005$), 1960-2000



Source: Center for International Comparisons at the University of Pennsylvania, "Penn World Tables 7.1," accessed on 20 April 2013 https://pwt.sas.upenn.edu/php_site/pwt71/pwt71_form_test.php

[37] Wie, "Indonesia's Economic Performance under Soeharto's New Order," 264.

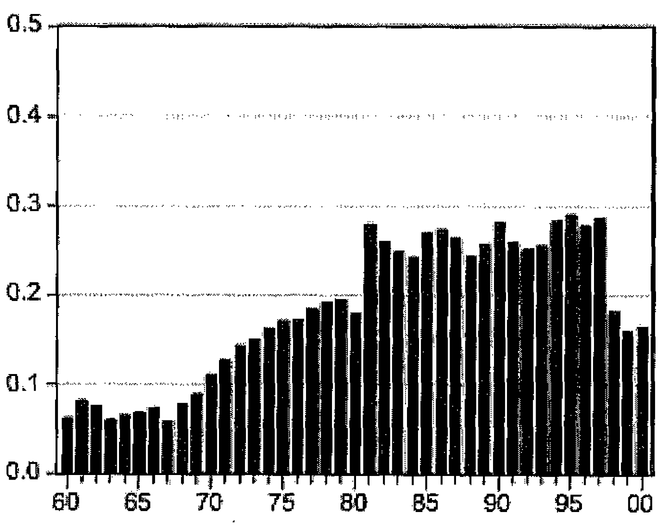
The 'Balanced Budget Rule' maintained macroeconomic fiscal stability in the economy, such that it "forswore...not to spend more than it earned from taxation combined with foreign aid (including foreign loans)."[38] Thus, government expenditure roughly matched government revenue, with the government not using other methods, such as central bank borrowing and printing money to fund public spending.[39] This fiscal discipline maintained Indonesia's inflation and deficit, stabilizing the economy as foreign and domestic investment and trade spurred growth.

Government initiatives led greater industrialization, investment, and economic growth for the country. New laws were enacted in 1967 to encourage foreign investment. Indonesian policymakers have looked to "foreign investment to provide the capital and technological inputs needed to strengthen Indonesia's manufacturing capabilities, to modernize its infrastructure, and to provide jobs to the millions of young adults entering the Indonesian work force each year"[40]. The new laws gave foreign capital guarantees and incentives for foreign investment, such as the continuation permit for over thirty years, tax holidays, and exemption from import duties[41]. Foreign investment took in over $1 billion from 1967 to 1973, which is a significant amount compared to Indonesia's total income from exports was $595 million.[42] Indonesia is also resource-rich, and significant exports in oil and gas resulted in great revenue for the country during the 1970s global oil boom. The Indonesian government also made efforts to promote manufactured exports to accompany the oil boom.[43] These efforts to increase industrial and manufacturing capacity developed the country, as it called for infrastructure and technology improvements as well. Further expansion in import substitution, "focusing on locally made consumer goods and consumer durables to replace imported products" increased

[38] MacIntyre, "Funny Money," 250.
[39] Ibid, 251.
[40] Robert N. Hornick and Mark A. Nelson, "Foreign Investment in Indonesia," *Fordham International Law Journal* 11.4 (1987): 724-75.
[41] Chua, *Chinese Big Business in Indonesia*, 66.
[42] Thomas Beech, "Indonesia #2 1965-," accessed on 20 April 2013 http://www.bemidjistate.edu/academics/departments/political_science/faculty/beech_notes/comp/Indonesia2.htm
[43] Wie, "Indonesia's Economic Performance under Soeharto's New Order," 266.

industrialization as well.[44] Indonesia's economic growth was also bolstered by the expansion of gross domestic investment in processing activities, such as wheat flour and soy-meal, oil processing, the plywood and timbre industry, distribution of cement, fertilizer, extraction industries like mining and palm oil, automobile industry, among others. Chinese-Indonesian conglomerates were active in all of these capital investments. Furthermore, as seen in Figure 4, the investment ratio of real investment (public plus private) to real GDP cumulatively increases during the Suharto era. This indicates that investment was a large contributory factor to GDP during this time, and consequently to economic growth.

Figure 4: Investment Ratio of Real Investment (public plus private) to Real GDP of Indonesia, 1960-2000



Source: Robert J. Barro, "Economic Growth in East Asia Before and After the Financial Crisis." *National Bureau of Economic Research* (2001).

The dominance of Chinese-Indonesian capital during the Suharto New Era was not surprising. The Chinese-Indonesian capital base had existed for centuries, as previously discussed. Thus, the Chinese capitalists were considered ideal partners in patronage networks in a

[44] Dowling and Yap, "Indonesian Economic Development: Mirage or Miracle?" 478.

country that direly needed economic growth. Along with their political and social marginalization, Chinese capitalists had to turn to the ruling elite for protection and favors. The ruling elite provided these necessities because they believed the capitalists to be harmless, as they had no political clout to challenge the regime. This symbiotic relationship exacerbated crony capitalism during the Suharto era.

There were also domestic investment laws specifically catering to domestic Chinese capital that allowed Chinese businesses to attain subsidized credits and security to invest in Indonesia. This policy, under the Instruction of the Cabinet Presidium No. 37 of 1967, is as follows:

> *"Different from FOREIGN CAPITAL as mentioned in Law no. 1 of the year 1967, capital which has been accumulated and expanded in the territory of Indonesia, which is domestic foreign capital is basically national wealth in the hands of aliens; therefore it is to be mobilized, fostered and used in the interest of rehabilitation and development."*[45]

As such, the Chinese capitalists, considered aliens within Indonesia, received security to perform business activities, among other privileges the state provided for them such as "exclusive contracts, licenses, and credits"[46]. Examples of these privileges included import and distribution monopolies for food from the Indonesian Bureau of Logistics (BULOG), concessions and protective trade regimes by several ministries, and highly subsidized credits below the market rate that were used for large investments[47].

Large Chinese elite capital formation took place during the Suharto era due to this protectionism and general incentive for investment towards economic growth. It is often said that Chinese big businesses constituted 40 to 60% of total GDP, and the conglomerates controlled 80% of Indonesia's corporate assets.[48]

In vein of this alliance for convenience, the symbiotic relationship of crony capitalism in Indonesia can be illustrated. The Chinese elite

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[45] As quoted in Chua, *Chinese Big Business in Indonesia*, 66.
[46] Ibid, 67.
[47] Ibid, 67.
[48] Juliette Koning, "Chineseness and Chinese Indonesian Business Practices: A Generational and Discursive Enquiry," *East Asia* 24 (2007): 129-52.

capitalists acted as the marginalized capitalist class that provided the capital goods and received patronage from the bureaucratic elite within the state. This alliance could only be possible with the patrimonial relationship between both Chinese and bureaucratic elites – with their personal connections dictating investment ventures that contributed to economic growth. Thus, the political elites and their business cronies create the notorious crony capitalism environment in the Suharto era.

Achieving Economic Growth with Crony Capitalism: Case Studies

Sampoerna Group

The Sampoerna group is Indonesia's largest tobacco company, with a long history of selling *kretek* (clove) cigarettes. Though the company grew during the Suharto regime under Putera Sampoerna, the family's tradition in the cigarette business dates back to Putera's grandfather, Liem Seeng Tee, who migrated from Fujian, China, to Java in 1898. Liem opened a stall selling cigarettes in 1913.[49] Putera took over the company in the 1980s from his father, Aga Sampoerna, who had transformed the company "from number four in the market to the most profitable cigarette firm."[50] As Dieleman has studied, about 70% of the Indonesian population smokes, with around 90% of smokers opting for *kretek* cigarettes.[51] The cigarette industry provides the government the most tax revenue than any industry in Indonesia, other than oil and gas. Thus, it is particularly significant to the overall Indonesian economy, explaining the government's choice in refraining from excessively taxing or restricting cigarette firms, such as Sampoerna.

This collusion between the cigarette firms and the state showcase David Kang's proposed mutual hostages situation. Being that the cigarette industry is important to the Indonesian economy that needed to develop, the government had the incentive to collude with cigarette firms and reduce transaction costs – such as taxes. This in turn creates productivity incentives for the cigarette firms to produce more,

[49] Marleen Dieleman, "Shock-imprinting: External Shocks and Ethnic Chinese Business Groups in Indonesia," *Asia Pacific Journal of Management* 27 (2009): 481-502.
[50] Ibid, 492.
[51] Ibid, 486.

employ more workers, and expand their businesses – because less tax payments would increase their overall profits. Such increased business incentives implies further investment in capital in the tobacco industry, which would contribute to economic growth.

Nonetheless, the cigarette firms could be seen as weak, and the state as strong, resulting in a "predatory state". This is because the government maintained a monopoly on cloves through the Clove Support and Marketing Board (BPPC), chaired by Suharto's youngest son, Tommy.[52] The government realized that this was an important commodity to regulate for it had vast rent-seeking opportunity. As said, the cigarette industry is large, and the *kretek* segment within it is significantly large as well. The BPPC bought cloves from farmers at a government-sanctioned low price, and sold the cloves at far higher prices to cigarette manufacturers. This means that the government acts as a predator, collecting on rents through the clove industry, and thus negatively impacting the cigarette firms for it increases their input costs. Though this gives a large rent-seeking opportunity for the government through the BPPC, given the scale of the cigarette industry, this monopoly had not hindered its growth. This can be as evidenced through Sampoerna's position as a market leader in the tobacco industry, despite such policy.

Salim Group

The Salim Group was Southeast Asia's former largest conglomerate, and in Indonesia as well, with 600 companies in 1996, and annual sales of US$22.2 billion. Some have said that in the early 1990s, the Salim Group accounted for 5% of Indonesia's economic output.[53] Liem Sioe Liong (Soedono Salim), the founder, migrated from Fujian, China, to Central Java in 1937. He began as a trader, and began to expand on small-scale industrial activities,[54] eventually accumulating enough capital to form a supplier relationship with a local garrison of the revolutionary army. He had links with the Diponegoro Division

[52] Philippe Lasserre, "The Coming of Age of Indonesian-Chinese Conglomerates - National, Regional, or Global Players?" *Euro-Asia Centre Research Series* 13 (1993).
[53] Bill Guerin, "World's Top Noodle Maker Loses Its Bite." *Asia Times Online*, 23 December 2003.
[54] Dieleman and Sachs, "Coevolution of Institutions and Corporations in Emerging Economies," 1288.

in Semarang that was commanded by then Liutenant-Colonel Suharto – thus the initial beginnings of the clientelistic relationship, as he was Suharto's main crony.[55] The Salim Group had a diversified business portfolio, owning and operating companies producing goods for the local market, such as food, chemicals, financial services, automotive, and plantations.[56] This focus on the domestic market allowed them to be a market leader, especially in the pre-packaged food sector through their company – Indofood Sukses Makmur. Indofood predominantly produces instant noodles called *Indomie*, and the company continues to be the world's largest instant noodle manufacturer to this day, with distribution networks all around the world. In 1999, Indofood had 90% of the noodle market in Indonesia.[57] Furthermore, the Salim Group owns PT Bogasari Flour Mill, one of the world's largest flourmills today.

Suharto and Liem had a close personal relationship, having regular weekly meetings, with the Salim Group being an "implementer and shaper of Indonesian economic policy"[58], as that they were capable of bending government policies towards the Group's own favor. Furthermore, Bogasari was a joint venture between Liem and Suharto's adopted brother and cousin, Sudwikatmono[59]. The Salim Group was granted a thirty-year monopoly on the import of wheat, such that BULOG sold imported wheat to Bogasari at subsidized prices, which was then processed into flour and sold to BULOG at higher prices – thus a source of monopoly rents.[60] This also contributed to the cheap production of *Indomie*, as that Indofood was able to attain cheap wheat flour to produce instant noodles. The instant noodle market was a booming market not only in Indonesia, but in the world, and with the cheap production costs, Indofood was able to produce more and sell more, ultimately garnering higher profits.

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[55] Chua, *Chinese Big Business in Indonesa*, 65.
[56] Dieleman, "Shock-imprinting," 489.
[57] Mark Landler, "Year of Living Dangerously For a Tycoon in Indonesia," *New York Times*, 16 May 1999.
[58] Dieleman and Sachs, "Coevolution of Institutions and Corporations in Emerging Economies," 1288.
[59] Helen E.S. Nesadurai, *Globalisation, Domestic Politics and Regionalism: The ASEAN Free Trade Area*, (Routledge, 2003).
[60] Ibid.

It can be seen that the close relationship between Liem and Suharto was mutually beneficial. Under the Goldilocks Principle, it is illustrated that under such centralized government, Liem was able to receive patronage benefits through crony capitalism, whilst Suharto's family also attained revenues. Given the centralized power in Suharto's hands, and the many business elites vying for his patronage, Liem had a clear advantage by having closer personal relationships with Suharto himself. Such advantages increased economic efficiency for the Salim Group, as they were able to take advantage of the wheat monopoly that allowed them to produce cheap instant noodles, and also gain monopolistic rents on flour production. Increased economic efficiency implies greater investment in their industrial and manufacturing capital, which contributes to greater Indonesian economic growth.

Astra Group

Astra is another large ethnic Chinese owned Indonesian conglomerate, and is the largest automobile retailer in Indonesia to this day. Founded by William Soeryadjaya in 1957 as a garage-based trading company, Astra diversified its portfolio, with holdings in automotive, financial services, heavy equipment and mining, agribusiness, infrastructure and logistics industries. Soeryadjaya was not directly a Suharto crony, being that his political connections lied with the state-oil-enterprise Pertamina's chairman, General Ibnu Sutowo, who controlled the government contracts for supply and construction.[61] Astra became the sole agent distributor for Toyota, Honda, and Daihatsu[62] – all automobile brands with large markets shares within Indonesia. In return, Sutowo received shares in the company, thus exhibiting the shared rent-seeking opportunity between the business and political elite. For instance, Sutowo was a 17.5% shareholder of PT Federal Motor, a subsidiary of Astra Group that was the Honda sole agent and assembler.[63]

Astra was able to dominate the automobile business through the granting of these contracts. It manufactured the majority of the compo-

[61] Chua, *Chinese Big Business in Indonesia*, 68.
[62] Astra International, "Overview," accessed on 10 May 2013 http://www.astra.co.id/index.php/profile/detail/2
[63] Raj Brown, *Chinese Business Enterprise V1* (London: Routledge, 2004).

nents for the automobiles it assembles for the Indonesian market[64], implying its contribution to the industrialization, investment, and greater consumption of the country. Ultimately, given the large automobile market in Indonesia and demand for Toyota, Honda, and Daihatsu cars, it implies Astra Group's large contribution to economic growth during the Suharto era.

Furthermore, the relationship between Soeryadjaya and Sutowo, a government official, is characteristic of Hutchcroft's bureaucratic capitalist system, in which the personal relationships between the business and political elites allow for rent-seeking opportunities for both elites. The patrimonial relationship between Soeryadjaya and Sutowo granted Astra Group access to government contracts, whilst also allowing Sutowo, a bureaucrat holding government office, to collect rents through company shares.

Conclusion

This paper answers the questions of whether the coexistence of economic development and corruption is possible, and the extent to which crony capitalism contributes to such coexistence. Though corruption and crony capitalism have been perceived to be factors that impede economic growth, it has not been the case in Indonesia. In fact, crony capitalism can be seen as a variable for economic growth in the country, as demonstrated by coexistence hypotheses such as the Centralized Developmental State, Goldilocks Principle, and Bureaucratic Capitalist State. Crony capitalism has been rampant throughout Indonesia's history, however the dominance of Chinese-Indonesian capital during the Suharto era has marked a significant interest in Chinese-Indonesian conglomerates involvement in crony capitalism, given their highly clientelistic relationships with the state. Under Suharto's autocratic regime, power was centralized such that it increased economic inefficiency and reduced transaction costs – creating incentives for increased investment in capital that contributed to Indonesia's economic growth. As evidenced in Sampoerna Group's relationship with the state, it received tax concessions due to the tobacco industry's

[64] Lasserre, "The Coming of Age of Indonesian-Chinese Conglomerates - National, Regional, or Global Players?" (1993).

importance to the Indonesian economy – demonstrating a "mutual hostages" situation that allowed the collusion for both business and state to benefit. Salim Group was able to attain government-sanctioned monopolies on wheat due to Liem Sioe Liong's personal relationship with Suharto, thereby reducing their production costs to produce *Indomie*, and increasing rent-seeking opportunities through selling their produced flour with inflated prices. Astra Group took advantage of their patrimonialistic relationship with a government official to receive exclusive agent distribution rights to important automobile companies in Indonesia: Toyota, Honda, and Daihatsu. These three conglomerate groups had, and still continue to have, obvious market power in the Indonesian economy.

Suharto confined the Chinese-Indonesian conglomerates to the business sphere through state-sanctioned discrimination policies. Thus, with their focus on business, the Chinese-Indonesian conglomerates have been able to expand their businesses and make large capital investments that have contributed to Indonesia's economic growth. This is striking under an autocratic regime, such that an important capitalist class was reserved purely for economic purposes, and could not form an autonomous political force.

I conclude that crony capitalism, and subsequently corruption, did not impede growth in Indonesia's case during the Suharto era. However, I believe Indonesia had special circumstances of a marginalized capitalist class that relied on the state for economic patronage and favors, and an autocratic government that was willing to supply the class with them due to the class' nonexistent political power. It is difficult to confirm that crony capitalism or corruption can be a variable for growth in other countries, unless the similar circumstances apply.