POLITICS OF PREMATURE DEINDUSTRIALIZATION: THE CASE OF INDONESIA[1]

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Abstract: The available literature on the issue of premature deindustrialization in developing countries has been mainly economic, i.e., explaining the economic causes of the phenomenon, such as trade liberalization (e.g., Bogliaccini 2013); and technological progress (e.g., Rodrik 2016). With this focus, the literature generally understands deindustrialization as an inevitable and secular trend of current economic development at the global level. This paper utilizes Indonesia's experience with premature deindustrialization to argue that the current established literature overlooks political causes--such as the breakdown of state capacity and authority, on the one hand, and capital being set loose, on the other; and failure in tackling the economic-political reform dilemma following the democratic transition. This omission undermines the role of agency and the possibility of overcoming this current problematic situation. Moreover, using a counter-factual analysis by comparing Indonesia's experience with how other countries affected by the 1997 crisis handled the IMF situation and how Indonesia itself handled another commodity (oil) boom in the 1970s, this paper further argues that premature deindustrialization would have not occurred even if the economic causes were there, had the political causes not also occurred—thus putting back the politics into the equation.

Key Words: *Premature Deindustrialization; State-Capital Relation; Democratic Transition*

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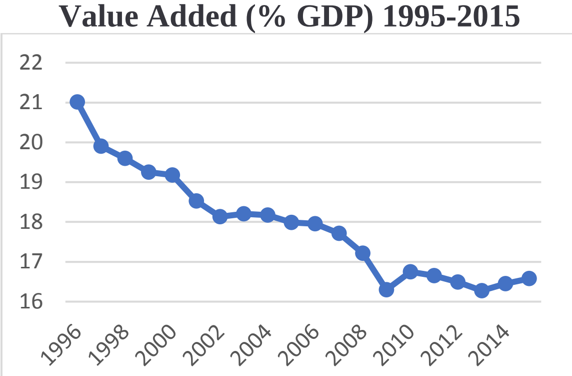
I. Introduction

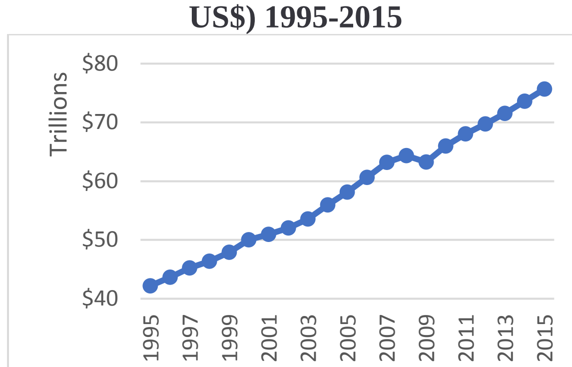
Over the last several decades, countries have experienced the phenomenon of deindustrialization—starting with developed countries in the 1970s and continuing with less developed ones into the current era (Tregenna 2015). Even though deindustrialization is not a particularly recent phenomenon—it also happened in the colonies during the era of colonization (Bairoch and Kozul-Wright 1998)—a new characteristic has arisen with this recent deindustrialization, i.e., that the overall economy continues to grow despite the diminishing share of the manufacturing sector (World Bank 2018), as shown in Figure 1 and Figure 2.[2] This new characteristic is at odds with the widely agreed understanding among economists and political scientists that manufacturing is the engine of sustained economic growth—whether for the old industrializers in 19th century northwestern Europe or for the late and late-late industrializers in most part of the rest of the world which gained independence following World War II (e.g., Kaldor 1966; Szirmai 2012).[3]

Figure 1. World's Manufacturing, Value Added (% GDP) 1995-2015



Source: World Bank's DataBank (2017)

Figure 2. World's GDP (constant 2010 US$) 1995-2015



Source: World Bank's DataBank (2017)

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[2] The data shown are from 1995-2015 which are the only data available for the "World Manufacturing, value added (% of GDP)" variable in World Bank's DataBank https://data.worldbank.org/indicator/NV.IND.MANF.ZS.

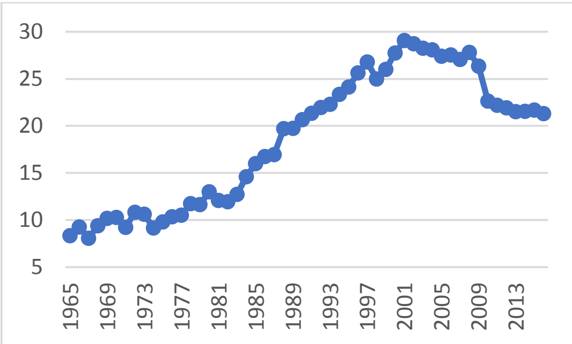
[3] It is important to note that manufacturing (ISIC 15-37) is a subsector of the sector of industry (10-45) which also consists of mining and construction. For full definitions of ISIC go to https://unstats.un.org/unsd/publication/seriesM/seriesm_4rev4e.pdf. Deindustrialization here is understood is simply the diminishing role of manufacturing sector in an economy.

While deindustrialization in developed countries could mean a maturation of the economy as the bulk of industry shifted from shop floor factories to high-tech research and development and finance, deindustrialization in developing countries is mainly perceived unfavorably as it brings many issues such as a constantly depreciating and volatile exchange rate in Indonesia (Nurunnisa & Hastiadi 2016), rising inequality in many countries, both developed and developing (e.g., Grabowski 2017), and widespread job loss in India (e.g., Kumar 2017).

In this trend of premature deindustrialization in developing countries, Indonesia is not different. Since the initial years following the 1997 financial crisis and the concomitant 1998 fall of authoritarianism, the manufacturing sector has also been diminishing, at least until about the year 2010, as measured by its share in export and gross domestic product (GDP)—reversing its previous steady rise since 1965, shown in Figure 3 and Figure 4.[4] As a result, the country has been becoming increasingly dependent on the export of non-manufactured commodities led by palm oil and coal (Coxhead & Jayasuriya 2010; Papanek et al. 2014) for its high and fast-rising GDP, as shown in Figure 5 and Figure 6. As shown in Figure 7 and Figure 8, the level of inequality has also reached an historic height (World Bank 2016) while the shift to a formal economy has stalled for a time (Nazara 2010)—arguably, all effects of the deindustrialization.

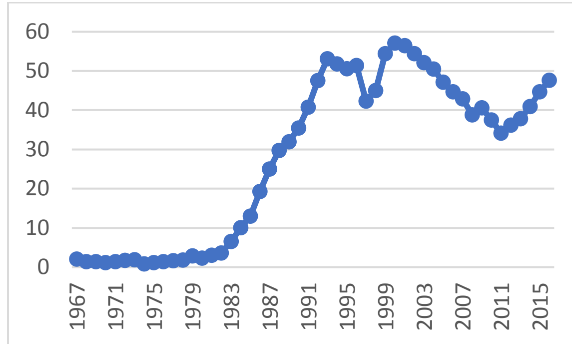
[4] The data on Indonesia's Manufacturing (% GDP) are available only from 2010-2016 in World Bank's DataBank newest 2018 edition. Fortunately, I managed to save the 2015 edition in which the data are available from 1967-2014. The two editions, 2015 and 2018, are then put together to show the full 1967-2016 data. The data of Indonesia's Manufactures Exports (% of merchandise exports) are the same in the 2015 and 2018 editions: available from 1967-2016.

Figure 3. Indonesia's Manufacturing, value added (% GDP) 1967-2016



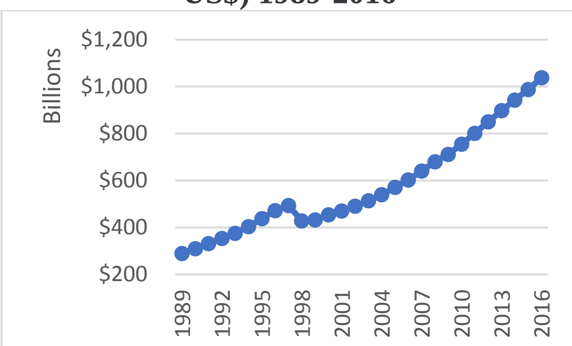
Source: World Bank's DataBank (2015; 18)

Figure 4. Indonesia's Manufactures Exports (% of merchandise exports) 1967-2016



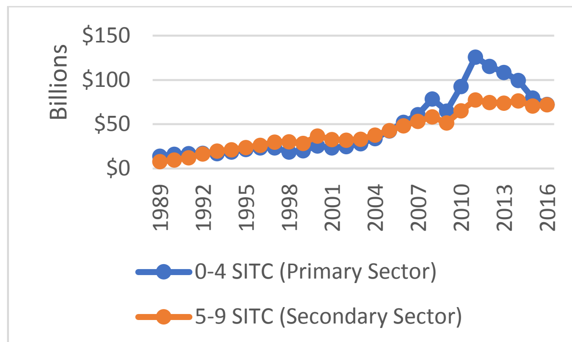
Source: World Bank's DataBank (2018)

Figure 5. Indonesia's GDP (constant 2010 US$) 1989-2016



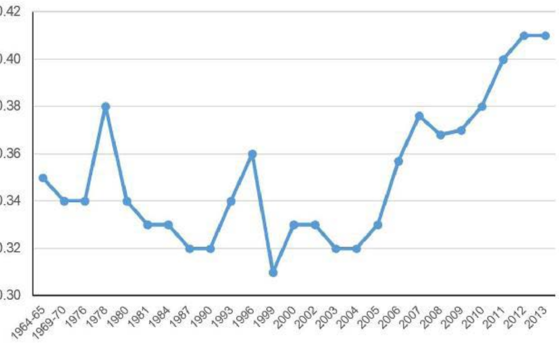
Source: World Bank's DataBank (2018)

Figure 6. Value of Indonesia's Export of Goods 1989-2016



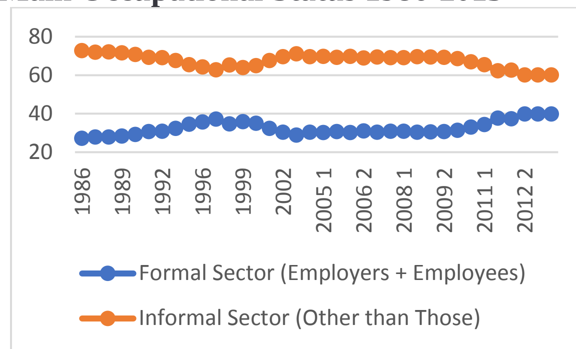
Source: UN Comtrade Database (2018)

Figure 7. Indonesia's Gini Index 1964/5-2013



Source: Papanek et al. (2014)

Figure 8. Shares (%) of Indonesia's Formal and Informal Sector Based on Main Occupational Status 1986-2013

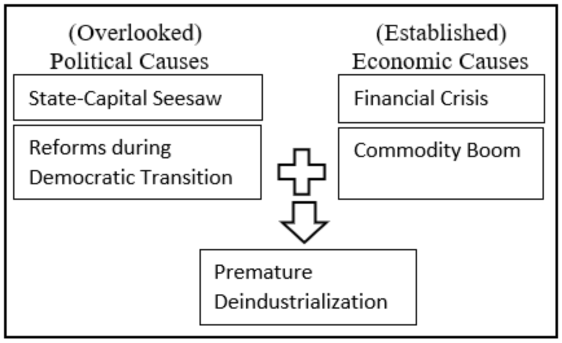


Source: Indonesia's Central Bureau of Statistics (2018)

However, the available literature on the issue of premature deindustrialization in developing countries comes overwhelmingly from an economic point of view, i.e., explaining the *economic* causes of the phenomenon, such as trade liberalization (e.g., Bogliaccini 2013) and technological progress (e.g., Rodrik 2016). The literature thus generally understands deindustrialization as an inevitable and secular trend of current economic development at the global level. By looking at why and how deindustrialization occurred in the Indonesian case, my research argues that the current established literature overlooks the crucial role of power struggles among and between political actors and economic actors in causing deindustrialization—the *political* causes.

To explain these political causes, I observe what has changed—and what has remained—of the power structure of state and capital, arguably two most vital institutions in affecting economic development, in Indonesia since the end of the authoritarian era; and how those factors have particularly caused the economy to deindustrialize prematurely. This research suggests two developments as politically causing the matter in hand: the changing balance of power between state and capital; and the unsuccessful, partial reform during the democratic transition period. These two developments explain why certain external, chronologically intervening variables, i.e., financial crisis and commodity boom, were handled differently compared to other countries (those impacted by the 1997 crisis) and another era (Indonesia's New Order) and led to the occurrence of deindustrialization in this period in Indonesia. The model of analysis is shown in Figure 9.

Figure 9. Model of Analysis



II. Causes for Premature Deindustrialization in Developing Countries: A One-Sided Explanation in Need of a Completing Piece of the Puzzle

Since the 1970s, assertions have been made of a phenomenon of deindustrialization occurring in the industrial centers of the developed world. Frobel et al. (1978) point to this phenomenon as part of a grander trend of what they call "the new international division of labor" in which manufacturing activities shifted to less-developed countries. Corden & Neary (1982) also touch on the issue of deindustrialization when they analyze the pressuring results of a booming sector, either extractive or not, on the displacement of manufacturing as the older industry. Davis (2009) represents another argument for the cause of deindustrialization in developed countries, in addition to offshoring and an economic boom: that it occurred because of the rise of finance in the economies. The International Monetary Fund (IMF) (1997) considers the kind of deindustrialization which occurred in the developed world favorable because it indicates the maturity of those economies; they do not even have to weigh the burden of manufacturing activities, such as environmental pollution, within their own territories anymore. Rowthorn and Wells (1987), however, distinguish the kind of deindustrialization which occurred in the developed economies and the kind which is occurring in the developing economies. They label the latter phenomenon negative/premature deindustrialization, as it indicates the poor performance of such economies.

Rodrik (2016) is arguably among the most cited regarding the phenomenon of premature deindustrialization. He argues that globalization/trade openness and labor-saving technological progress are behind this phenomenon. Bogliaccini (2013) similarly blames trade liberalization for the deindustrialization which occurred in Latin American countries. Mansur (2008) and Priyarsono et al. (2010) also posit a similar narrative about globalization and trade being the cause of deindustrialization in Indonesia. Tregenna (2015) categorizes these types of causes as policy-related, pointing specifically at austere macroeconomic policies as having negative effects more on the manufacturing than financial sector of an economy. Akinrinade & Ogen (2008) adds a twist to this story of globalization: that deindustrialization in Nigeria is also specifically a Chinese policy of export competitiveness.

There has been, however, more than an exclusively Nigerian encounter with the rise of China. Jenkins (2015) illustrates a similar argument regarding the trade relation between China and Brazil. On one hand, imports of manufactured products from China weakens the competitiveness of Brazilian counterparts. On the other hand, huge demand from China traps Brazil in specializing its export in commodities. Coxhead & Jayasuriya (2010) address the impact of the rise of China and India as the main manufacturing hubs of the world on competitive pressures of trade and on the commodity boom. Both impacts have negative results on the industrial development in resource rich countries with weak institutions.

Although not looking for the causes, Castillo & Neto (2016) shine a light on an important trend related to the trade with China—that premature deindustrialization incorporates the element of trade-specializing in primary goods/commodities. Clavijo et al. (2014) treat Dutch-disease and economic boom, in their case energy-mining, as factors accelerating the secular trend of deindustrialization in Colombia. Palma (2014) conceptualizes Dutch disease as a factor putting into place an excess of an already ongoing trend of classical, 'inverted-U' type deindustrialization as introduced by Rowthorn (1994).

From this review, it is obvious that the available literature on the question of "what causes premature deindustrialization in developing countries" is filled primarily with economists' proposing their economic explanation of the phenomenon. The main camp explains policies undertaken that embrace globalization, liberalization, and trade openness as the cause. The other two big camps bring up the rise of China and commodity boom as causes. There are, of course, several other alternative explanations such as labor-saving technological progress (Rodrik 2016), rising inequality which reduces demands for manufactured products (Grabowski 2017), and domestic outsourcing which causes a statistical illusion of overestimated deindustrialization (Tregenna 2015). But they also do not depart from the category of "economic explanation."

The contribution of political scientists in attempting to address the issue is still very minimal, even though we should have recognized that industrialization as we know it is among the most impactful variables on our current modern political life. Deindustrialization has also revealed its impacts on social and political situations in both developed and developing countries. Political scientists concerned with development have also generally been aware that economic development does not happen in a vacuum. It is a manifestation of conflicts and compromises of clashing interests; it is sometimes results from policies ruled out by political actors; and it always impacts the condition of the society in general. In other words, we can understand economic development, whatever its appearance, as a mixture of both economic and political events: a coin with two sides.

I begin with the assumption that an explanation which tells only one side of the story, in this case the economic side, necessarily lacks nuance and even strength in uncovering the working reality beneath the surface. Moreover, such an assumption may result in incomplete or even false prescriptions for action in overcoming the problem at hand. Therefore, I attempt to position this research to show the other side of the story, i.e., the political explanation of premature deindustrialization. I do so by arguing that Indonesia would not have experienced premature deindustrialization, even with the economic causes, had not the political causes occurred. A categorization of the literature is suggested in Figure 10 to show the missing piece of the puzzle that this research addresses.

I attempt to go further than the development economists who indeed have touched on the problems of the role of government and industrial policies in causing premature deindustrialization. Chaudhuri (2015) prescribes a specific role of government to overcome premature deindustrialization, that is, to establish an integrated set of industrial policies. Further, Nazeer & Rasiah (2016) point out the failure of industrial policies as the cause of premature deindustrialization in Pakistan. Yet as we develop a more complex understanding that the actions of government itself are structurally constrained, we need to take a bird's-eye perspective, not that of governmental advisor, to contextualize government within the schematic of forces impacting the outcome of economic development. Particularly, I situate the state vis a vis capital as the two main societal forces whose actions, relation, and balance of power are the constitutive formula of economic development, in this case, premature deindustrialization.

Figure 10. Categorization of Literature on Premature Deindustrialization in Developing Countries

Economic Causes (Established)	Main Camps	Globalization → Rodrik 2016; Bogliaccini 2013; Mansur 2008; Priyarsono et al. 2010; Tregenna 2015
		The rise of China → Coxhead & Jayasuriya 2010; Jenkins 2015; Akinrinade & Ogen 2008
		Commodity boom → Palma 2014; Clavijo et al. 2014; Castillo & Neto 2016
	Alternative Arguments	Technological progress → Rodrik 2016
		Rising inequality → Grabowski 2017
		Domestic outsourcing → Tregenna 2015
Political Causes (Proposed)		**Uneven balance of power of capital over the state**
		Unsuccessful reforms during democratic transition
Impacts	Labor Market	Job loss → Kumar 2017; Dasgupta & Singh 2007
		Job informalization → Nazara 2010; Dasgupta & Singh 2007
		Labor defeminization → Greenstein & Anderson 2017
	Others	Exchange rate → Nurunnisa & Hastiadi 2016
		Inequality → Grabowski 2017; Bogliaccini 2013; Papanek et al. 2014
Prescriptions		Industrial policy → Chaudhuri 2015; Nazeer & Rasiah 2016

Source: Author

III. How Did It Occur? The Economic Causes

From Figure 3 on the share of manufacturing value added in GDP and Figure 4 on the share of manufactures in merchandise exports, it can be assumed for the sake of clarity that the agreed timeframe of premature deindustrialization in Indonesia started about 2000/2001 at the peak of manufacturing's importance in the Indonesian economy and continued until 2011 when the share of manufactures' export began to rise again—or until at least 2016 if measured exclusively by the share of manufacturing in GDP.

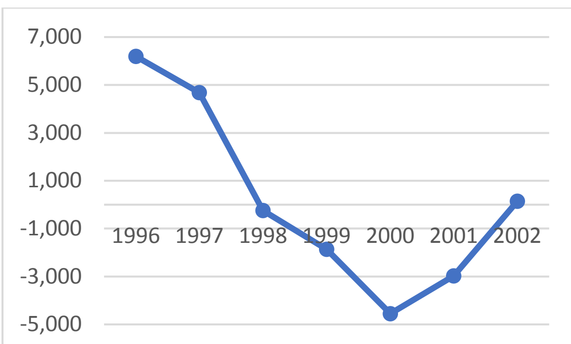
Before the Asian financial crisis in 1997, especially during the reign of the authoritarian New Order regime (1967-1998), Indonesia could be seen as exemplary in following the prescriptions of structural change in the economy from agriculture-based to manufacturing-based. This structural change can be seen, for example, by the continuously rising share of manufacturing in GDP (Figure 3) and in export (Figure 4). However, the aftereffects of the 1997 Asian financial crisis suggest that this structural change, or industrialization, was not built on a solid basis.

Economic Liberalization, Financial Crisis, and Capital Flight

Immediately following the 1997 crisis, Indonesia experienced capital flight from 1998 until 2001 (World Bank 2018), in which for four consecutive years, Foreign Direct Investment (FDI) showed a negative inflow, as depicted in Figure 11. Furthermore, Asian Development Bank (ADB; 2015) records that in 2003 and 2004, FDI inflow was again negative. Chua (2008) traces Indonesia's biggest investors' moving their monies to more stable currencies as a reaction to the crisis.

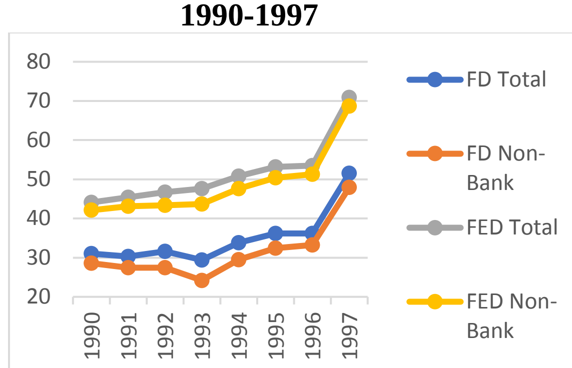
It was these investors who gained the most from Indonesia's economic liberalization in the 1980s, following the end of the state-centered oil boom of the 1970s. After solidifying large amounts of capital, they liquefied it into the more mobile financial sector. The 1980s' liberalization not only gave way to a bigger role of private entities in the economy but also established the legal basis for opening of Indonesia's financial system. This move into the financial market by the biggest investors in Indonesia occurred under the context of the investment boom which exactly preceded the crisis—from 1994 until 1997 (Matsumoto 2007). This period can be considered the beginning of the rising decisive role of private capital in the Indonesian economy. The Indonesian financial market became, as a result of this financialization, more fragile. The economy became increasingly dependent on foreign debt and foreign exchange debt as shown in Figure 12.

Figure 11. Indonesia's Net Inflow of FDI (US$ million) 1996-2002



Source: World Bank's DataBank (2018)

Figure 12. Dependency of Indonesia's Corporate Sector on Foreign Debt (FD) and Foreign Exchange Debt (FED) (%) 1990-1997



Source: Matsumoto (2007)

Winters (1997) notes another ongoing development at the global level which also pushed the nature of capital in developing countries to become more mobile. As the Cold War ended at the end of the 1980s, the orientation of investments from both the USSR bloc and the US bloc became less toward a strategic/security alliance and more toward private profit. This latter kind of investment orientation is less committed than the former and thus is easier to move across countries, simply following market signals.

The 1997 crisis served as a second blow to the steadiness of capital in Indonesia's manufacturing sector, following the 1980s' liberalization as the first, preconditioning blow. In dire need of fresh money to keep the government running in a time of crisis, in his last days in office, Soeharto signed a Letter of Intent (LoI) with the IMF to obtain loans accompanied by conditionalities in the form of Structural Adjustment Policies (SAPs). Included in the LoI were reforms in the financial sector. Ramli (2002) records that two of IMF's suggested policies led to "mass bankruptcy in the corporate sector and the loss of thousands of jobs". These suggestions were 1) super-tight monetary policy which rocketed the inter-bank interest rate, causing a liquidity crunch and 2) recommendation to close more than a dozen banks, causing a bank run that resulted in sharp depreciation of the Rupiah (Indonesian currency).

The crisis, in addition to the loss of capital available to continued investment due to capital flight, also caused negative GDP growth, a six-fold burst of inflation, and three-fold depreciation of the Rupiah—all occurring in the single following year: 1998.

Figure 13. Immediate Economic Consequences of 1997 Crisis 1996-2002

Year	1996	**1997**	**1998**	1999	2000	2001	2002
GDP Annual Growth	7.64	**4.7**	**-13.13**	0.79	4.92	3.64	4.5
Annual Inflation	8.85	**12.57**	**75.27**	14.16	20.45	14.3	5.9
Annual Official Exchange Rate / 1 US$	Rp 2342	**Rp 2909**	**Rp 10014**	Rp 7855	Rp 8422	Rp 10261	Rp 9311

Source: World Bank DataBank (2018)

In brief, post-crisis Indonesia suffered from the lack of funds to push the economy to function as it had before. As much as four and one half billion US$ left the economy in only one year—2000. Factories closed after they failed to obtain continuing investments from the banks as well as to continue exporting because the huge loss of value of the Rupiah. In a more indirect manner, factories' closing was another impact of increasing demand from workers for higher pay. This demand came from the deteriorating financial situation of Indonesia's poor and middle-class households—initial victims of the wider market reform that consisted of, among other measures, the rise of fuel and electricity prices. The government apparently did not have any other option except to raise those prices to deal with the problem of growing public debt caused by, again, IMF's suggested policies (Ramli 2002).

The enormous impact which Indonesia's manufacturing sector experienced from the shortage of capital in the early 2000s reveals the sector's vital reliance on foreign capital and the shallow nature of Indonesia's industrialization in general. If we observe the distribution of foreign investment in Indonesia, either during the New Order era or after the crisis, the manufacturing sector obviously attracted the biggest chunk of the inflow FDI as shown in Figure 14 and Figure 15.

Figure 14. Foreign Investment in Indonesia Based on Sectors (5 Biggest) (Excluding Oil and Banking) 1967-1980 (in US$ million)

Sector	Approved	Executed
Agriculture	193	64.8
Forestry	643.2	299.4
Mining and Quarrying	1127.2	385.6
Manufacturing	**5807.9**	**2216.8**
Trade and Hospitality	190.8	106.2

Source: Muhaimin (1990)

Figure 15. Foreign Investment in Indonesia Based on Sectors 2004-2014 (5 Biggest

Sector	Amount (US$ Million)	%
Mining and Quarrying	34888.89	17.65
Manufacturing	**79375.65**	**40.16**
Wholesale and Retail Trade; Repair of Motor Vehicles, Motorcycles; and Personal and Household Goods	17651.6	8.93
Transportation, Storage, and Communication	24384.41	12.34
Financial Intermediation	16573.85	8.39

Source: Bank Indonesia (2015)

However, if we look specifically at the sources of investment within the manufacturing sector, it is only recently in the Post New Order era that foreign capital has become the biggest source of investment as shown in Figure 16 and Figure 17.

Figure 16. Sources of Investment in Indonesia's Manufacturing Sector 1975 & 1983 (in %)

Sources	1975	1983
Foreign	21	23
Domestic	51	57
Government	26	15

Source: Hill (1990)

Figure 17. Sources of Investment in Indonesia's Manufacturing 2010-2014 (in US$ million)

Sources	2010	2011	2012	2013	2014
Foreign	3373.3	6789.6	11770	15858.8	13019.3
Domestic	2817.53	5167.75	6568.8	6407.45	6072.71

Source: Investment Coordinating Board of Indonesia (2015)[5]

As the sector which most attracts foreign investment, it only makes sense that the manufacturing sector becomes the most vulnerable to the availability of foreign capital and thus is most impacted when there is a shortage of capital inflow. Such has been the situation since the

[5] The amount of domestic investment was converted from Rupiah billion to US$ million according to 2015's official exchange rate in World Bank DataBank.

New Order era. Hill (1990) provides a nuanced reading of his data as shown in Figure 16. That foreign capital was not the biggest source of investment, does not mean that during the New Order era, it was domestic capital which dominated investment in the manufacturing sector. First, there were many joint projects with mixed sources of investment, and in such projects the foreign party usually had greater power and took the leading role even if the domestic party provided the bigger part of the investment. Second, the "privateness" of the domestic sources of investment was questionable due to the close link between the domestic conglomerates and Indonesia's military generals who essentially were part of the government. Third, if we compare the kinds of corporations in terms of those owned by domestic investors and those owned by foreign investors, the former generally consisted of small corporations while the latter consisted of bigger ones—measured both by value added and employment.

Besides the historic reliance on foreign sources of investment, Indonesia's manufacturing sector, which bloomed during the 1990s following the 1980s' liberalization, has also suffered from a "shallow industrialization" (Dhanani 2000) in which the industrialization failed to establish further industrial linkages. Indonesia thus served only as an assembling hub, with most of the raw materials, intermediary inputs, and components for manufacturing coming from other countries and the products themselves exported back to foreign markets. Dhanani (2000) records the reliance of the subsector of electronics on foreign inputs was as much as 70%, while that of transport equipment was 56% and that of machinery was 53%.

From the discussion above we can see how the nature of economic liberalization which has been implemented since the 1980s in Indonesia has contributed to making Indonesia's economy, especially its manufacturing sector, dependent on foreign and mobile sources of investment. That liberalization has also failed to establish industrial linkages. It was not until the 1997 financial crisis that the consequences were revealed. Both capital flight and the IMF's monetary policies negatively affected the development of the manufacturing sector, diminishing its role in Indonesia's economy. Since then, Indonesia's manufacturing sector still has not fully recovered.

While the manufacturing sector is currently still in the recovery, the capital flight has ended, and foreign, mobile capital has once again flooded Indonesian economy. This return of capital should have re-boosted the manufacturing sector, but it has not. It is because the capital was not redirected to the manufacturing sector, but instead, this returning capital found a far more rewarding sector: extractives.

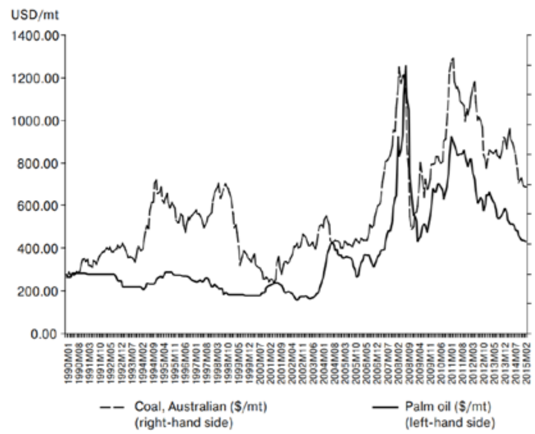
The China Effect, Commodity Boom, and Palm Oil

Starting in early 2000s, Indonesian economy had experienced another phenomenon, this time an external one: a commodity boom. The boom had occurred from 2001 until 2012 as shown in Figure 18 (Wihardja 2016). This had been a global level boom, impacting not only Indonesia but also many other resource rich countries especially in Southeast Asia, Latin America and Africa (Coxhead & Jayasuriya 2010).

Coxhead & Jayasuriya (2010) also point out that the surging demand from the rapidly-growing Chinese economy has played the most dominant role in skyrocketing the commodity prices during the boom. It has been the world's main importer of palm oil among other agricultural commodities. In addition, even though it extended the reach of trade as far as to Latin America and Africa to fulfill the demand for its industrialization, it is its relation with economies inside Asia that has expanded most significantly. The reasons behind it are the geographical proximity, the already established trade network, and that the relation incorporates the trade of both commodities and what is understood as "parts and components" in manufactured goods.

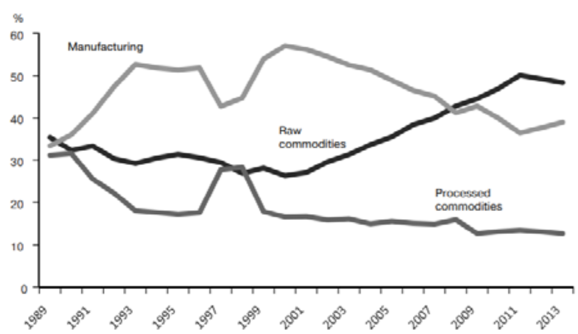
As it seems on the single case of Indonesian economy, Coxhead & Shrestha (2016) identify the boom as a natural resource export boom. Figure 19 shows how the diminishing trend of manufacturing corresponds with the rising trend of raw commodities in Indonesia's export during the period of the commodity boom.

Figure 18. Coal and Palm Oil Prices 1990-2015



Source: World Bank (2016) in Wihardja (2016)

Figure 19. Indonesian Export Shares (%) 1989-2013



Source: World Bank (2014) in Wihardja (2016)

The explanation of the trend shown by Figure 19 is that when the private capital which once flew out of the economy returned, they restructured their investments into the then more lucrative sectors, i.e., commodities. To be exact, as Wihardja (2016) points out, the 1997 crisis on one hand has left Indonesia's manufacturing firms deteriorated due to the devaluated rupiah, the drop of the society's purchasing power, and the defaulting banking sector. On the other hand, some policy changes—arguably both as response to the rising price of commodities and as an effect of Indonesia's changing political regime—such as the easier license issuance by the newly authorized provincial governments for extractive activities and the change from contract-based to license-based system in the mining sector has caused particularly two commodities to strikingly raise in prominence in Indonesian economy, especially its export, namely coal and palm oil as shown in Figure 20.

Figure 20. Indonesia's Top Ten Exported Products in 2000 and 2014

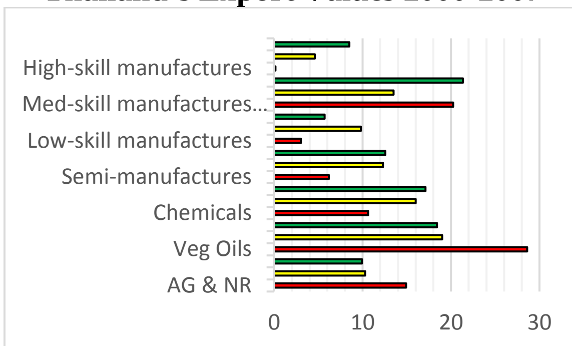
Commodity groups	% in 2014	Commodity groups	% in 2000
Coal	11.82	Gas	10.66
Palm oil	9.91	Crude oil/ petroleum	9.80
Gas	9.75	Garments	7.62
Chemical materials	6.84	Chemical materials	4.53
Crude oil / petroleum	5.40	Electronic parts	4.28
Garments	4.40	Plywood	3.74
Other manufactured products	3.41	Computers, auto data process	3.71
Transport equipment	3.06	Paper and paper products	3.64
Rubber	2.73	Video and audio recorder	3.51
Electronic parts	2.44	Textile fabric	3.51
Total % of top 10	59.76	Total % of top 10	55.01

Source: Indonesia's Central Bureau of Statistics and World Bank staff calculations in Wihardja (2016)

Garnaut (2015) similarly explains that the international economic environment had changed dramatically when Indonesia came out of 1997 financial crisis. While Indonesia's manufacturing sector was in the situation of deterioration, China had come to dominate the global market for manufactured goods and the price of commodities had soared to an unprecedented height—I argue the latter as the effect of the former. Indonesia's comparative advantage then, after the 1997 crisis, reversed back to resource-based commodities after being dominated dynamically by manufactured goods during the 1980s and 1990s. In other words, the diminishing importance of manufacturing sector in Indonesian economy occurred side by side with the raising importance of commodities sector in Indonesian economy especially its export.

However, not all countries affected by the China effect and the commodity boom experienced the similar problem like Indonesia did. Comparatively speaking, the commodity boom affected Indonesian economy the most compared to other neighboring economies (Malaysia and Thailand) as shown in Figure 21. On one hand, the export of agricultural products, natural resources, and vegetable oils, i.e., the least skill-intensive and capital-intensive products, rose more significantly during the commodity boom in Indonesia than in the other two countries. On the other hand, the export of other more skill-intensive and capital-intensive sectors rose less significantly in Indonesia than in the other countries.[6]

Figure 21. Average Annual Sectoral Growth (%) of Indonesia's, Malaysia's, and Thailand's Export Values 2000-2007



Source: UN Comtrade (undated) in Coxhead& Jayasuriya (2010)

Coxhead and Jayasuriya (2010) also point out that Malaysian and Thai previous industrial structures have put these economies on different pathways from Indonesian economy, on how China's rapid growth gave an impact to them. With their higher level of skill endowment in economy compared to China, Malaysian and Thai economies have been impacted by Chinese industrialization more positively that Indonesian economy. While their lower level labor-intensive sectors were put under competitive pressures by the ones in China, their higher-level skill-intensive sectors grow more rapidly fulfilling the increasing demand of parts and components from Chinese more labor-intensive manufacturing.

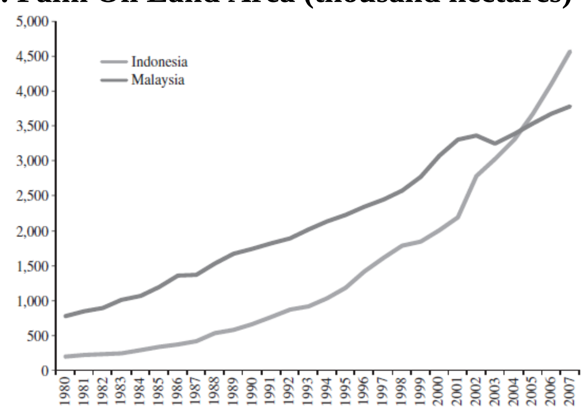
A different story, however, was experienced by Indonesia (Coxhead & Jayasuriya 2010). Since its economy was less skill-endowed than China, Indonesian manufacturing sector as a whole has been squeezed by its more competitive Chinese counterpart. The abundance of natural

[6] In order from the bottom, red is Indonesia, yellow is Malaysia, and green is Thailand. Coxhead & Jayasuriya (2010) follows OECD's (2007) categorization of the exported products based on skill-intensity with the real data from UN Comtrade (undated).

resource, in this case exemplified especially by palm oil and coal, puts greater pressure on its manufacturing sector in a Dutch disease kind of story since the rapid growth of China occurred in the same time range with a commodity boom.

In addition, even though Indonesia and Malaysia are the first and second biggest exporter of palm oil totaling around 85% of the world's export, the production of palm oil in the two countries was executed differently. Arguably, Indonesia and Malaysia share an unequal yet interdependent relation in terms of palm oil production. While Indonesia supplies unskilled labor into Malaysian plantations (Coxhead & Jayasuriya 2010), Malaysian corporations play a big role in expanding Indonesian plantations (Varkkey et al. 2018). Considering Malaysia's consistent commitment on 50% forest cover pledge and Indonesia's non-existing commitment of such (Varkkey et al. 2018), Indonesia's outstripping of the land area over the Malaysia's (Coxhead & Jayasuriya 2010) during the commodity boom, as shown in Figure 22, comes as a non-surprise.

Figure 22. Palm Oil Land Area (thousand hectares) Compared



Source: FAO (2008) in Coxhead & Jayasuriya (2010)

In short, these some handful of related variables, which can be summed as "China-induced commodity boom", acted as second episode, chronologically following the "liberalization-induced capital flight" as the first episode, of the economic explanation on how Indonesian economy ended up experiencing premature deindustrialization. The two variables are distinct, but they are linked together to comprise the story of premature deindustrialization in Indonesia—from an economic point of view.

One could intuitively argue that without China emerging rapidly at the turn of the millennium—and thus inducing a commodity boom especially of coal and palm oil, Indonesia could have come out of the crisis, even though still experiencing the capital flight and the concomitant return of reconsolidated capital, remaining as member of "East Asian Miracle" as World Bank (1993) once called it. The manufacturing sector could have instead become more vibrant as post-crisis governments deregulated the investment market in order to lure back the previously fleeing capital, even though most probably still have maintained the shallow character as a mere hub without much domestic linkages and dominated by external investment. On the other side, without liberalization prior and after 1997 crisis, the 2000s commodity boom would have impacted Indonesian economy in a similar way the 1970s oil boom has impacted Indonesian economy on which the following sections will elaborate more.

As the most central argument in this research, the next section deals with the political changes Indonesia has experienced after the 1997 financial crisis which I argue play the role as political causes for Indonesian economy's premature deindustrialization.

IV. How Could It Possible to Occur? The Political Causes

In addition to the operation of economic causes as elaborated in the previous section, it is the argument of this research that there are political causes in play regarding premature deindustrialization, at least as the case of Indonesia shows. Of course, it does not need to be said that the dichotomy of economic and political causes as proposed here lies on the analytical realm, while in the practical realm, the two seem to be intertwined tightly that an attempt to clear-cut between the two may result in more confusion than clarity. It is because the nature of a social phenomenon, where the economic causes and the political causes are parts of, is always multidimensional, incorporating various aspects in a single complex occurrence. Therefore, even though this research focuses on the economic and political causes of premature deindustrialization, the matter discusses is also at the same time a legal a cultural phenomenon to name a few.

The argument for political causes of premature deindustrialization in this research attempts to not stop in offering a mere alternative point of view, but rather, seeks to prove that its case, i.e., the political causes, are as important and determining as the already established economic causes in causing premature deindustrialization to occur. As the limitation of the economic-minded established literature demands, an analysis of the politics behind the occurrence of premature deindustrialization is therefore proposed utilizing the case of Indonesia.

The understanding of politics here starts from one of its most classic definition, “who gets what, how, and when” by Lasswell (1936). Contextualized in contemporary Indonesia, this definition is operationalized as the politics between arguably two of most vital analytical actors involved in power struggle for resources in the human society, in the specific spatiotemporal setting of modern nation state, i.e., state and private capital or capital to be short. In addition to that, specific area of power struggle, i.e., post-authoritarian reform and democratization, among a more diverse and nuanced set of actors surrounding the dyadic state-capital, are also discussed.

The Breakdown of the State

It is to be noted that by claiming that Indonesian state has experienced a breakdown following the 1997 crisis, this research does not imply that the pre-crisis authoritarian state was a coherent, Weberian ideal type of modern state. If anything, this research would argue that the authoritarian New Order regime of Indonesia failed to benefit from its authority and capacity to establish a comprehensive industrialization project for the economy. Instead, it became, to use Winters (2018) words[7], a "leech state" as a better terminology than "octopus state" as what is most commonly imagined.[8] Winters (2018)[9] conceptualizes how the regime handled the economy and its resources as "an extraction out of extraction", referring to how bureaucrats and corporates extract resources for themselves from the activities of extracting Indonesian natural resources. Gellert (2010) also offers "Extractive Regime" as a concept in similar path of understanding on how the New Order state relied on extraction of resources.

Nonetheless, for better or worse, the previous regime still maintained relatively more political and economic capacity and authority vis a vis private capital, if we compare it with the post-New Order Indonesian state after the 1997 crisis. It is this erosion of political and economic capacity and authority after the crisis that this research frames as breakdown of the state. Some of them are indeed demands of reform from the society. But some of them are mere conditionalities from the IMF, while some others are somewhat combination of both.

In the realm of politics, some changes were considered as indicative to the breaking down of the state such as the decentralization which gave weaker provincial leaders to deal directly with international investors, erasure of long-term planning which cut the possibility of a state-led industrialization project, electoral competition that was hijacked by the oligarchs and made the political field succumb into deep rent-seeking mechanism, and rights of association that was also hijacked by the state especially to counter progressive, mobilization-based alternative political

[7] In a face to face discussion.
[8] Among those who uses the term "octopus" to define Indonesian state and its exploitative machinery is Aditjondro in *Debunking Cikeas Octopus: Behind the Bank Century Scandal* (2009) (title translated by me from Indonesian language).
[9] In a face to face discussion.

power such as labor unions being faced by thugs masked as non-governmental organizations. In the economic field, the breakdown of the state consists mainly of privatization of SOEs, deregulation in general which hinders the state's ability to safeguard its citizens basic needs.

The Return of Capital

On one hand, these new post-authoritarian regimes[10] took steps to lure back the once vanishing capital to Indonesian economy. On the other hand, they were also bonded under Soeharto's agreement with IMF to get fresh fund to keep his government running after the crisis, to execute several economic and politico-legal reforms packed in Structural Adjustment Programs (SAP) as conditionalities for IMF's loan. This second side of the situation only opens a wider road for the capital to come back to Indonesia, now with far easier terms and more space to conduct business. Now, with Indonesian state opening its hands wider than ever, the capital came back to Indonesia more than happily and they even managed to grow stronger influentially, taking benefit from the new electoral competition system that the reform movement introduced. The nature of the oligarchy has changed, but the oligarchs were still there and they even became stronger.

Unsuccessful Reforms during Democratic Transition

The reforms succeeded in changing the nature of Indonesian oligarchic system away from sultanistic oligarchy. However, this has also led to a rent-seeking based political competition system masked in liberal democratic procedures. Even though democratization was kick-started and could be seen as a first step toward a deeper and more essential democracy, the members of

[10] Ir. (academic title for engineer) **Habibie**, the former vice president of Soeharto, first took office as Soeharto declared his resignation in May 21st, 1998. His main agenda was to hold election which resulted in KH. (honorary religious title) **Gus Dur** taking office from October 20th, 1999 to July 23rd, 2001 in which he was forced to resign and was replaced by his own vice president, **Megawati**. Megawati ruled the rest of Gus Dur term until election in 2004.

the sultanist oligarchy in the past were virtually secured from pressures for democratization in the economic realm.

Hellman (1998) discusses the politics of economic reform in post-communist states. He challenges the conventional J-curve model of economic reform in which costs of transition initially emerge for short time, followed by benefits of transition for a longer period. In such a model, the problem of reform lies in how to endure the short transitional time, with its costs, to be able to enjoy afterward the longer period of benefits. The common prescription is to exclude the losers—such as workers and the unemployed—in the reform from the political process during the short time so they would not be able to backlash against the reformers; thus the reform agendas could continue.

From the cases of post-communist reforms, however, the challenge to the long-term reform did not come from those who suffer the costs—the losers—but precisely from the initial winners of the reform—such as state managers-turned-private owners and mafioso-turned-entrepreneurs. In these cases, the winners tend not to push the reform further but instead stall the equilibrium which benefits them—during the initial time of reform when it is only partial. This different outcome leads Hellman to suggest a counter-intuitive prescription to keep the reform process going: to include, instead of exclude, the losers in the reform from the political process. This solution, however, is not practical since the winners would not give the losers the chance to participate in the political process.

Indonesia, this research argues, suffers from that common mistake to exclude the losers in the reform process. The result is that, even though there have been democratic political institutions established, the democratization in the field of economy was far from succeeding. If anything, the capital power instead became stronger while the state became weaker.

The changing state-capital relation, or the post-crisis state breakdown in the face of reconsolidated capital, together with the failure of post-authoritarianism democratizing reforms, constitute the two main political causes of premature deindustrialization as derived from the experience of Indonesia. Even though this research does not suggest a generalization of these causes unto other experiences with premature deindustrialization in the rest of the developing countries, the two causes abstracted from Indonesia's case do tell us something about the situation of political changes occurring in the developing world.

The overall weakening of the state vis a vis strengthening power of capital is a common narration in various parts of the world as efforts to democratize the state virtually have not succeeded except in a handful outlying cases. The ruling of the state is captured by the interests of capital in favor of a weaker state, so the private capital may have more space to maneuver, evolve, and adapt to the everchanging social and political dynamics. It is the technicalities on which this general trend is standing on that differ from country to country, since the self-strengthening move of capital always meets specific contextual contingencies such as the social configuration and the cultural characteristics of the societies, geopolitical factors, and the path-dependent institutional arrangement of the local regimes.

What is striking is that this trend encompasses not only the countries moving in the direction of Polanyian marketization (1944), but also those in the opposite, countermovement direction. For example, we witness the emergence of investor-state dispute settlement (ISDS) in various such as North American Free Trade Agreement (NAFTA) and the proposed Trans Pacific Partnership (TPP). Here, the nation-state's sovereignty is eroded by the increasing corporate power under the push for marketization. However, we also witness attempts to strengthen corporate power and weaken the state's being carried by political leaders who is riding the wave of countermovement such as right-wing populism. The Republican party's tax reform bill during Trump administration is one of the examples.

Winters carefully notes (1996) that this kind of tension between state and private capital is an existential fact in capitalist society, or as he describes it, a society where there is a division of labor and where the subsistent production is limited. There is always an investment imperative to be met if the society wants to continue functioning, and with some luck, experience economic growth. As he puts it, there is only a dynamic of power between the two, contingent of certain factors such as alternative sources of investment at the hand of the state. but in most cases, there is always an investment imperative, and the capital controller always holds a structural power over the state and the society more generally.

To sum, whether these changes also play the same role as causing premature deindustrialization in other cases, or are the other cases caused by different political changes, are subject to further research to illuminate us more about what political changes come side by side with the economic changes, i.e., widespread premature deindustrialization, in today's developing countries.

V. Interplay between the Political and the Economic Causes

There are two sides of liberalization-induced capital flight as Indonesia experienced it. The first side is a more fixed reality, that is, there indeed is a valid need for new source of growth since the end of the end of the 1970s oil boom. However, the way and the source from which that needed continued growth is sought by Indonesian government is not the only possible choices. Of course, the decision makers do not live in a social vacuum where they can choose policies as they like it.

There indeed are historical institutional constraints. The policy choices that were lined up in front of the Indonesian state at that time are the second side of the liberalization-induced capital flight.

The Indonesian state however had chosen, based on the configuration of interests and conflicts around the actors, to conduct a path of economic liberalization which has caused the manufacturing sector dominated by external and more mobile kinds of investments. The incentive for capital to stay committedly in Indonesia was then low since there was no comprehensive trajectory for building industrial linkages and the manufacturing sector was built mainly around the regional industrial fragmentation in which the components were imported, and the products were also mainly to be re-exported. In other words, Indonesian economy played the role of a mere hub for the bigger industrial bases such as China. This low commitment of the mobile capital surely played an important role in their decision to leave Indonesia once signs of a crisis kicked in. their absence then forced the post-authoritarian, post-crisis regimes to do all they can to lure back the capital, to fulfil the investment imperative. This has been the case since the state at that time did not have enough alternative source of investment.

The capital flight therefore was actually preventable if the state during the New Order regime was more aware of the need to gain the long-term commitment of the mobile capital by directing the investment toward industrial linkages building and was more cautious in maintaining the debt level of its corporate sector.

Moving to the timeline of after crisis era, this research argues that Suharto’s and then Habibie’s decisions to accept IMF’s loans together with the conditionalities, around the time of the crisis, were arguably among the most important critical juncture that had put Indonesia on a development pathway different from other countries, such as Malaysia on the extreme case who did not take IMF’s deal. The conditionalities from the IMF has forced Indonesia to bail out banks, privatize vital State-Owned Enterprises (SOEs). The bailing out of banks has put Indonesia under large amount of debts which harden the state's fiscal capacity to provide for basic needs of the citizens. And the SOEs, if they were not privatized, could have been alternative sources of investment, so the state could have handled the commodity boom differently. In that case, the state would also not need to let go almost all of its authority just to lure back the private capital, which would lead to the state's having stronger governing capacity over the market. With a stronger governing power, the state would have been able to open the way to a feasibility of long-term economic planning which is needed to implement industrial policies in favor of continued industrialization and progressive structural change of economy. Moreover, some vital SOEs were monopolized vertically by the state out of efficiency reasons due to the nature of the market such as electricity and oil. With those SOEs being privatized, and the prices of basic needs of the society being left on the fluctuating market price, the investment imperative became stronger as the capacity of the citizens to subsistent their needs is becoming less.

All these counterfactual argument leads to the narration of weaker state and stronger capital in terms of political and economic capacity and authority. With this development pathway that Indonesia is already on it, a trajectory toward wiser, long-term management of natural resources and navigation of commodity boom, is becoming farther from reality. Such wiser ways of management are for example rechanneling the revenues of export to a wealth fund; investing in processing activities for a higher value added of the natural resources, or in other words, natural resource-based industrialization as implemented by countries like Australia, Canada, and Norway. Other viable trajectory is directly rechanneling the revenues to a big push by the government by investing by itself in the manufacturing sector, of course without in anyway blocking private investments.

This was actually the case on how Indonesian state managed the 1970s oil boom. Since the sector that was booming was dominated by the SOE, i.e., Pertamina, the revenues were able to be channeled to programs such as food sovereignty, mechanization of agriculture and high subsidies on primary education (Papanek et al. 2014). The only problem was that besides these positive rechanneling, the 1970s Pertamina was also corrupt to the core and serves as the pocket money for building the corporatist political arms of the regime. However, the paper argues that this is an avoidable side effect, not an inherent consequences of a bigger state sector in the economy.

China, Vietnam, and Taiwan have been among the examples on how big state sector can also be vibrant and act as the spearhead of the economic development. The problem during the New Order when the state sector was relatively bigger, was only that the regime was not able, or was not willing, to “take the benefit of authoritarian regime”. On the other side of the table, a call for a bigger state sector does not necessarily translate into a call back for an authoritarian political system. A further re-investigation is needed in the future to check the relation between the form of a regime and the size and composition of its state sector in the economy.

VI. Conclusion and Implication: Political Solution for Political Problem

I have pointed out the necessity of the political causes to also occur in order for the premature deindustrialization to also occur. If the Indonesian state during the 2000s, relative to the private capital, was stronger as was the case during the New Order, the commodity boom would have been handled differently which may lead to a building of wealth fund, or the kick-off of natural resource-based industrialization project, or a bigger state sector in the economy in which the state does not rely as much on the private capital to invest in its manufacturing sector. To overcome the already occurring problem, this research calls for a bigger state sector starter by reexamining some of the liberalizing changes taken during the democratic transition, either which were taken by constitutional amendments, or which were taken as conditionalities of the IMF. Second, this research also calls for democratizing the state by opening up political field to include Hellmann's "losers" in the political processes, to curb the overwhelming capital's structural power over the state.

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