Funny Money: Fiscal Policy, Rent-seeking, and Economic Performance in Indonesia

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I Introduction

As Asia's economic crisis continues to unfold commentators have been scrambling to review earlier ideas about the political economy of the region's rapid economic rise. One theme which has been widely touted in this context is that rent-seeking and corruption lie at the heart of the current problems. Although having considerable popular and intuitive appeal, this line of argument faces an immediate problem: if rent-seeking and corruption are so economically destructive, how is it that the region did so well for so long? This is a knotty theoretical problem, with important policy implications.

I will explore this problem by focusing on Indonesia and a set of ideas about the political and institutional underpinnings of rent-seeking. My aim is to develop an argument that will help to explain why Indonesia (and perhaps some other countries) succeeded in achieving sustained rapid economic growth in the midst of what was widely regarded as a sea of rent-seeking activity. Inevitably my focus will be on the Suharto era - the roughly three decades of rapid growth that came to an abrupt halt with the current region-wide economic crisis.

Long before the onset of the Asian economic crisis a large academic literature on the political economy of industrial success in Asia focused on the so-called strong states of South Korea, Taiwan, Hong Kong, Singapore, and earlier, Japan. One of the most well known propositions from this literature was that relatively strong and capable states were insulated from the diversionary political pressures of rent-seekers, and were thus able to push rapidly ahead with policy measures which underpinned high speed export-led industrial growth. Curiously though, there was little direct attention in this voluminous literature to the dynamics of rent-seeking in these countries.[1] By implication, it was often simply assumed that rent-seeking was either moderate in these countries, or it was limited and managed by the existence of technocratic and impervious institutional arrangements.

Political economists working on the industrial newcomers of Southeast Asia (Thailand, Malaysia, Indonesia, and the Philippines) have been much more troubled by the question of rent-seeking, believing it to be neither moderate nor limited in these countries. These concerns predated the Asian economic crisis. Unsatisfied with the assumptions of so much of the literature on Japan and the first wave of NICs, a number of writers working on Southeast Asia have been casting around for ways to explain the coexistence of pervasive rent-seeking and sustained good economic growth (Doner & Ramsay 1995; Jomo & Gomez 1995; Laothamatas 1994; MacIntyre 1994; MacIntyre 1995), or in the case of the Philippines, explaining how rent-seeking has inhibited economic growth (Hutchcroft 1994; Hutchcroft 1996; Hawes 1992).

In this essay I am continuing in this vein. I draw on some recent microeconomically-rooted institutionalist literature to argue that rent-seeking activity in Indonesia - although pervasive - produced less economic inefficiency than it might have because of the incentive structure arising from the prevailing political framework. Simply put, because power was so centralized (under the political framework which evolved during the 1970s) the leadership was able to sustain something approximating monopolistic control of rent management and thus had direct economic and political interests in preventing unrestrained plundering and inefficiency. A recent body of literature on fiscal federalism has suggested that under certain conditions a strongly decentralized federal framework can generate policy competition among subnational units of government, leading to an increasingly market-oriented policy environment -- which would tend to reduce the scope for rent-seeking activity (Montinola, Qian & Weingast 1995; Weingast 1995; McKinnon 1994). This is a

[1] There are some notable exceptions to this generalization, such as Chang (1994).

fascinating thesis which, in the Asian context, has so far been applied only to China. The argument I develop here, although sharing an analytical emphasis on the economic consequences of political institutions, in fact pulls in the opposite direction. It suggests that, under certain conditions, a highly centralized political framework may produce more satisfactory economic outcomes (which is not to say ideal economic outcomes) than some more decentralized alternatives. In principle, these two approaches are not necessarily mutually exclusive. Paralleling the diverse political economies of Asia, it is possible that different approaches will explain different types of cases.

In addition to this underlying theoretical objective, in this essay I try to widen the empirical focus of discussion about rent-seeking and development in general by presenting new material concerning off-budget fiscal activity in Indonesia. Debate about the economic significance of rents and rent-seeking in Asia is almost always caste in terms of familiar empirical material relating to trade and industrial policy, and to a lesser extent, the regulation of financial markets. Thus, we typically hear a great deal about tariffs, preferential credit, monopolies and other restricted market arrangements. But this by no means exhausts the sites of significant rents and rent-seeking. Indeed some of the largest rents are located in other policy sectors altogether. Fiscal policy -- particularly the expenditure side of the ledger -- is one important but largely overlooked site for rent-seeking. Government spending is all about handing out money and is thus a natural venue for rent-seeking. To the extent that government spending provides subsidies, it is in effect creating a rent for the recipient of the subsidy. Often such benefits are small or diffuse and thus, for our purposes at least, unremarkable. Other times, however, they can create very large rents indeed which are transferred to private or public actors.

Political leaders sometimes find the official state budget to be an awkward vehicle for the transfer of such rents because it may be exposed to the glare of scrutiny from a range of groups which may oppose the transfer or even seek to prevent it from happening. Depending on the precise political and economic circumstances in any given country, any of the following might be constraints on the use of the budget for large-scale rent-transfers: inflexible and uncooperative technocratic officials in finance ministries and kindred agencies, the legislature, the press (and the wider community of economic policy commentators), foreign donors (both foreign governments and international financial institutions), and possibly, foreign investors more generally. The desire to avoid scrutiny and minimize constraints can lead political leaders to seek out more covert and flexible ways to dispense money. One important option is off-budget spending. Precisely because such activity is typically subject to little scrutiny or restriction it is an optimal venue for rent-seeking. As we shall see, in Indonesia under Suharto, there was large-scale off-budget fiscal activity which has gone largely unstudied, but is in fact analytically interesting both for discussions about the political economy of rent-seeking in general, and Indonesia's development in particular. It is not a coincidence that one of the stringent conditions that the IMF demanded of Indonesia as part of its ‘rescue packages’ in 1997 and 1998 was the that all off-budget sources of revenue be brought into the open and included in normal budgetary calculations.

Already embedded in the opening paragraphs of this essay is the implicit assumption that rent-seeking is a matter of economic concern. Although the primary theoretical concerns of this essay centre on the organizational or institutional underpinnings of rent-seeking rather than the more explicitly economic question of the efficiency implications of rent-seeking, some of discussion of the latter is necessary. The chapters by Khan, Jomo, and Ravenhill in this volume present detailed and cogent critiques of the prevailing neo-classical economic orthodoxy concerning the efficiency implications of economic rents in general, and rent-seeking in particular. In different ways, each argues forcefully that it is unwarranted to dismiss summarily the possibility that government intervention in resource allocation can produce net national economic gains, and then goes on to make the case that in principle there is no necessary reason why the creation and deployment of economic rents by governments will result only in the dissipation of resources and overall inefficiency.

In principle, I find such arguments persuasive. However, as Khan in particular, is careful to emphasize in his detailed and systematic analysis of rent-seeking, there is indeed much potential for inefficiency and loss. One of the most impressive features of Khan's input-output framework for assessing the creation and transfer of rents (or, rights, as he conceptualizes them) is that he is able to specify, on an a priori basis, the conditions under which efficiency-enhancing rents might be created. On the one hand this does serve to undermine the blanket dismissal of interventionist government policies in the orthodox rent-seeking literature stemming from the work of Krueger (1974), Bhagwati (1982) and others. On the other hand, however, it also underscores the point that very specific and stringent conditions are required for efficiency-enhancing rents to be created and deployed on a sustained basis.

One of the core assumptions I am working with in this paper, is that although rents and rent-seeking need not be injurious to economic growth -- and, indeed, may be essential for the development of some industries -- on balance, much of it is damaging. Certainly this is the prevailing assumption of most disinterested commentators on economic affairs in Indonesia. Although cognizant of the policy achievements of nearby Singapore, few analysts believe that the political economy of Indonesia is hospitable to efficiency enhancing interventionist measures.

The essay begins with a discussion of Indonesia's economic performance during the Suharto era, focusing first on the official fiscal record, and then the problematic issue of off-budget fiscal activity. For the most part, attention will be directed to the expenditure side of the ledger and the ways in which government was able to spend money beyond that which it had in its official budgetary accounts. Next, I introduce some theoretical argument relating to the institutional foundations of rent-seeking. Finally, these ideas are tied back to Indonesia in an attempt to explain how it is that apparently pervasive rent seeking is deeply destructive to economic activity in some circumstances, and much less so in others.

Before getting underway, a quick word on terminology is needed. Although the terms rent-seeking and corruption are analytically distinct, for convenience I will treat the latter as a subset of the former. Accordingly, in using the term rent-seeking, some (but not all) of the phenomena I am covering could also be classified as corrupt. Further, I conceive of rent-seeking as something undertaken by both private individuals and public officials. I should also make clear that my focus is almost entirely on the political economy dimensions of rent-seeking. There are, of course, deeply important legal, social, and moral dimensions to this phenomenon but I do not attempt to address them here.

II Government Spending: The Official Story

Although the Indonesian economy has suffered a very sudden and devastating reversal, for roughly 30 years prior to the current crisis, its performance was indeed very impressive. The economic achievements of the Suharto era have been widely documented (Hill 1996; Booth 1992; Battacharya & Pangestu 1993; Woo, Glassburner & Nasution 1994; Little et al. 1993; World Bank 1993). Accordingly, it is unnecessary here to do more than restate the core empirical point: from having been one of the worst performing economies in the region - and one seemingly beyond redemption - Indonesia notched up remarkably good rates of sustained economic growth and did so on a reasonably equitable basis compared to many other developing countries.

Among the panoply of national economic policy settings, our focus is on fiscal policy and the expenditure side in particular. While Indonesia's fiscal record under Suharto was far from unblemished, it is generally viewed as having been remarkably creditable. In macroeconomic terms the picture was very positive. By comparison with its own past as well as the experiences of many Latin American and African countries, government spending was quite restrained in Indonesia since the late 1960s. Much has been made of Indonesia's 'Balanced Budget Rule', whereby Suharto's New Order regime forswore the fiscal debauchery of the Sukarno years and resolved not to spend more than it earned from taxation combined with foreign aid (including foreign loans).[2] While the government's published budgetary data gave the impression that expenditure had been carefully regulated to ensure that it always exactly matched government revenue, the reality was that this was only achieved by an accounting trick whereby aid and foreign borrowings were treated as revenue. In conventional terms, Indonesia ran a moderate deficit more or less continuously since the inception of the New Order.[3] The important point here is not convenient accounting fictions, but the fact that the government in effect disavowed the use of central bank borrowing, or more crudely, the use of the printing presses, to fund public spending. In short, for the first time Indonesia acquired a serious (if padded) measure of fiscal discipline.

Fiscal discipline by macroeconomic authorities was remarkably effective in stabilizing the economy and eliminating hyperinflation in the late 1960s, and again in reasserting control following the oil-driven inflationary surges of the 1970s and early 1980s. Equally, when faced with a sharp fall in domestic revenue following the collapse in oil prices, the government was prepared to abandon expensive heavy industry projects, to cut subsidies on fuels, and to introduce more effective domestic taxation measures[4]. Notwithstanding the fact that there was a moderate deficit for much of the last thirty years, the commitment to fiscal discipline was crucial. As Hill (1996) concludes: "It is one of the basic tenets of the (New Order) regime, and helps to explain why macroeconomic stability has been broadly maintained since the late 1960s." Little et al. (1993) in their massive comparative

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2 Although it is sometimes said that the Balanced Budget is a constitutional provision, in fact, as McLeod (1997) notes, it appears not even an act of Parliament, but a convention which became established following a Presidential Decree (*Presidential Decree no. 13 on the 1969/70 Budget*, issued March 13). Not only is it therefore of limited legal standing, it is possible that it is no longer in force. Certainly it could be overturned by the simple issuance of another presidential decree overriding it.

3 The size of the budget 'deficit' depends on the method of measurement employed. Hill (1996) provides an illuminating discussion of this.

4 As noted, this paper focuses on the expenditure side of fiscal policy. For a discussion of the economics taxation in Indonesia, see (Gillis 1989; Asher & Booth 1992; Booth & McCawley 1981; Hill 1996; Gray 1986).

study argue that Indonesia's macroeconomic management (including, specifically, fiscal management) was among the most 'responsible' of the nineteen developing countries they surveyed, and was of fundamental importance to its economic achievements. If the comparator set is narrowed from developing countries in general, to countries 'blessed' with a resources boom, and particularly an oil boom, Indonesia's record of fiscal restraint looks even better. As is increasingly recognized, for a variety of reasons ranging from Dutch Disease and macroeconomic imbalances through to fiscal indiscipline and rampant corruption, resource booms in developing countries usually end up being associated with distortion, waste, and even economic chaos, rather than sustained welfare gains (Sachs & Warner 1995). In a study of six oil exporting countries, Gelb and Associates (1988) concluded:

> Indonesia was, in fact, the only country in the sample to implement a determined policy of expenditure reduction and exchange rate realignment before the fading of the second oil boom. In this sense, its macroeconomic management in 1973-81 could be considered as the most prudent in the sample.

But perhaps the most telling indicator of the macroeconomic dimensions of Indonesia's fiscal record is not with other sets of developing countries, but instead with its own immediate past. The contrast could not be more striking. From the late 1950s through until the mid-1960s the economy was in continuous decline with fiscal policy settings playing a leading role in the decay. The tax base was thin, budgetary auditing was very weak, expenditure always exceeded revenue, and from the late 1950s fiscal conditions degenerated from indiscipline to near-debauchery. From 1963 the deficit was almost double the size of revenue as funds hemorrhaged in the name of a quasi-socialist industrialization drive, expensive military campaigns, and unrestrained rent-seeking. The extraordinarily lax fiscal framework played a critical role in fueling the eruption of hyperinflation (reaching an estimated 600%), economic meltdown, and then political upheaval (Mackie 1967; Hill 1996).

If we shift from the macroeconomic level to focus on the details of expenditure patterns, the picture becomes rather more complex but remains generally quite positive. Analysis of expenditure patterns is complicated by the disaggregated and disjointed presentation of official statistics. Spending is separated into a Routine Budget (largely current expenditure) and a Development Budget (largely capital expenditure). The former is relatively straightforward, being primarily a formula-driven funding of civil service and military salaries, together with foreign debt repayment. During the 1980s debt repayment came strongly to the fore, becoming the dominant component of the Routine Budget. This reflected not just Indonesia's high level of indebtedness, but also the government's unwavering commitment to meet all of its international financial obligations. (Unlike the big debtor economies of Latin America and Africa, since the stabilization of its economy in the late 1960s under Suharto Indonesia neither defaulted nor had a loan rescheduled - opting instead to accept cuts in domestic spending.)

The Development Budget was somewhat more discretionary and thus somewhat more politicized than the Routine Budget in that ministries and regional authorities were to some extent able to compete for allocations. However there was still a strong (if inconstant) formulaic dimension to this spending and the Development Budget was not subject to systemic plunder or capture by societal or bureaucratic interests. Although by no means immune from rent-seeking, pork-barreling, bureaucratic capture, and outright theft, the striking point about the Development Budget is that it was as well used as it was. There was consistently strong support for education (particularly at the primary and lower secondary levels), health services, agriculture, and transport and communications infrastructure. Also, there were no stark spending biases corresponding to standard developing country stereotypes: there was not a heavy urban bias, there was not a major bias towards Java (by far, the most populated island), there was not a heavy bias towards the industrial sector, there was not a heavy bias towards military spending (indeed Indonesia had one of the lowest defence spending ratios in the region, and was one of the few countries in which defence spending actually fell in recent years), and there was no discernible strong bias towards the electoral cycle (indeed, civil service salaries were cut in three successive election years - 1982, 1987, and 1992). More generally, expenditure was reasonably positive in terms of equity and was modestly, but appreciably, positive in its distributional consequences (Hill 1996; Booth 1992; World Bank 1993). In short, while there were indeed real problems of leakage, distortion, corruption, and incompetence with public spending, the striking point is that, on balance, the pattern of expenditure looked surprisingly good.

III Off-Budget Fiscal Activity

Notwithstanding these many favourable points of comparison for Indonesia's fiscal record, there is reason for pause. For there is more to this story than meets the eye. Too often discussion of Indonesia's fiscal record (particularly in the comparative literature) takes the budgetary record at face value. This, however, is problematic. Simply put, there was a great deal of fiscal activity in Indonesia that took place off the budget. This is a large and shadowy issue which is only now beginning to attract scrutiny. Several overview studies of the Indonesian economy have suggested in passing that off-budget fiscal activity has become more prominent in recent years (Nasution 1995b; World Bank 1994; Hill 1996).

Origins

Off-budget fiscal activity is not a new phenomenon in Indonesia. Nasution (Nasution 1995b) points out that a system of informal financing became established back in the 1940s during the armed struggle for independence, when both the civilian and military arms of the fledgling Republic had to scramble to find resources as best they could in the midst of upheaval and battle. Even though formal revenue streams were developed after the fighting stopped and the Dutch were ejected, the pattern of informal fiscal activity continued. Senior military and civilian officials cultivated covert relationships with business people, with the resulting revenue being hidden and managed through various so-called social or charitable foundations (*yayasan*) and commercial joint ventures.[5]

Following the chaotic collapse of Sukarno's Guided Democracy, the fiscal framework was overhauled. As part of the emergency economic stabilization program of the late 1960s, the Balanced Budget rule was established, important reforms were introduced to the state enterprise sector (particularly the state banks) and there were gradual moves to strengthen the level of economic coordination among key economic policy agencies. Notwithstanding these important changes, off-budget fiscal activity continued and appears to have expanded very rapidly with the oil boom. As oil prices shot up, revenue was slopping around in such abundance that the scope for off-budget activity was very great. The most spectacular example of this was the state oil company, Pertamina. Under the leadership of former General Ibnu Sutowo, Pertamina became a law unto itself and siphoned off an apparently large share of oil revenue. Along with enriching himself and many of those around him, Sutowo used the off-budget revenue to fund grandiose and stunningly unsuccessful industrial development plans. In addition to the funds spent in this way, Pertamina accumulated a staggering level of international debt which the central bank was forced to indemnify following the near-default of the oil company to its international credits. The debt was paid off over a number of years, and represented a massive off-budget transfer from the central bank to foreign creditors. But the Pertamina debacle was only the most

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5 For details on the early development of informal financial linkages of this sort, see (Crouch 1978; Robison 1986).

crude and glaring example of off-budget fiscal activity. As the New Order institutionalized itself, a range of sophisticated systems were developed.

Types

In simple terms, off-budget fiscal activity refers to the use of money by the government that was not covered in the official budget document approved by the parliament each year. In Indonesia, off-budget fiscal activity operated in many different ways under Suharto. Some were mundane while others were shadowy and politically sensitive. Much of it was highly susceptible to rent-seeking. In broad terms, most of this activity can be classified under one of there are three basic types.

1 Command Lending: The government could direct the managers of one or more of the many state enterprises and official economic entities to make resources under their control available to support a government initiative. Although in principle most of these state enterprises and economic entities had official reporting requirements and were subject to oversight from a government ministry, in practice such constraints could be readily circumvented. The institutions most susceptible to being tapped for this purpose were the central bank, the state commercial banks, the state pension funds, and other entities such as the grain stockpile authority (BULOG). The central bank was a special case, for unlike other state enterprises or economic entities, when it was directed to fund a given project it also expanded the money supply in the process. Command lending via the central bank can thus be thought of as unfunded form of off-budget fiscal activity which may also have had significant inflationary consequences.

2 Private Contributions: The government could also informally induce the private sector to provide financing for a project about which the government cared but was unwilling or unable to finance through the budget. In this case, the government persuaded selected business people that it was in their best interests to contribute to a pressing but unfunded policy priority. Although these monies were used for public purposes, because their source was private they were highly discretionary and easy to conceal.

3 Hidden Government Funds: A third possibility was that the government could draw upon funds it had hidden away in bank accounts other than its official treasury accounts. In other words, the government could use off-budget revenue to fund off-budget expenditure. Again, such expenditure was entirely discretionary, since officially these accounts did not exist. That is to say, they did not show up in the

> official statement of the government's financial position (the budget) and were not subject to the scrutiny of either taxation authorities, or the parliament.

Of the three possibilities, the first is the one we know most about. It is well known, for instance, that although state enterprises received support through the budget, they also received very large scale assistance from the state banks. Similarly, the state banks themselves received off-budget assistance from the central bank. Additionally, many private firms benefited enormously from command lending. Examples of this type of off-budget fiscal activity ranged from the issuance of financial guarantees to public and private firms to underwrite their activities (as in the 1991 case of the head of a state bank being directed to provide an uncollateralized $550 million letter of credit for the politically well-connected Prajogo Pangestu's Barito Pacific Company); the writing-off or rolling-over of repayments on loans that firms were unable or unwilling to make (as in the 1994 decision of the central bank to extend a loan for some $350 million when the Clove Marketing Board controlled by presidential son 'Tommy' Hutomo Mandala Putra indicated it would not be able to repay as scheduled); the provision of heavily subsidized credit (as in the 1995 takeover of an ailing textile firm, PT Kanditotex by a group including another presidential son, Bambang Trihatmodjo, and a son of a former Chief of the National Intelligence Agency, Bambang Yoga Sugama); through to massive bail out operations (as in the almost $600 million rescue in the 1994 of Bapindo, a state bank) (Schwarz 1994; World Bank 1994; Nasution 1995a; MacIntyre 1993).

Somewhat less well understood is the second type of off-budget fiscal activity described above. Why would private business people contribute very large sums of money (beyond their official taxes) to fund government policy objectives? The explanation was bound up with the intensely clientelistic relationships between leading business groups on the one hand, and senior government officials - principally, the president - on the other. Three examples will illustrate the dynamics of the phenomenon. In 1983, when oil revenues began to fall, the government decided to cut back drastically on planned investments in a number of large heavy industrial developments in order to keep a 'balanced' budget. But this did not mean that all such shelved planned investments were entirely abandoned. In one case Indonesia's wealthiest businessman, Liem Sioe Liong, was persuaded by the government to invest in a massive new $875 million steel plant. Liem injected about $100 million into the operation and helped arrange supplementary funding from a number of international banks. In another case, in 1990 Liem and a newly ascendant business magnate (the earlier mentioned) Prajogo Pangestu agreed to inject $420 million between them to make good losses on foreign exchange trading by Bank Duta, a large bank controlled by three social foundations headed by President Suharto. In other words, the two businessmen agreed to compensate the President's bank for the losses it had incurred through its own mismanagement. In neither case is it likely that they were compelled to take this action. Rather, it can be understood as part of the ongoing political and economic exchange that characterize clientelistic relationships. The businessmen helped the politician and the politician helped the businessmen. A month after the Bank Duta bailout, despite howls of protest, Liem and Prajogo were designated the local partners in two massive and keenly contested joint venture projects. And earlier, when in 1989 Liem found the ongoing losses in the steel mill plant he had subsidized (back in 1983) to be too great, the government agreed to buy back his share on extremely generous terms (Schwarz 1994). A recent example of this phenomenon which attracted considerable attention involves private contributions to fund the development of a new jet aircraft (the N-2130) by the state aerospace corporation, IPTN. Controlled by (then) Technology Minister Habibie, IPTN's aircraft projects have long been controversial because of their great cost and uncertain return. In a bid to circumvent fiscal constraints imposed on his operations by the Ministry of Finance, Habibie has turned to the private sector and, with the official backing of President Suharto, set about persuading private individuals to contribute a massive $2 billion (International Herald Tribune, 13-14 July 1996). It is difficult to believe that the business people who injected money into this fund were doing so purely on the basis of any commercial enthusiasm for the project itself. Instead, as with the other cases described here, was driven by wider clientelistic calculations and an expectation of being granted a substantial rent elsewhere.

Most shadowy of the three types of off-budget fiscal activity outlined above was the use of hidden off-budget revenue to fund an array of government priorities. As is normal, the Indonesian government maintained official treasury accounts with the central bank in which public revenue is held. Beyond this, however, it also maintained a range of other accounts with the central bank and some state commercial banks. The funds stored in these accounts did not appear anywhere in budgetary reporting. Very little is known about them and even less has been written about the origins and purposes of the funds held in them. On the revenue side, it would seem that three particular sources were very important. For most of the New Order period, the outstanding source was of course the oil and gas industry. Overwhelmingly, revenue from oil and gas extraction came in the form of royalties or taxes collected from foreign oil companies. Once these were collected, it was a simple matter for the government to hold back a portion of the oil and gas receipts from the taxation authorities and store the residue in an off-budget account. As mentioned earlier, during the early 1970s control of such funds lay with Pertamina's head, Ibnu Sutowo. In more recent times, as Pertamina was reined in, management responsibility for these off-budget funds passed to the Ministry of Finance.

Another similar source was the informal taxes collected from the country's vast timber industry. The timber industry was (and is) notorious for rampant cronyism and corruption, and being largely beyond the law. But while the state had difficulty imposing its official writ on the industry, unofficially firms in the timber industry contributed directly to a large fund controlled by the President and managed in the Forestry Ministry. While official tax receipts from the timber industry were problematic, from about the early 1990s very large pools of unofficial revenue were accumulated off-budget.

A third and little known source of off-budget revenue which also became important in recent years was the covert re-cycling of foreign aid funds. This was an intriguing operation and can be briefly described as follows. Official aid flows received by the Indonesian government were distributed via the Development Budget as capital expenditure on particular projects. Often the funds the government distributed took the form of a loan. Thus, suppose international donors extended funds to support the expansion of electricity production, the Indonesian government then lent these monies to the state power company which, in due course, repaid the loan to the government, and the government repaid the donors. The key was in the way the resources were shuffled. While the government repaid the international creditors from the (Routine) Budget, the loan repayment from the state power company did not return to the government's budgetary accounts, but instead went into an off-budget account known as the Investment Fund Account (Dana Rekening Investasi) managed by the Ministry of Finance. From the government's point of view the beauty of this operation was that while international debt obligations were fully satisfied, the revenue coming back from the domestic recipient of the funds was stored off-budget, out of sight, and thus available for inconspicuous and discretionary deployment. This was another example of the government keeping a portion of revenue away from the taxation authorities and the glare of public scrutiny. As with the off-budget forestry accounts, beginning in the early 1990s this account swelled to become very large.

Beyond oil, timber, and aid-recycling, other sources of revenue for secret government accounts include unreported funds accumulated by the giant state grain and staple stockpile (BULOG) and a variety of shadowy foundations to which business people made contributions in order to maintain good political standing with the government.[6] Funds of this sort could be used for almost any purpose, ranging from the provision of covert financing of political operations, through to industrial subsidies (as in the recent case of the transfer of $200 million from a Reforestation Fund to support the development of another Technology Minister Habibie's projects, the N-250 turbo-prop aircraft, through to support of periodic macro-economic 'smoothing' (whether this was counter-cyclical style fiscal initiatives, or moves to alleviate sharp movements in the terms of trade).

Although the value and location of all hidden government reserves of this sort was of course a closely guarded secret, it is possible with considerable digging, to generate some partial indicators which provide a glimpse of the scale on which at least some of these funds were deployed. Drawing on published hints of underlying World Bank disapproval and statistical clues buried in reports we can calculate the difference between the Indonesian government's 'declared' level of capital expenditure, and an intelligent estimate of its actual capital expenditure. Because some of the data necessary to perform these calculations is difficult to obtain across years, figures for only one year are presented here.[7] The relevant data is set out in Table 1, and is calculated as follows. We start with the published figure for the Development Budget (line A) and clean it up by removing the major items which are not really of a capital expenditure nature (lines B,C,D, & F). The resulting figure (line G) represents a corrected capital expenditure total based on official data. However, if we compare this figure with the World Bank's independent estimate of capital expenditure which is derived from the national accounts by accounting first principles (line H) there is a substantial residual amount of just over Rp 1 trillion, or $500 million (line I). In short, the difference between capital expenditure as reported in budget tables and an informed estimate of actual capital expenditure is an amount the government has funded from off-budget sources - half a billion dollars in 1991/92.

6 For a rare and very useful account of some of the larger foundations see, Vatikiotis (Vatikiotis 1990)

7 Informed sources indicate that the relevant official figures published in the Development Budget for 1991/92 are reliable. This however is reportedly not true of all relevant figures in some other years. (One example of this is the fertilizer subsidy figure.) Consequently, it is not possible to replicate these calculations for all other years without a deep inside knowledge of the actual expenditure levels for the relevant categories.

Table 1

Off-budget Capital Expenditure, 1991/92

Rp trillion (current prices)

A: Official Development Expenditure Total	21.764
B: Fertilizer Subsidy	0.301
C: Defence	1.085
D: "Development Expenditure in Reserve"	1.500
E: A-B-C-D	18.878
F: Operations & Maintenance (=10% E)	1.888
G: Corrected Official Capital Expenditure (=E-F)	16.990
H: World Bank Capital Expenditure Estimate	18.000
I: Off-Budget Capital Expenditure (=H-G)	1.010

Source: (World Bank 1994)

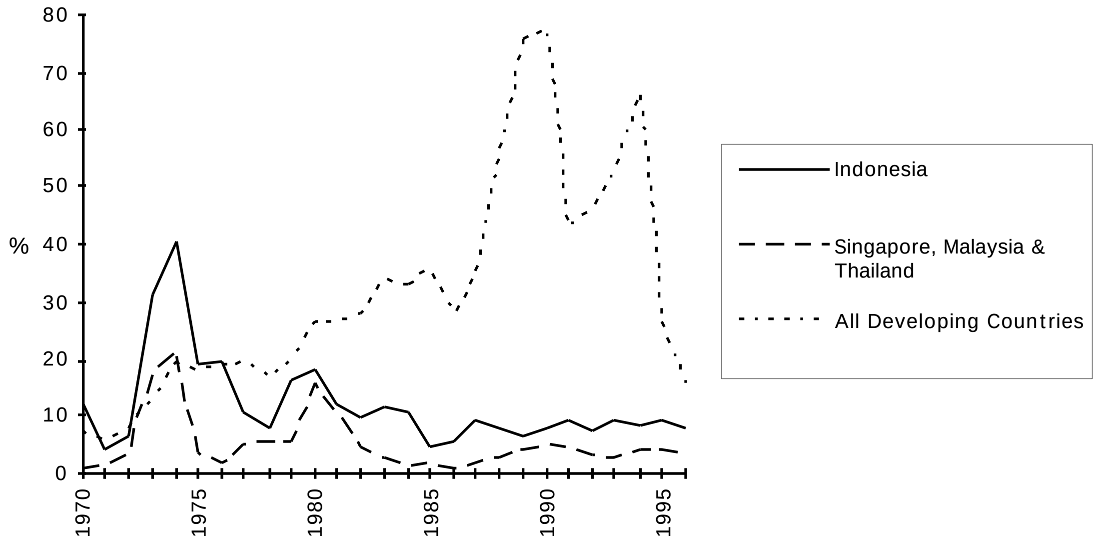
IV Off-Budget Fiscal Activity and Economic Performance

Perhaps the most obvious conclusion to draw from the preceding discussion is that there was much more to fiscal policy in Indonesia than was conveyed in the official budgetary figures. Moreover, even this initial foray into the area of off-budget fiscal activity in Indonesia reveals that there was a veritable smorgasbord of rent-seeking opportunities. For our purposes, the key question centres on the consequences of the rents arising from off-budget spending and even more so the rent-seeking activities surrounding them for national economic growth. Were the net efficiency implications of activity of this sort positive, negative, or neutral for national economic growth? The prevailing presumption in both the scholarly literature on Indonesian economic policy and indeed, much public discussion in Indonesia itself, is that the clientelistic nature of the country's political economy ensured that most government created rents were so mired in cronyism and corruption as to be injurious to national economic growth. And more so than most other cases of government-created rents, off-budget fiscal activity would seem likely to have generated a frenzy of covert rent-seeking behaviour. We might expect this not only because the subsidies to be had were potentially very large, but also because the environment in which the political activity surrounding the allocation of these rents took place was characterized by little or no transparency. Depending on the precise source of the funding the key fiscal authorities may not have been able to scrutinize the expenditure, and if it was effectively concealed, the parliament, the press, and other non-government local and international financial analysts would not get to hear of it, much less scrutinize it. In short, precisely because off-budget expenditure was either totally secret or if known, usually not known till after the event, it was subject to little if any scrutiny.

These points notwithstanding, generalizations about the economic consequences of off-budget fiscal activity are difficult. In part, it depends on the perspective from which the question is viewed. From a macroeconomic perspective, the key issue is the extent to which off-budget government spending fueled inflation; a concern which centres principally around what we have called 'command lending' by the central bank. When the central bank made resources available in this way it was increasing the money supply. If the resulting increase was greater than the increase in demand for money arising from growth in the economy then it would have been contributing to inflation. We know that this has been a problem in many other developing countries (Rodriguez 1993). What of Indonesia? Does evidence of this off-budget activity necessitate a reassessment of the macroeconomic record under?

Certainly the existence of extensive off-budget fiscal activity calls into question Indonesia's reputation for fiscal rectitude and its (already qualified) balanced budget convention. Ultimately, however, we know that while command lending funded by the central bank contributed to growth in the money supply, this could not have been on a truly alarming scale simply because the country's inflation record was creditable. As figure 1 shows, although not as good as some of its Southeast Asian neighbours, Indonesia's inflation over the last twenty five years was much lower than the average for all developing countries.

Figure 1
Inflation Comparators: 1970-94



Source: *International Financial Statistics Yearbook* (1997)

Of greater interest, for our purposes, are the microeconomic dimensions of off-budget fiscal activity for at this level we directly engage the rent-seeking issues. Unfortunately assessing the microeconomic efficiency implications is very problematic, both for reasons of data quality and inherent analytical difficulties. To begin with, although it is a significant empirical advance, we have only partial estimates of the order of magnitude of off-budget fiscal activity. Secondly, beyond a few a particular cases which have come to light we know very little about the specific purposes to which off-budget spending was put. As already noted, this ranged from innocuous counter cyclical-style macroeconomic smoothing to covert political side-payments, or from prudent international debt repayment to subsidies for crony business people that border on official theft. In other words, not all off-budget fiscal activity generated rents to be captured by firms. More generally, in the absence of detailed information it is not possible to determine conclusively whether any particular subsidy generated net economic gains or not. As the chapters by Khan, Jomo, and Ravenhill demonstrate it is unsatisfactory simply to assume that government-created rents created are necessarily inefficient. In order to determine whether any particular subsidy generated net welfare gains we would need, among other things, to weigh the opportunity cost of the provision of this subsidy, the extent to which it was used productively by the recipient firm, and whether any significant externalities were generated. Further, in addition to evaluating the efficiency implications of the rent itself, we would also need to consider whether the costs of securing the rent (and if it was of more than a one time nature, the costs of sustaining the rent) outweighed the any net welfare gain arising from the rent. Here again, the chapters by Khan and Jomo demonstrate that contrary to the neo-classical rent-seeking literature it is unsatisfactory simply to assume that costs associated with rent-seeking activities outweigh any benefits of the rent.

Plainly, then, there is a high level of indeterminacy here. Even with excellent data sets, reaching a determination on whether a particular rent arising from off-budget expenditure and the politics surrounding it assisted or hindered national economic growth is inherently a very difficult task -- to say nothing of generalizations about whole categories of rents. This basic difficulty besets not only an analysis of the political economy of off-budget fiscal activity; most categories or sectors of rents and sector-seeking are similarly afflicted. However, if we make some assumptions about likely outcomes we can proceed. As already noted, the conventional wisdom about rents and rent-seeking in Indonesia is that the net effects are decidedly injurious to the country's economic performance. This may or may not be true in the case of any particular rent arising from off-budget fiscal activity (or any other government-created rent). But given the exacting set of conditions specified by Khan for rents and rent-seeking to be productive, and given our general understandings of Indonesia's clientelistic political economy under Suharto it would seem entirely reasonable to assume that, at a minimum, a very significant portion of government-created rents were ultimately productive of net welfare losses.

If this is accepted, we can proceed on an deductive basis to wrestle with the basic puzzle posed at the outset of this essay: explaining the coexistence of widespread rent-seeking and sustained national economic success. In so doing it is of course necessary to widen our focus beyond just the rents and rent-seeking associated with off-budget fiscal activity. Significant though these assuredly are, they are only one segment of the total spectrum of rent-seeking activity in Indonesia. With the entire panoply of rent-seeking as our focus, we turn in the next section of this paper to a set of ideas about the institutional underpinnings of rent-seeking.

V Institutions and Efficiency in Rent-Seeking

In a number of basic respects, Indonesia's political economy under Suharto would seem to be inviting of highly destructive patterns of rent-seeking behaviour. First, by virtue of its factor endowments, there were very large resource rents available to be captured. Second, as a result of its long history of dirigisme there were also many government-created rents to be captured. Third, as a result of the country's highly clientelistic political system, policy making processes were quite porous and very conducive to rent-seeking activity from officials as well as private actors. Rent-seeking surrounding off-budget fiscal activity provides a clear and representative microcosm of these wider patterns. And yet, this environment notwithstanding, it would appear that the existence of widespread rent-seeking somehow did not exact the heavy economic toll we might otherwise have expected. Why?

In the remainder of this essay I seek to develop a coherent and plausible explanation for this puzzle. The argument I advance goes beyond just off-budget fiscal activity and is caste in more generic terms so that it might embrace all cases of rent-seeking. Simply stated, the argument to be developed is that because the political character of the regime that has evolved under Suharto was highly centralized, he had powerful incentives to ensure that rent-seeking was managed in such a fashion as to prevent excess and gross inefficiency emerging. The argument is derived from a theoretical discussion of corruption by Shleifer and Vishny (1993) which concentrates on bribery and the sale of government goods (permits etc.). Although their focus is on corruption, the essential logic they set out can readily be applied to the wider phenomon of rent-seeking.

They draw an analogy from industrial organization theory to model the consequences of the political and institutional environment on the level of corruption and the extent to which it inhibits investment and economic growth. The underlying model comes from the much earlier work of the 19th century French mathemetician Cournot, on complementary monopolies. That is, a contrast between the pricing decisions of a single monopolist who produces strongly complementary goods and individual monopolists each producing only one of the strongly complementary goods. The single monopolist will have an incentive to price his goods in a concerted fashion, because pushing up the price of one of his goods will tend to push down demand for the others since consumers require all. Conversely, where there are independent monopolists, even though the goods remain strongly complementary, they will tend to push up the price of their respective products and all will suffer because they are in a prisoners dilemma type situation.

Shleifer and Vishny take this insight and apply it to corruption, by focusing on bribery and the market for government regulatory goods (ie. licenses and permits needed by firms to do business). They assume there are multiple regulatory goods involved and there is strong complementarity among them all (so that potential investors will need a building permit, and an import license, and an employment contracts etc). For present purposes, the relevant point is the contrast they draw between two stylized models of the market for government regulatory goods under authoritarian or weakly democratic political conditions and where corruption is rife; one highly centralized, and the other much less so. In the first national political leadership exercises sufficiently strong oversight and control of regulatory agencies that we can think of the relevant sections of the state as functioning as a unified or centrally coordinated monopoly for bribe-collecting. Monitoring and enforcement from the top are sufficiently strong that the political leadership is able to prevent regulatory agencies from acting independently and to ensure that a healthy share of bribes collected flow upwards, with the remainder being distributed proportionately among relevant officials at the coal face. In short, officials in regulatory agencies are unable to operate independently to maximize their own take. Under this model, if a firm is seeking the necessary permits to, say, establish a factory, once it has provided the appropriate corrupt inducements, it acquires secure property rights to the package of regulatory 'goods' it has purchased.

The second model is one in which political control is weaker and less centralized. Instead of there being a situation approximating a unified monopolist, there is a multitude of independent monopolists selling complementary regulatory goods. Because the political leadership is unable to exercise effective control over bureaucratic agencies, officials (and/or their respective agencies as a whole) seek to maximize their own take by acting as independent monopolists and pushing up prices without regard for the effect on overall demand for government goods. Also, unlike the unified monopoly model, in this situation the firm purchasing all these government goods can never be sure it has secure property rights as any agency might subsequently seek to extract further bribes. The weaker the political leadership's control, the greater the scope for independent and uncoordinated extraction by officials pursuing their own individual interests.

The key insight to be drawn from Shleifer and Vishny is that there may be an important analytical distinction to be drawn between situations in which corruption is pervasive but the framework of government is tightly centralized and those were it is only loosely centralized. If the leader enjoys effective control over regulatory agencies, then we can think of his or her interests on the pricing of bribes as being equivalent to those of the unified monopolist under conditions of strong complementarity. As such, he or she has a direct interest in imposing coordination and ensuring that no individual agency enriches itself at the expense of the system of as a whole, and the political leadership in particular. On the other hand, where the leader enjoys only weak control over regulatory agencies, officials will be far less constrained and facing the incentive structure of the independent monopolists under conditions of strong complementarity, will seek to maximize their own take by driving up the bribes necessary to obtain the particular regulatory good that they control, even though this will drive down demand. According to this logic although corruption is pervasive in both, strongly centralized government will produce the lower individual bribes, but the higher level of overall rent collected (because more bribes will be collected), whereas loosely centralized government will produce the higher level of individual bribes, but the lower overall rent collection (because less bribes will be collected). And, more importantly from an overall economic viewpoint, corruption under conditions of loosely centralized government will be more injurious to economic growth because it will reduce economic activity by driving down demand for the government goods necessary firms to go about their productive business. Note the counterintuitive result here, under conditions of strong centralization there will be more bribes collected and higher total revenue extracted by from the private sector, but less damage will be done to the economy because the bribes will not be priced excessively (that is, they will not drive down demand significantly).

In addition to being a model which provides a plausible theoretical explanation of how, in certain political circumstances, it is possible for the processes of rent-seeking and corruption to be 'managed' in a tolerably efficient manner, I would argue that this framework fits the broad empirical realities of the Indonesian case remarkably well -- helping to explain both the woeful economic conditions of pre-1967 Indonesia, and the increasingly good economics conditions of post-1967 Indonesia.

During the 1950s and 1960s the broad framework of Indonesia's political economy approximated Shleifer and Vishny's weakly centralized, or independent monopolists model reasonably closely. Although some elements changed between the shaky period of Parliament Democracy (early to mid 1950s) and the turbulent period of Guided Democracy (late to 1950s to mid 1960s), the general picture is one in which central leadership and control were weak, and there were multiple independent agencies and actors operating independently in pursuit of opportunities to collect rents. Given these conditions, under the Shleifer and Vishny logic it should come as no surprise that there was nothing remotely approaching coordinated rent-management, and that economic performance slid from bad to worse. If we were to focus on fiscal performance, we would see that in addition to all sorts of off-budget activity, on-budget fiscal activity became increasingly debauched. As the 1960s progressed unrestrained spending took place on the back of rapid money creation which ignited hyperinflation and economic catastrophe at the same time as the country slid into political chaos.

Following the upheaval of 1965-66, a military-based regime developed under the leadership of Lt.General Suharto. In fundamental ways the political economy of the New Order has differed from that which preceded it. First, there was a process of enforced political stabilization and centralization through the late 1960s and into the mid-1970s. Secondly, the bureaucracy was overhauled with bureaucratic agencies and state enterprises being transformed from independent centres of patronage into something resembling instruments of the presidency. A comparable process of organizational rationalization took place in the armed forces as well. And thirdly, the political parties and the electoral process were brought under close government control, with interest group activity being channeled into a government controlled corporatist network. Above all, there was a centralization of authority and patronage around the presidency. Along with a swing to much more determinedly authoritarian politics, this political transformation was greatly assisted by the oil bonanza of the 1970s and early 1980s which created a vast and centrally channeled flow of revenue.

Although the realities of New Order political economy are by no means as neat and tidy as the ideal-typical unified monopoly of Shleifer and Vishny's highly centralized or unified monopoly model, the descriptive fit seems remarkably good. Once Suharto consolidated his grip on the presidency and the administrative apparatus beneath him, he achieved something approaching monopolistic rent-management and thus had a direct interest in ensuring that government goods were not priced excessively and thus did not depress economic activity. Two examples of rent-management in off-budget fiscal activity will help to make this clearer: one macroeconomic, and the either microeconomic.

The big macroeconomic issue is of course why there has been has been not been more resort to spending (on- or off-budget) on the basis of money creation. Although it cannot be known, it is certainly plausible to postulate that the President has acted in a manner entirely consistent with the behaviour of someone facing the incentive structure of Shleifer and Vishny's leader of a highly centralized regime, or unified monopolist. Once firmly established in power, he had a direct material interest, and more importantly, a direct political interest in indulging moderate borrowing from the central bank (to fund rents for others), but ensuring that this did not become too onerous an inflation tax as this would hurt his economic interests (as the person who sits alone atop the pyramidal network of patronage relationships) and his political interests, since beyond mere personal enrichment, these economic resources are essential political tools for purchasing support and sustaining political alliances.

A more microeconomic illustration of behaviour consistent with the highly centralized model centres on the earlier mentioned drive to raise contributions to fund (then) Technology Minister Habibie's new N2130 jet aircraft project. Conveniently, this ties our generalized theoretical discussion back to our earlier focus on off-budget fiscal activity. This is an interesting case, because after the President's children, Minister Habibie is usually seen as the most 'fiscally indulged' member of the government. If one was to look for an example of rent-seeking which was clearly and directly injurious to the economy, some of Minister Habibie's activities would be high on the list of many observers. As such, his empire is a most unlikely place to look for evidence of economically efficient rent-management on the part of the President. And yet, while the President has indeed overridden the objections of the Finance Ministry and given his blessing to another Habibie project, there are two important restrictions to note. First, this measure was made necessary presumably because the President would not allow Habibie his first preference, namely to have the venture either funded from on-budget sources, or (more) extensively from hidden government reserves. Secondly, the person put in charge of managing these funds is not a cipher of Minister Habibie, but a respected independent and technocratic senior official (Cabinet Secretary, Minister Mursjid) who has so far managed to insist on arms-length accounting and contractual arrangements governing access to the funds that have been raised. In short, at the same time as allowing major resources to be diverted and rents to be captured, the President has also imposed some restraints and checks. Even in this most unlikely of areas, there has apparently been some significant effort to limit inefficiencies. Such behaviour is entirely consistent with the incentive structure facing a leader controlling a unified monopoly on rent management.

V Conclusions, Before and After...

This paper has had two goals. The first has been to cast light on an area of economic policy that receives surprisingly little attention in discussions about rent-seeking. Fiscal activity -- both on- and off- the budget -- is a very important area of economic policy and is quite susceptible to rent-seeking behaviour. I have presented an overview of off-budget fiscal activity in Indonesia, including previously unpublished empirical details of some of the processes involved. The central empirical message of this first section is that there is much more to Indonesia's fiscal record than meets the eye, with an array of off-budget resource transfer activities of a broadly fiscal nature. Although we are unable gauge the total scale of such activity, there is good reason to believe that it is substantial. (Indeed, why else would the IMF strive to eliminate them?) In macroeconomic terms there have been no catastrophic consequences. In microeconomic terms, the efficiency implications of the rent-seeking surrounding off-budget fiscal activity remains necessarily indeterminate. Nonetheless, we do know that along the myriad of other case of rent-seeking, this has not prevented the achievement of strong economic growth.

The second goal of this paper has been to experiment with a set of ideas about the political economy of rent-seeking in an effort to generate a broad-based theoretical explanation of the seemingly paradoxical coexistence of pervasive rent-seeking and economic success. Although this essay is only a first cut at applying the microeconomic logic of Shleifer and Vishny, in my view it has yielded promising results. (The logic is developed further in (MacIntyre forthcoming))**.** While not demonstrating anything conclusively, I have argued that the model fits Indonesian experience surprisingly well: it offers an explanation both of why rent-seeking proved so economically debilitating in the 1950s and 1960s, and why it has been economically bearable under the New Order. Now, to be sure, this does not <u>explain</u> Indonesia's economic success, for there are many other causal factors that go into determining whether or not an economy grows rapidly. Nevertheless, one area of enduring theoretical frustration in the literature on rapid economic growth in Asia has been our difficulty in accounting for the coexistence of rapid economic growth and pervasive rent-seeking and corruption. I suggest that the ideas explored here offer the basis for an explanation for Indonesia during the Suharto period, and quite possibly, for other countries that have paired very centralized political systems on one hand, with rapid growth and pervasive rent-seeking on the other, for instance South Korea under Park Chung-Hee and Chun Do-Hwan, Malaysia under Mahathir Mohammed, or Taiwan under Chiang Ching-Kuo. Moreover, this analytical framework seems likely to help illuminate useful comparisons that might be explored in future research: Indonesia under Suharto vs. Indonesia post-Suharto, Indonesia under Suharto vs. the Philippines under Marcos, perhaps Thailand under Prem vs. Thailand under Chatichai, and so on. In short, I believe this model carries very considerable theoretical promise for tackling one of the enduring puzzles of rapid economic growth in Asia. To be sure, this will not be the only model that will help us here, for the political frameworks of successful Asian economies are diverse (with the fiscal federalist explanations of China providing the most striking counterpoint).

The core of this essay was conceived and drafted some time before the current regional economic crisis. What are we to make of a set of ideas purporting to help explain why pervasive rent-seeking and corruption may not be inconsistent with economic success in Indonesia, when that economy now lies a smouldering wreck? Surely the current stark realities suggest that such a line of inquiry - while perhaps interesting - is nonetheless fundamentally misguided? I think not.

The pattern of rent-seeking that existed in Indonesia under Suharto was economically effective in the sense of producing a tolerable rather than an intolerable drain on national economic efficiency. However it was also inherently fragile and, indeed, contained the seeds of its own eventual destruction. The fragility of the system was rooted in the heavy political centralization. With such a concentration of authority, if the actions of the leader are misguided or, more simply, fail to engender market confidence, then very serious economic consequences can follow quickly in a crisis environment as there are no institutional checks on the leader's behaviour. In short, in such a political system, a great deal rides on the behaviour of the leader. This applies both to the focus of this study -- the conduct of rent-seeking activity -- and more fundamentally, to the overall management of economic policy. In the case of rent-seeking activity, it is plainly the case that a highly centralized political framework in no sense guarantees effective rent management. Rather, it should be viewed as an enabling set of conditions, creating incentives for a political leader to promote a pattern of rent-seeking which is not too costly to national economic efficiency. However, as we assess Indonesia's suddenly devastated economy today, of even greater immediate significance are the implications of the fragility of highly centralized politics for overall economic policy management. The same autocratic political framework which facilitated effective economic policy management and quite dramatic episodes of successful structural adjustment in the past, also produced a highly destructive policy paralysis in late 1997 and early 1998. As Suharto's leadership increasingly vacillated and his commitment to economic reform became increasingly uncertain, market confidence very quickly eroded. Serious doubts about his health and the process of political succession greatly exacerbated these problems. With no institutional constraints to put a break on his behaviour, market confidence simply continued to slide until economic conditions became so severe that they produced a political backlash which swept Suharto from office.

More broadly, from a longer term perspective there is a strong sense in which this highly centralized political economy carries with it the seeds of its down destruction. Inevitably, the rapid economic growth which it helped promote produces long run socio-political consequences as new middle- and working-class formations emerge, and demands for increased political openness and accountability mount. The long run sociopolitical consequences of the rapid economic growth this framework helped to promote are inimical to the original political framework itself. In sum, rather than sweeping away the arguments that have been made in this essay, Indonesia's economic devastation underscores the fact that the institutional framework which underpinned the country's pattern of rent-seeking from the early 70s until 1997 had real vulnerabilities. But this should not be a complete surprise. An institutional framework which produces satisfactory outcomes in one set of circumstances, may produce quite different outcomes in other circumstances. Institutions clearly matter, but so do their socio-economic contexts.

The political economy of rent-seeking in the new Indonesia -- the Indonesia that is now taking shape amidst the rubble of the previous regime -- will be different from the pattern that prevailed under Suharto. Rent seeking and corruption are likely still to be very widespread. But given that it is almost inconceivable that power will again be so tightly centralized, the ironic logic of the argument presented here is that at least in the short- to medium-term future, the more open political framework which seems now to be emerging may well impose a greater rather than a lesser drag on the economy.

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