

## **FROM DUTCH MERCANTILISM TO LIBERALISM: INDONESIAN HISTORICAL PERSPECTIVE**

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### **ABSTRAKSI**

*Paper ini membahas sejarah ekonomi Indonesia yang dapat dibagi menjadi beberapa periode yaitu pre-kolonialisasi, intrusi Eropa, pendudukan Jepang dan masa kemerdekaan. Negara Eropa yang paling mewarnai sejarah Indonesia adalah Belanda. Paper ini menganalisis evolusi pendekatan ekonomi dan politik yang dilakukan Belanda pada masa kolonialisasi di Indonesia kaitannya dengan sejarah pemikiran ekonomi di Belanda. Paper ini memiliki beberapa kesimpulan. Pertama, hubungan internasional Indonesia telah dilakukan jauh sebelum intrusi Eropa yang ditandai dengan perdagangan internasional. Kerajaan-kerajaan Hindu, Budha dan Islam memainkan peranan penting dalam perdagangan internasional pada masa sebelum intrusi Eropa. Kedua, era intrusi Eropa khususnya Belanda dan masa kemerdekaan mewarnai sejarah perekonomian Indonesia. Perspektif sejarah menunjukkan fakta bahwa terdapat hubungan kuat antara politik dan kinerja perekonomian Indonesia. Hal tersebut ditunjukkan oleh pertumbuhan GDP, volume perdagangan, harga ekspor dan pengeluaran pemerintah pada masa sistem Tanam Paksa, Liberal, Politik Etis, Orde Lama dan Orde Baru. Ketiga, terdapat hubungan erat antara perkembangan sejarah pemikiran ekonomi di Belanda dan kebijakan-kebijakan masa kolonialisasi. Dalam kasus Indonesia, hal tersebut direfleksikan dengan pembentukan Dutch East India Company- Vereenigde Oost-Indische Compagnie, VOC- oleh Belanda (Indices Company oleh British Mercantilism), Sistem Tanam Paksa, Politik Etis dan Liberal. Keempat dari perpektif sejarah ekonomi, Indonesia beberapa kali kehilangan kesempatan (missed opportunity) untuk memiliki kinerja ekonomi yang baik dikarenakan kondisi institusi dan politik.*

**Kata Kunci:** Colonialism, Dutch Mercantilism, Cultivation System, Missed Opportunity.

*The first enthusiasts judged a colonial adventure as they would have judged an extremely favorable branch of foreign trade. A colony was to yield raw materials and dispose of English manufactures, order, as the younger Hakluyt said, that 'what in the number of things to go out wrought, and to come in unwrought, there need not one poor creature to steal, to starve, or to beg as they do.*

-Richard  
Pares

## INTRODUCTION

Indonesia<sup>1</sup> is one of countries stated in a famous publication of the World Bank which is titled *'The East Asian Miracle: Economic Growth and Public Policy'* in 1993. In the publication, the countries consist of Hong Kong, Indonesia, Japan, Korea, Malaysia, Singapore, Taiwan and Thailand. The defining characteristics of the 'miracle' were high economic growth and reduced income inequality. Although, Indonesia performed the 'miracle' during the 1980s and 1990s, Indonesia had significant troubles after the financial crisis in 1997. Rao (2001) writes a book, which has longer time dimension than the previous World Bank's publication. It is titled *'East Asian Economies: the miracle, a crisis and the future'*. The 'miracle', crisis and the post-crisis eras were only parts of the economic history of Indonesia. It is important to put a country in the long term historical perspective.

Indonesia was a former colony of the some European countries; therefore the economic history of Indonesia might be closely related with the history of economic thought in Europe. The European country that had given significant contributions in the economic history of Indonesia was the Netherlands. This country had ever occupied Indonesia for around 350-years. The evolution of economic thought, especially (Dutch) Mercantilism<sup>2</sup>, in

the Netherlands was more or less inquiringly reflected in policies implemented in the colony, Indonesia.

This paper aims to portray the economic history of Indonesia in longer time dimension and then to analyze the impact of the evolution of economic thought in the Netherlands especially upon the policies implemented in the colony, Indonesia. Figure 1 shows real Gross Domestic Product (GDP) per capita of Indonesia 1880-2002. The GDP per capita was relatively constant during the period 1880-1900. There were significant increases of the GDP per capita during the heyday of the colonial export economy (1900-1942). There was no data during the Japan occupation (1942-45) and the war of independence (1945-50). It became stagnant during period 1950-73 and increased significantly since 1973 before hit by the financial crisis in 1997.

The rest of this paper is organized as follows. Part 2 represents some elements of Indonesian economic history. Part 3 describes Indonesian economic history. Part 4 exhibits relevance of history of economics: from Dutch mercantilism to liberalism. Part 5 describes some conclusions.

## SOME ELEMENTS OF INDONESIAN ECONOMIC HISTORY

Indonesia has some important elements of the economic history i.e. 'unity in diversity', 'missed opportunity economy' and 'state formation'. *First*, 'unity in diversity' is one important element of Indonesian economic history because of the existence of wide range cultural diversities such as local language, religions (beliefs), social habits, values, etc. The Indonesian culture diversities have been

<sup>1</sup> 'The archipelago' is sometime stated in this paper - instead of Indonesia- to reflect the situation before the Independence Day of Indonesia was established. The name of Indonesia itself was coined by a British geographer, James Richardson Logan, to depict the vast archipelago of islands lying off the Indian subcontinent. The word means 'Indian Islands' as the world *Indo* originally comes from 'Indian' and *nesia* comes from 'nesos' the Greek word for 'islands' (Zuehlke, 2006).

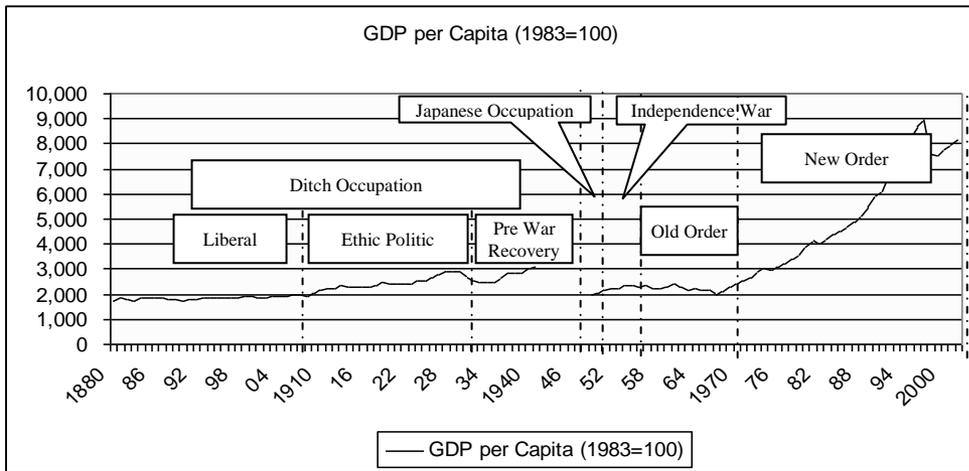
<sup>2</sup> The mercantilists were 'Pamphleteers' rather than a school of thought (Reynolds, 2000). They emphasized international trade as means of increasing the wealth and power of nation, and, in particular, focused on the balance of trade between nations. They have no systematic, comprehensive, consistent treatise, no leader, common method, or theory. Each 'mercantilist' sought advantage for a specific, trade, merchant, joint-

stock company or social group. 'Protectionism' is often seen as a primary characteristic of Mercantilism. The main objective of Mercantilism was to increase the power of the nation state. One of the important aspects of national power or strength was wealth that was equated with specie. The states that followed a policy of Mercantilism tended to see trade, colonialism and conquest as the primary ways of increasing wealth.

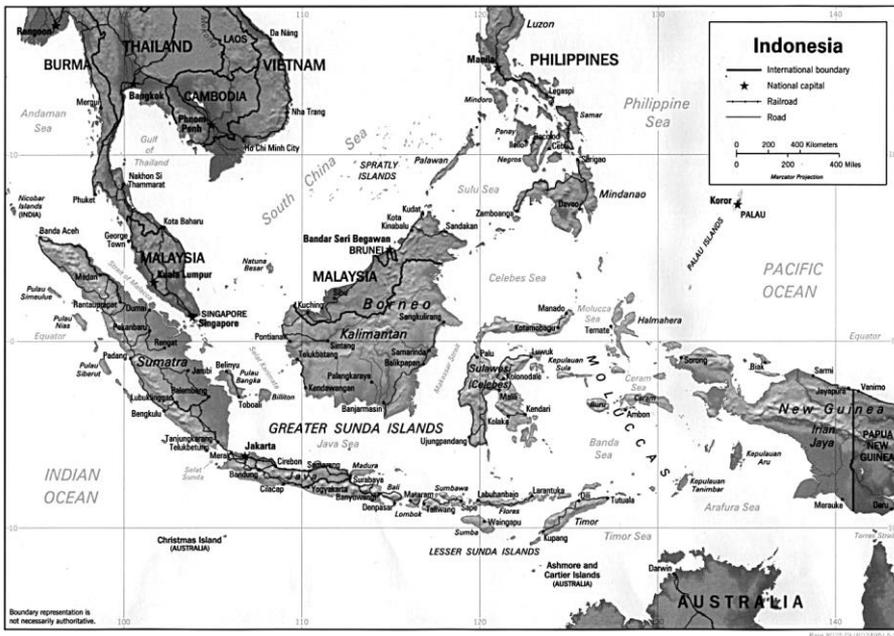
shaped by centuries of complex interactions with the physical environment. Indonesia is a huge archipelagic country extending 5,120 kilometers from east to west and 1,760

kilometers from north to south. It encompasses 17,508 islands of which about 6,000 are inhabited (Zuehlke, 2006:8).

Figure 1. Gross Domestic Per Capita of Indonesia 1880-2003



Source: Maddison, (2003); For methodology and sources, see: van der Eng (2002) *Author's calculation.*



Source: University of Texas Libraries (2006)

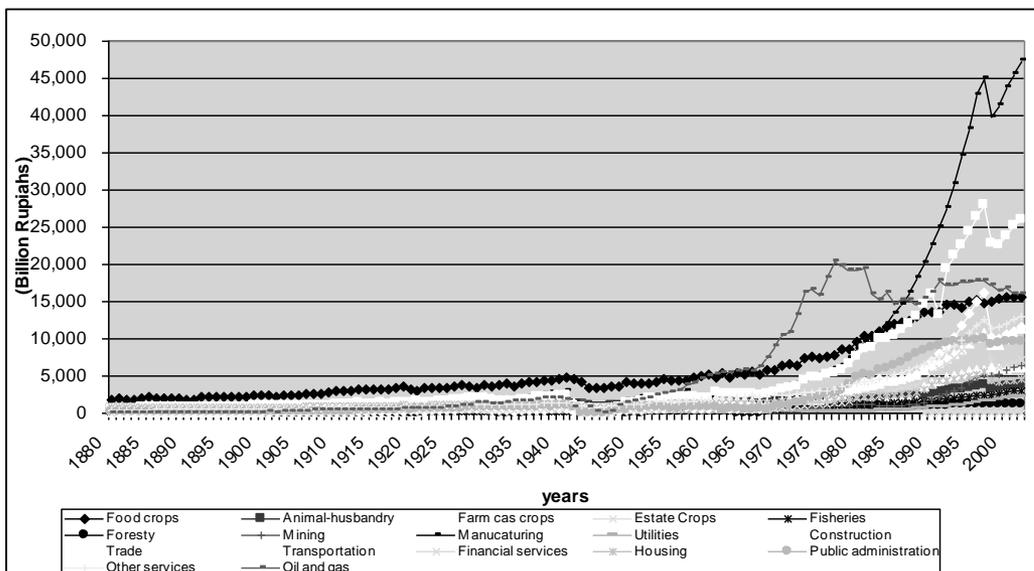
Figure 2. The Islands and Archipelagos of Indonesia

Figure 2 shows islands and archipelagos of Indonesia. There are five main islands (Sumatra, Java, Kalimantan, Sulawesi, and Irian Jaya), two major archipelagos (Nusa Tenggara and the Maluku Islands), and about sixty smaller archipelagos. Two of the islands are shared with other nations; Kalimantan (known in the colonial period as Borneo, the world's third largest island) is shared with Malaysia and Brunei, and Irian Jaya shares the island of New Guinea with Papua New Guinea. Indonesia is a heterogeneous nation state in term of tribes, islands, populations, religions, languages, cultures and so on. The founding fathers of Indonesia realized that logically the political problems arose from such a heterogeneous nation state had negative effects on the development of the national economy. Therefore, they established a national slogan *Bhineka Tunggal Eka* ('unity in diversity'). The most striking difference is between densely populated Java, which has a

long tradition of politically and economically dominating the sparsely populated Outer Islands (Hill, 1989).

*Second*, Indonesia is sometimes called a 'missed opportunities' economy. Booth (1998) wrote a book which is titled '*The Indonesian Economy in the Nineteenth and Twentieth Century: A History of Missed Opportunities*'. In this book, Booth illustrates: "the economic history of Indonesia with the somewhat melancholy phrase a history of missed opportunities".

The 'missed opportunities' refers to the fact that although Indonesia has abundant natural resources and fabulous variety of cultural tradition, the Indonesian economy has been underperforming for large periods of history. Figure 3 shows the real Gross Domestic Product (GDP in 1983 prices) by commodities or sectors of Indonesia in 1880-2002.



Source: Maddison, (2003). For methodology and sources, see van der Eng (2002) *Author's calculation*.

**Figure 3.** Real GDP by Commodities/sectors 1880-2002

It is clear that since 1960s, oil and gas has become the first rank in GDP. Therefore, Indonesia is frequently called as an 'oil economy'. Some opportunities to get favorable economic development and ongoing modernization have been missed, for instance Java in the late of nineteenth and Indonesia in the late 1930s; in the early 1930s (Touwen, 2006) and in the oil boom era (1973-81). The internal reasons might be from institutional or political spheres (either after independence or in the colonial times). In addition, the external reasons might also affect the Indonesian economy - such as the 1930s Depression.

*Third*, state formation can be seen as a condition for an emerging national economy. In Indonesia, this process started in the nineteenth century – as the Dutch colony, 'the Netherlands Indies' – to present day as Indonesia. '(Dutch) East Indies' was used in the seventeenth and eighteenth centuries. The first come of the Dutch in Banten in 1596 might not be said as the starting point of Dutch colonization. It is more realistic to say that the Dutch colonization started in 1830, when the Java war ended and the Dutch introduced a bureaucratic, centralizing politic in Java. From the mid-nine century onward, the Dutch colonization did shape the borders of the Indonesian nation state, even though it also incorporated weaknesses in terms of ethnic segmentation of economic roles, unequal spatial distribution of power, and a political system that was largely based on oppression and violence (Touwen, 2006). Legge (1964:2) illustrates the important of understanding the state formation:

*The key to an understanding of these developments must be sought to some extent in a study of the past. First, it is necessary to see the nationalist revolution itself in wider historical contact – in dramatic terms of the rise and fall of empires, of the emergence of the new*

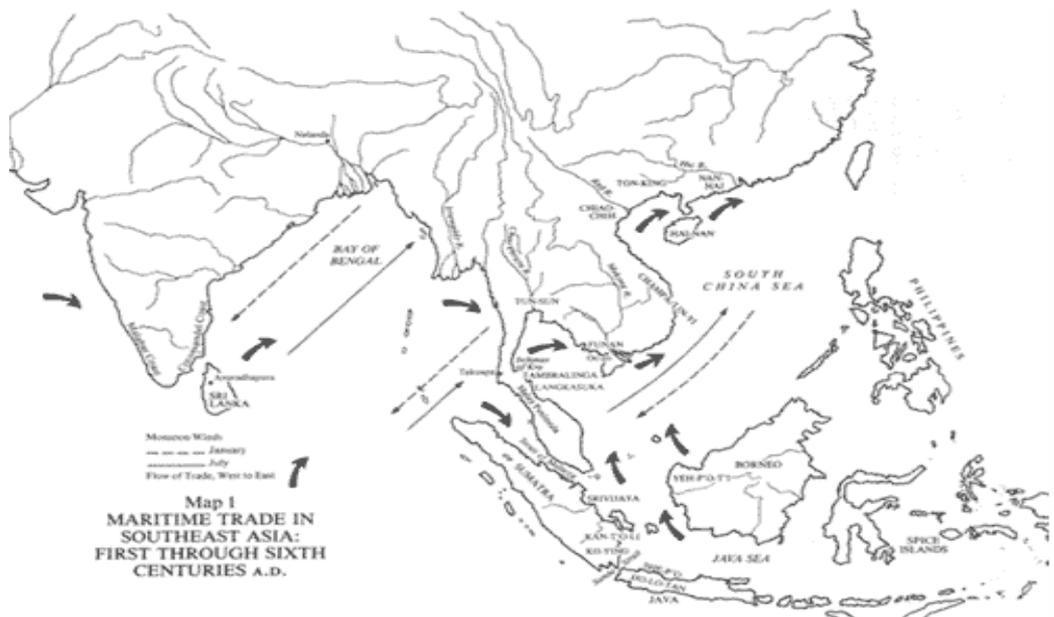
*republics of Africa and Asia. In many respects Indonesia's experience is not unique but is the product of our age. More narrowly, however, to understand this one particular country, and its present politics, one must examine the deeper currents that have contributed, over the centuries, to the formation of Indonesian society.*

## INDONESIAN ECONOMIC HISTORY

It might be common to divide the economic history of Indonesia into some main historical parts: the pre-colonial (Hinduism, Buddhism and Islam influences: kingdoms), the European intrusion (Sixteenth to Nineteenth centuries and Dutch empire in the indices (1870-1942)), the Japanese occupation and the period after the Independence Day.

### 1. The pre-colonial period

There were a number of prominent kingdoms in the Indonesian archipelago during the pre-colonial era. The kingdoms were influenced by Indian (especially Hinduism and Mahayana Buddhism) and Islam civilization. Some big kingdoms influenced by Indian civilization were Sriwijaya, Mataram and Majapahit. South Asian trading system brought Indian civilization. From the 1<sup>st</sup> century up to the 7<sup>th</sup> century, the massive trade was done between China and India, with Southeast Asia providing only the ports in which to reload supplies for ships traveling the maritime trade route. Figure 4 shows the trade route of South Asian trading system. Started from India (usually Gujarat), the traders sailed down the Malabar coast, the Coromandel coast to Burma, then down to the Isthmus of Kra. From the Isthmus of Kra they transported their goods over land to Fu-nan (Cambodia), then to Vietnam, until they reached their final destination—China.



Source: Hall (1985:22)

**Figure 4.** Trade Route of South Asian Trading System

Since the Indians dominated the trade route, the spread of Indian religious ideas at that time contributed Southeast Asian kingdoms' religions. During the early centuries, elements of Indian civilization were brought to Sumatra and Java, and encouraged the emergence of centralized states and highly organized societies. Although historical records and archeological evidence are obviously rare, it confirms that by the seventh century the Indianized Kingdom of Sriwijaya, centered in the Palembang area of eastern Sumatra, established influential large areas of Sumatra, western Java and much of the Malay Peninsula. Dominating the Malacca and Sunda Straits, the kingdom controlled the trade of region and served as a mediator for Chinese, Indonesian and Indian markets. The golden age of Javanese Hindu-Buddhist kingdoms was in the late thirteenth and fourteenth centuries i.e. Majapahit era. The state of Majapahit established an empire that spread throughout much of the territory of modern

Indonesia. By the mid-fifteenth Majapahit's disintegration was happened due to the succession crisis and the economic competition of the Malay trading network that focused on the state of Malaka (Malacca<sup>3</sup>), whose rulers had adopted Islam.

The major drive to the spread of Islam civilization was provided by Malaka, a rich port city that dominated the Strait of Malacca and controlled much of the archipelago's trade during the fifteenth. A territory of strong allegiance founded in the early sixteenth century at the western tip of Sumatra was the state of Aceh. In eastern Indonesia, the island states of Ternate, Tidore, Halmahera, Gowa had Muslim sultans. In the early seventeenth

<sup>3</sup> Some key element of Malacca's success are a principal centre for spices cloves (from the Moluccas, and nutmeg and mace from the Banda Islands), and for redistribution of Indian textiles, conducive culture for trade (international community of traders and ruler's skill), Malacca's conversion to Islam (majority of traders were Moslems),

century, the most powerful state in Central Java was Mataram whose rulers cultivated friendly relations with the Pesisir states, especially Gresik.

## 2. The European Intrusion

### 2.1. Portuguese

The Portuguese were the first European to come frequently to the archipelago. The Portuguese exploration in Asian began with Vasco da Gama's voyage to India in 1497-99 continued through the first half of the sixteenth century. These early European explorers were mainly motivated by faith and profit<sup>4</sup>. The Portuguese came to Indonesia to monopolize the spices (nutmeg, mace and cloves) trade of the eastern archipelago. The spice was highly demanded by European markets, but the trade had been dominated by Muslim and Mediterranean city-state of Venice. The Portuguese were minimally involved in Java. Given Portugal's small size, small labor pool, limited resource, and its routinely brutal treatment of indigenous people, Portugal's trading empire was short-lived.

### 2.2. Dutch (*The United East India Company, 1602-1795*)

The first four-ship Dutch entered Indonesian waters in 1596, visiting Banten on the western tip of Java as well as north-coast Javanese ports. The main aim was to get profitable spices. Following the first-ship, then there were 'wild' or unregulated voyages, when several Dutch trading concerns sent out ships to the archipelago. In 1602, however, these companies merged to establish the United East India Company (also known as

the Dutch East India Company<sup>5</sup>, *Vereenigde Oost-Indische Compagnie*, VOC (1602-1795)) under a charter issued by the Dutch parliament, *The Staten-Generaal*. The directors (*the Heeren Zeventien*) of the VOC were motivated solely by profit. The VOC had authority or power to build fortresses, wage war, conclude treaties with indigenous rulers, and administer justice to subject populations.

The VOC successful became a monopolist of the spices trade – controlling output and keeping non-VOC trader out of the islands. Ambon had been seized from the Portuguese in 1605. However, the British East India Company, established in 1600, proved to be a tenacious competitor. The Spanish were forced out of Tidore and Ternate in 1663. The Dutch burned the port of city of Palembang on Sumatra, ancient site of Sriwijaya Empire, in order to secure control the pepper trade in 1659.

During the eighteenth century, sugar and coffee were the most important exported products and Java became the most important area, especially Batavia (modern: Jakarta). Progressively, the VOC was able to take over power from local rules and also productive areas of Java. The VOC become aware with the political situation of Java. The key to Dutch commercial success was the security of its base of operation at Batavia. The security issue was related with the VOC in the internal politics of Java. Previously, the earliest governor general of VOC had not intended to become involved in Java's politics. They had envisioned the company as primarily a maritime power, consisting of a network of forts and heavily defended trading routes. But

<sup>4</sup> It is sometime abbreviated with the three goals (3G), i.e: Gospel, Gold and Glory. Portugal was charged with converting Asia to Christianity. It was noted that the Portuguese goal of Christianizing Asia was unsuccessful. East Timor was under controlled by the Portuguese for three centuries surrounded by Dutch colonialism.

<sup>5</sup> The establishment of Dutch East India Company (VOC) followed the establishment of the British (English) East India Company in 1600. The British East India Company was mainly a joint-stock company which was granted an English Royal Charter by Elizabeth I on December 31, 1600, with the intention of favoring trade privileges in India. British and Dutch East India companies were granted exclusive monopoly rights to engage in trade to Asia.

during the seventeenth century and especially the eighteenth century, the Dutch found themselves caught up in Java's perennial political instability. Defense of VOC interest required the raising of armies and collection of revenue from rulers and the general population to pay for them.

The VOC bankruptcy was caused by some factors. Not only nonstop wars on Java (the first, second and third Javanese war of succession (1704-19), (1719-23), and (1746-55), respectively) but also the VOC's own greediness led to its collapse by the end of the eighteenth century. Corruption, lack of capital investment, and increasing competition from England were also main factors of its bankruptcy. In addition, war between the Netherlands and Britain in 1780-84 also prevented the VOC from shipping its goods. The Netherlands was occupied by French troops in 1795, and a French protectorate established. The new government abolished the VOC by allowing its charter to lapse in 1799. VOC territories became the property of the Dutch government.

### *2.3. British (1811-16)*

Lois Bonaparte, who had been established as king of the Netherlands by his brother Napoleon, assigned Herman Willem Daendels as governor general of the Dutch possessions in 1808. Daendels, inspired with the ideas of the French Revolution, wanted to change the Java's 'feudal' political system and introduced a comprehensive set of reforms. But in 1811, a year after the Netherlands had been incorporated into the French empire, the British occupied Java. In August 1811, they seized Batavia and a month later received surrender of French forces.

Thomas Stamford Raffles was established as the lieutenant governor of Java (1811-16) and its dependencies by the British East India Company in Calcutta (India). Raffles had done comprehensive reforms. Many of his thoughts were enlightened: abolition of forced labor

and fixed quotas for cash crops, peasant's free choice of which crops to grow, salaries for government slaves.

### *2.4. Dutch return*

At the beginning of the Napoleonic Wars, the British government had promised the Dutch Government that at the end of the war occupied territories be returned to the Netherlands. Over the objection of Raffles, Dutch authority was reestablished 1816. Therefore, in the beginning of nineteenth century Indonesia faced not only changeover of the company rule by Dutch government rule but also the absolute transformation of Java into a colonial society and the successful extension of colonial rule to Sumatra and the eastern archipelago. The modern state of Indonesia is in real sense a nineteenth century creation. It was during this century that most of its boundaries were established and a process of generally exploitative political, military and economic integration started.

There some important issues need to underlie in the Netherlands Indies Empire era i.e. Java War, Cultivation System (CS) in Java, Dutch Expansion, and the Ethical policy. The following paragraphs will briefly describe the issues.

#### *Java War*

Some rules and actions taken by the Dutch invited protest from local elites. In Java during the VOC period, the Dutch depended on the agreement of the Javanese aristocratic class, which allowed them to rule them in an indirect manner. The regent's role of expropriating cash crop from peasants to deliver to the VOC gave them a comfortable income, since they also continued to tax their subjects for rice and labor. Variations on this pattern were found throughout Java, with local adaptation. But the reforms of Daendels and Raffles threatened this arrangement. Moreover, the elite in Central Java were humiliated by a British occupation and partition of Yogyakarta in 1812. Many of

the elite found themselves short of fund and indebted as Dutch demands for tax revenues expanded after 1816. The common people also suffered from years of war, disruption and the exploitation of Chinese farmers employed by the British and the Dutch. It was not surprised that the Dutch reforms were protested by local aristocratic class. It created Java war of 1825-300 constituted the last resistance of Javanese aristocracy to Dutch rule. Its central figure was *Pangeran Diponegoro* (1785-1855). The Java war was not a modern anti-colonial movement. Diponegoro and his followers probably did not want to restore an idealized, pre-colonial past. Nor did they envision an independent, modern nation. Rather they sought a Javanese's heartland free of Dutch rule.

The Java War gave considerable impetus to a conservative trend in Dutch colonial policy. Rather than reforming their regime in the spirit of Daendels and Raffles, the Dutch continued the old VOC system of indirect rule. As it evolved during the nineteenth century, the Dutch regime consisted of a hierarchy in which the top levels were occupied by European civil servants and a native administration occupied the lower levels. The latter was drawn from the *priyayi* class, an aristocracy defined both by descent from ancient Javanese royal families and by the vocation of government service. The centerpiece of the system was the *bupati*, or regents. Java was divided into a number of residencies, each headed by a Dutch chief administrator; each of these was further subdivided into a number of regencies that were formally headed by a Javanese regent assisted by a Dutch official. The regency was subdivided into districts and subdistricts and included several hundred villages. The states

of Surakarta and Yogyakarta remained outside this system. However, both they and the local regents lost any remnant of political independence they had enjoyed before the Java War. The sultanates played an important cultural role as preservers of Java's traditional courtly arts, but had little or no impact on politics.

#### *Cultivation System in Java (CS)*

Starting in 1830, a set of policies known as the Cultivation System (*Cultuurstelsel* CS) was implemented as a means of covering the high cost of colonial administration in Java and bolstering the Netherlands' weak financial condition following the Napoleonic Wars and a civil war with Belgium, with which the Dutch had united in 1815. Governor General Johannes van den Bosch (served 1830-34), the system's establisher, argued that the Cultivation System would benefit both colonizer and colonized. In fact, it brought the Netherlands big profits, increased the conspicuous consumption of the indigenous elite, enriched European officials and Chinese middlemen, but was a terrible burden for Javanese villagers.

The Cultivation System in theory required that participating villages grow export crops to raise funds sufficient to meet their land-tax commitment, which was based on rice production. Export crops--the most profitable being coffee, sugar, indigo, tea, cinnamon, pepper, tobacco, cotton, silk, and cochineal--were sold to the government at fixed prices. A balance was supposed to be established between rice production and export crops and both the village and the colonial economy--and the Netherlands--would enjoy the benefits. Table 1 exhibits the financial result of the CS.

**Table 1.** The Financial Results of the Cultivation System, 1840-1849 (in thousands of guilders in current value)

Period	Products				
	Coffee	Sugar	Indigo	Pepper, Tea	Total Net Profit
1840-1844	40.278	8.218	7.3836	647	39.341
1845-1849	24.548	4.136	7.726	1.725	35.057

Source: Fasseur (1975:20)

In practice, however, as some historians have pointed out, there was not a "system." Wide local and regional variations in applying van den Bosch's theory occurred and, instead, colonial exploitation took place. The growth of export crops became compulsory. The crops themselves were shipped to the Netherlands by the Netherlands Trading Company (*Nederlandsche Handel-Maatschappij*, NHM established in 1824), which held a monopoly over Cultivation System trade until 1872, and Amsterdam regained its seventeenth-century status as the primary European market for tropical products. Table 2 exhibits the estimates of total profits during the CS. Profits from the system constituted between 19 and 32 percent of the Netherlands' state revenues between the 1830s and 1860. These profits erased the colonial government's deficits, retired old VOC debts, financed the building of the Netherlands state railroad, funded the compensation of slaveholders after the abolition of slavery in the colony of Suriname,

and paid for Dutch expansion into Sumatra and the eastern archipelago. The success attributed to the Cultivation System inspired a Briton, aptly named James William Bayley Money, to publish a book entitled *Java, or, How to Manage a Colony* in 1861.

During the early 1860s, a liberal Dutch government began dismantling the Cultivation System, abolishing government monopolies over spices, indigo, tea, tobacco, and cochineal (the spice monopoly had been in effect since the early seventeenth century). In 1870 the Sugar Law provided for government withdrawal from sugar cultivation over twelve years, beginning in 1878. The Agrarian Law also passed in 1870, enabled foreigners to lease land from the government for as long as seventy-five years, opening Java up to foreign private enterprise. These developments marked the gradual replacement of the Cultivation System and the beginning of an era of relatively free trade, although compulsory cultivation of coffee continued until 1917.

**Table 2.** The Financial Results of the Cultivation System, 1840-1849 (in thousands of guilders in current value)

Variables	1831-40	1841-50	1851-60	1861-70
Gross revenues of sale of colonial products	227.0	473.9	652.7	641.8
Cost of transport etc (NHM)	88.0	165.4	138.7	114.7
Sum of expenses	59.2	175.1	275.3	276.6
Total net profit*	150.6	215.6	289.4	276.7

Source: Van Zanden & Van Riel (2000:223) in Touwen (2006)

### *Dutch Expansion*

British occupation of the archipelago during the Napoleonic Wars and the Java War seriously weakened Dutch authority outside of Java. Pirates flourished in the power vacuum, making Indonesian waters among the most dangerous in the world. In the 1840s, the British established a presence in northern Kalimantan (North Borneo), where James Brooke made himself the first "White Rajah" of Sarawak. Alarmed by such developments, the Dutch initiated policies of colonial expansion in the Outer Islands, which brought all the land area of modern Indonesia, with the exception of Portuguese Timor, under their control. Dutch expansion started with Sumatra. By 1823 the eastern part of Sumatra island, including Palembang, was controlled by the Dutch. Some wars surfaced such as the Padri War (1821-38) in the Minangkabau region. Between the 1870s and the end of the century, colonial troops also defeated the fierce Batak ethnic group, living north of the Minangkabau, and the colonial government encouraged the people to convert to Christianity.

### *The Ethical Policy*

Both the VOC and the Netherlands Indies states after 1816 focused mainly on commercial trade and profit. Nevertheless,

opinion in the Netherlands was changing. In 1899 a liberal lawyer named Conrad Theodoor van Deventer published a controversial essay, "A Debt of Honor," the Dutch journal *De Gids*. He argued that the Netherlands had a moral responsibility to return to the colony all the profits that had been made from the sale of cash crops. When a liberal government was elected in 1901, these ideas became the basis for what was known as the Ethical Policy. It covered improvement in agriculture, especially irrigation, expansion of educational opportunities for population as a whole and the settlement of villagers from overpopulated Java onto some of the Outer Islands (transmigration program). By the late 1920s, the colonial government seemed to have moved a long way from idealistic commitments of the Ethical Policy. Attitudes hardened in the face of growing Indonesian demands for independence.

The period of 1900-1942 was the heyday of the colonial export economy. After 1870 private sectors were promoted but the exports of raw materials experienced significant momentum after 1900. Coffee, tobacco, sugar, pepper and the old export products were increasingly supplemented with the highly profitable exports of petroleum, rubber, copra, palm oil and fibers.

**Table 3.** Annual Average Growth in Economic Key Indicator, 1830-1990

Periods	Years	GDP per Capita	Export Volume	Export Price	Government Expenditure
Cultivation System	1830-1840	n.a	13.5	5.0	8.5
	1840-1848	n.a	1.5	-4.5	Very low
	1849-1873	n.a.	1.5	1.5	2.6
Liberal Period	1873-1900	Very low	3.1	-1.9	2.3
Ethical Period	1901-1928	1.7	5.8	17.4	4.1
Great Depression	1929-1934	-3.4	-3.9	-19.7	0.4
Prewar Recovery	1934-1940	2.5	2.2	7.8	3.4
Old Order	1950-1965	1.0	0.8	-2.1	1.8
New Order	1966-1990	4.4	5.4	11.6	10.6

Source: Booth (1998:18)

Table 3 shows the annual average growth in economic key indicator 1830-1990. During Ethical period, the annual growths of export volume and export price were higher compared to the other periods. Agricultural exports were cultivated both in large-scale European agricultural plantation and by indigenous smallholder. The momentum of profitable exports led to a broad expansion of further economic development in the archipelago for example, constructing the road system, railroad system (in Java and Sumatra), port system, establishing shipping line – royal packet boat company (*Koninklijke Paketvaart-Maatschappij*, KPM), and subsidizing shipping line into remote corner of the vast archipelago, etc.

### 3. The Japanese Occupation (1942-45)

To support Japan's invasion of North China, which had begun in July 1937, Japan required a lot of petroleum, scrap iron and other raw materials. Previously, such kind of raw materials had to import from foreign sources. The Japanese occupied the archipelago, Indonesia, in order to secure its rich natural resources. German occupation of the Netherlands in May 1940 led to Japan's demand that the Netherlands Indies government supply it with fixed quantities of vital natural resources, especially oil. Although their motives were largely acquisitive, the Japanese justified their occupation in terms of Japan's role as, in the words of a 1942 slogan, *'Nipon Pemimpin Asia, Nipon Pelindung Asia, Nipon Cahaya Asia'* (The leader of Asia, the protector of Asia, the light of Asia). The most crucial legacy of the occupation was the opportunities it gave for Javanese and other Indonesians to participant in modern politics, administration and the military. That gave valuable

experiences and inspirations for the next step of Indonesian independence. In his paper, Dick (2003: p5) mentions the positive points of Japanese occupation in terms of encouraging nationalism which was important for the independence:

*Although only three and half years in duration, the Japanese occupation (1942-45) marked the turning point in Indonesia's 20<sup>th</sup> century history by creating new political and social possibilities (Anderson 1972). Above all, it gave breath to the struggling nationalist movement and infused it with the oxygen of Japanese ultra-nationalism through relentless propaganda and more accessible primary and secondary education. At this critical movement, the democratic impulse was stifled by an even more vigorous and malign authoritarianism and the colonial system.*

### 4. After The Independence

On 17<sup>th</sup> of August, 1945, two nationalists Soekarno and Mohamad Hatta proclaimed the independent Republic of Indonesia with Soekarno as president and Hatta as vice president. Allied forces (mostly British and British Indian troops) did not arrive until six weeks later, by which time the republic had begun to establish itself and nationalist pride had flourished.

Indonesia as a new country has been in the process of choosing of appropriate economic and political system. Dick (2003) notes that Indonesia's 20<sup>th</sup> century can be broken down into the following periods of political and economic change. Table 4 exhibits the classification with that political and/or economic development in italics.

**Table 4.** The Periods of Political and Economic Change in Indonesia in 20<sup>th</sup> Century

Year	Politics	Economics
1901-20	<i>Ethical Era</i>	<i>Expansion and boom</i>
1920-30	Reaction	<i>Expansion</i> (after 1923)
1930-42	Repression	Depression and Recovery
1942-45	Occupation	Catastrophic decline
1945-49	<i>Revolution</i>	Uneven recovery
1950-57	<i>Parliamentary Democracy</i>	<i>Rehabilitation</i>
1957-66	Guided democracy (1959)	Stagnation and decline
1966-73	<i>Modest reform</i>	<i>Economic Recovery</i>
1974-98	Repression	<i>Rapid development</i>
1998-	<i>Democratization</i>	Crisis and stagnation

Source: Dick (2003)

#### 4.1. Old Order

##### 4.1.1. Parliamentary Democracy

Indonesia was lastly independent and formally unified. Nevertheless, the society remained deeply divided by ethnic, regional, class, and religious differences. Its unitary political system, as defined by a provisional constitution adopted by the legislature on August 14, 1950, was a parliamentary democracy: governments were responsible to a unicameral House of Representatives elected directly by the people. Soekarno became president under the new system. His powers, however, were drastically reduced compared with those prescribed in the 1945 constitution.

There was little in the various cultures of Indonesia or their historical experience to prepare Indonesians for democracy. In colonization era, the Dutch had done practically nothing to prepare the colony for self-government. In addition, the Japanese had espoused an authoritarian state, based on collectivist and ethnic nationalist ideas, and these ideas found a ready reception in leaders like Soekarno. Powerful Islamic and leftist currents were also far from democratic. Conditions were exacerbated by economic disruption, the wartime and postwar devastation of vital industries, unabated population growth, and resultant food

shortages. By the mid-1950s, the country's prospects for democratization were indeed grim.

Despite the holding of democratic election in 1955, the years following the struggle for independence were characterized by economic and political problem such as regional dissidence, military-civilian conflict, attempted assassinations and coup d'état and economic stagnation. The system of parliamentary democracy had lost credibility because of frequent changes of cabinet, their inability to resolve intractable political and economic problems, and worsening corruption but it still worked according to an agreed set of rules and there was no obvious alternative (Dick, 2003).

##### 4.1.2. Guided Democracy

A period of Guided Democracy was announced in 1959 because Soekarno had long been impatient with party politics. He suggested in a speech on October 28, 1956, that they be discarded. Soon after, he introduced the concept of Guided Democracy. Although the concept was new in name, its various themes had been part of the president's thinking since before the war. In the first years of independence, his freedom of action had been limited by parliamentary institutions. But on March 14, 1957, the liberal phase of

Indonesian history was brought to an end with Soekarno's proclamation of martial law. In an unstable and ultimately catastrophic coalition with the army and the PKI, he sought to rescue the fragile unity of the archipelago.

In September 1963, Soekarno proclaimed himself president-for-life and presided over a political system in which the civilian nationalist leadership, much of the Islamic leadership, the large Indonesian Communist Party (*Partai Komunis Indonesia*, PKI) and the army were all at odds. This tense and hostile atmosphere was broken on September 30, 1965, when what appears to have been an attempted PKI coup against the Soekarno government. The coup was failed. On March 11, 1966, power was transferred from Soekarno to a high-ranking army officer, Soeharto. The PKI was formally banned the following day. Soeharto became the acting president on March 12, 1967, and the New Order era began.

#### 4.2. New Order

Like Soekarno's Guided Democracy, the New Order under Soeharto was authoritarian, but it was more successful bringing stability to the nation. Apart from rejection of *left*-ism, probably the single greatest discontinuity between the Soekarno and Soeharto eras was economic policy. Soekarno abused Indonesia's economy, undertaking ambitious building projects, nationalizing foreign enterprises, and refusing to undertake austerity measures recommended by foreign donors, because such measures would have weakened his support among the masses. Soeharto used the economy for political ends, but initiated a generally orderly process of development supported by large infusions of foreign aid and investment. Unlike Guided Democracy, their economic achievements were enormous and the well-being of the majority of Indonesian undeniably improved.

Helped considerably by oil revenues after the quadrupling of prices during the 1973

global "oil shock," Indonesia emerged from low to modest prosperity. The development of new, high-yield varieties of rice and government incentive programs enabled the nation to become largely self-sufficient in this staple crop. In most areas of the archipelago, standards of nutrition and public health improved substantially.

Oil revenues were vital for the Soeharto regime because they provided it with resources to compensate groups whose cooperation was essential for political stability. Government projects and programs expanded impressively. Table 5 shows how policy directions of Indonesia were very much affected by international shocks, especially oil price. The oil boom (1973-81) led to a fundamental revision of industrial policy objectives. In the case of trade liberalization in Indonesia, we strongly agree with statement of supporter of deregulation: 'good times mean bad policies; bad times mean good policies'. During the oil-boom period, the Indonesian government followed an inward oriented i.e. state-directed industrialization or import substitution.

The state's heavy involvement in banking and industry, especially the petroleum and natural gas sectors, worked against competition and encouraged corruption on a large scale. Heavy-handed political control and propagandizing of a national ideology (*Pancasila*) may have aided stability, but also did not prepare the nation for a modern political existence. A modernizing, educated, and better-off middle class grew, but gained little or no political clout; poverty was reduced, but some particularly severe pocket appeared to be intractable. When a financial crisis hit in 1997, the New Order lost the economic justification that had guaranteed much of its public support, and there was widespread call for Soeharto to step down. He resigned on May 21, 1998 little more than two months after being elected for his seventh terms as president.

**Table 5.** External Shocks and Policy Direction

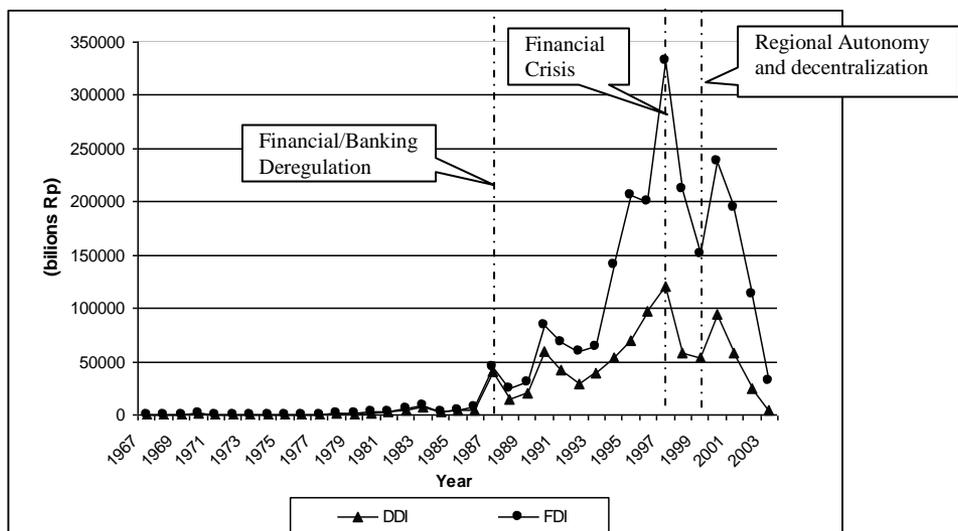
Period	Change in External Environment External	Policy Direction		
		Macroeconomic Policy	Trade and Industrial Policy	Government Regulation
1974-81 Oil boom	Sharp increase in oil prices 1973; non-oil commodity boom 1975-79; second oil price increase	Maintenance of macroeconomic stability, although some inflation from lack of sterilization of oil revenue	Growing inward orientation (increasing import substitution)	Increasing share of public investment and state owned enterprise
1982-85 First external shocks	Decline in oil prices; decline in commodity prices	Macroeconomic stabilization; fiscal austerity, devaluation and tight monetary policy	Strongly inward oriented; proliferation of non-tariff barriers	Continued reliance on State Owned Enterprise (SOE) and regulation of market economy
1986-88 Second external shocks	Sharp decline in oil prices and continued decline in primary commodity prices; shocks on external debt due to yen appreciation	Continued macroeconomic stabilization; devaluation; tight monetary policy and balance budget	Shift to outward orientation	Deregulation of customs and imports, relaxation of investment regulations, reduced reliance of SOE and public investment
1988-92 Non-oil led economic recovery	Stable oil prices, further decline in prices of primary commodity	Maintenance of macroeconomic stability	Further shift to outward oriented economy	Deregulation extended to investment, finance and other areas initial steps towards SOE reform
1993-96 Continued deregulation and some ambivalence	Stable oil prices, some increase in commodity prices, increased competition from other developing countries	Maintenance of macroeconomic stability; increased flexibility of exchange rate and other instrument to assist monetary policy	Continued emphasis on exports, but some deviations to import substitution (petrochem.) and local content (automotive)	Continued deregulation, improvement in financial sector supervision, substantive FDI deregulation
1997 – present Asian Economic Crisis, Commitment to IMF International and Multiregional commitments like AFTA, APEC and WTO	Sharp increase in oil price	Macroeconomic recovery	Deeper integration and accelerating trade liberalization, Elimination of non-tariff measure for agricultural product and measures to protect national car scheme, Removing all import license (for example: the national logistic agency, BULOG), open competition on rice import,	Continued deregulation, improvement in financial sector supervision, substantive FDI deregulation

Source: mainly adopted from Pangestu & Stephenson (1996) with some additional information from: Vansetty *et al.*(2005), Aswicahyono & Pangestu (2000), Amiti & Konings (2005), Basri (2001).

#### 4.3. From 1998 to Present

Soeharto was succeeded by Bacharudin Jusuf Habibie who sought first to resolve the East Timor situation and begin a new and more open electoral process. In 1999, following Indonesia first freely contested parliamentary election since 1955, Abdurrahman Wahid, well-known as both a progressive intellectual and as leader of Indonesia's largest Muslim organization (*Nadlatul Ulama, NU*) became president. His quirky and often uncompromising leadership style, and question about his competency and his health, brought him increasing opposition and eventually serious threats of impeachment. He was dismissed from office in July 2001 in favor of Megawati Soekarnoputri, his vice president and head of the Indonesia Democratic Party of Struggle (PDI-P). Megawati, Soekarno's eldest daughter, was decisively defeated in the September 2004 presidential runoff election by the Democratic Party candidate, retired general Susilo Bambang Yudhoyono. Yudhoyono was sworn in as president in October 2004 for the next five years.

Indonesian economy hit by crisis in 1997. The Indonesian economy now still suffer from severe economic development problems following the crisis and substantial political reforms after the stepped down of President Suharto in 1998. Since the late 1990s, companies have remained wary of investing in Indonesia and an increasing number of manufactures have relocated outside the country because of security issue, deteriorating infrastructure, substantial corruption, high interest rate and increasing labor cost. Figure 5 exhibits trend of domestic and foreign investment value approvals (billion Rp, foreign investment is converted by current exchange rate) 1967/1968 - April 2003. The value of investment covers new project, expansion; and change status and excludes oil and gas, non-bank financial institution, insurance and leasing. It increased sharply for period 1988-1997 and then it decreased after economic crisis 1997. It continued to decline in 2001 and 2002 after regional autonomy was implemented.



Source: BKPM, (2003) *Author's calculation*

**Figure 5.** Trend of Domestic Direct Investment (DDI) and Foreign Direct Investment (FDI)

The 1997-1998 economic downturns hurt Indonesia more deeply and for a longer time than other Southeast Asian nations. In 2003 the government terminated its loan program with the international Monetary Fund (IMF) because of its reluctance to continue implementing unpopular economic restrictions. However, there are positive economic signs in steady domestic consumption, a strengthened currency, and successful small and medium business enterprises.

### **RELEVANCE OF ECONOMIC THOUGHT: FROM DUTCH MERCANTILISM TO LIBERALISM**

The Dutch had given significant contributions in the Indonesian economic history during 350 years of occupation. On the importance of the rise of the Dutch in Indonesia, Dick *et al* (2002:3) notes: "The colonial state with its Napoleonic pedigree was arguably the most fateful technology transfer between Europe and the archipelago". It was the effective way of the colonial state that made a transformation of the economic activity of the region through the establishment of infrastructures, creating better centralized administration and the mass mobilization of local labor for the production of export-oriented products.

By looking through the annals of colonial policy, one might see that mercantilist governments aided colonialism by providing military assistance to support the colonial infrastructure in exchange for a share of profit. In addition to protecting colonial entrepreneurs, governments often played an active role by suppressing forms of production that could harm the home economy. For example, the Dutch government, in early eighteenth century, began the practice of destroying the surplus spices, that is, the portion of the supply that might depress prices below the point that would maximize their return. The true revolution of mercantilist thought was the increased demand for a

unilateral monopoly. The motive for unilateral monopoly was clear enough – the 'laissez-faire' economist Jean-Baptiste Say justified monopoly on the grounds that it served as an inducement for the establishment of trade in such a risky and volatile environment. The Dutch government founded the VOC, which was granted exclusive monopoly rights to engage in trade to Asia.

In parallel with the rapid development of European and commercial, military organization and technology in the seventeenth century, naval power and local alliances enabled the Portuguese and then the Dutch and British to perform increasing control over trading activities in Southeast Asia. It was a gradual process by which the European intrusion proceeded from free trade (rivalry amongst the Europeans) to monopolistic trade and only eventually to occupation and territorial invasion. This process was taken by the Dutch between 1602 and 1789 through the Netherlands East India Company (VOC). The VOC used an unprecedented military capacity to the conduct of its trade. Direct conflict with local states and attempts to control local production as well as trade, increasingly made the VOC from merchant to landlord (Dixon, 1991:61). The VOC over-extended the capacity of the company as expenses in administration and military campaigning rose. Between 1795 and 1800 the VOC was bankrupted and all of its colonial possessions were taken over by the Dutch government. The new colonial state started.

Taking over the control by the Dutch government gave rise to a centralized and focused approach to economic development. There were different approaches conducted by VOC and the Dutch government. The VOC had been an expansive, region-wide trading entity in contrast the Dutch government become much more concerned about how to exploit effectively the resources of the specific territory. In that time the fertile land Java Island was the specific territory. Therefore, the

Dutch government applied Cultivation System (*Cultuurstelsel*, or CS). In spite of the fact that debates about the merits of free trade become very remarkable in the Netherlands, it was decided that the state would directly ensure that production on Java would be directed in generating revenue for the home country.

Under the *Cultuurstelsel* the farming peasant population of Java would be required to produce exported commodities such as coffee, indigo and sugar. The government would buy the crops at an officially fixed price. The crops delivered to the government must be equivalent of one fifth of the value of the farmer's production. The commodities purchased on Java were transported on Dutch ship and sold by auction in the Netherlands by a semi-private trading company which the King was a major shareholder. It was a well-sealed mercantile arrangement. During the period of 1832-52, income from the colony was almost 19% of total income of the Netherlands and during the 1860-66 one third of the Netherlands' state revenue was created through the *Cultuurstelsel* (Fasseur, 1992).

The *Cultuurstelsel* was finished in 1870 with the passing of the Agrarian Law, and the period that followed until 1930 is quite referred to as the liberal period. There were several reasons for that i.e. growing influence of economic and political liberalism in the Netherlands; growing strength of the Dutch industrial and financial bourgeoisie and the general ascendancy of Adam Smith's ideas in many parts of Europe at that time (Ridings 2004). Robinson (1986) argues (in Ridings 2004):

*Beginning in the mid-nineteenth century, the mercantile nature of the colonial economic presence was transformed into an increasingly capitalist enterprise..... To secure an entry for private capital, the Dutch bourgeoisie first had to dismantle the state mercantile monopoly.*

After the abolition of the CS, there was a change in business paradigm from state

intervention and organization of production toward free trade enterprise. It was argued that the extensive state involvement had been a transitional arrangement and that the CS itself had just been a step toward a more liberal, market-driven economy. The practical result was that the state-run culture system was superseded by the spread of corporate plantations. This transition to a free market economy was observed by Geertz (1963) as a state hand-over to the Dutch merchants since they 'did not create, as they later came to claim, the Netherlands East Indies estate economy. They bought it-and rather cheaply considering the social costs of its production. Private investment supported by banking interests expanded agricultural plantation production to the Outer Islands, and also developed much expanded irrigation, railways, port facilities, and processing capacity. It created, according to Geertz, 'a comprehensive agro-industrial structure practically unmatched for complexity, efficiency and scale anywhere in the world. The colonial state supported this development with the provision of infrastructures but the agricultural economy had become a state-facilitated private concern.

## CONCLUSIONS

Before the intrusion of European countries, the archipelago (modern: Indonesia) had international relation (trade activities), especially in the kingdom or empire era. The Hinduism-Buddhism and Islam kingdoms played important international trade. The kingdoms tried to influence each other and it was conducted frequently by doing a war. The eras of pre-colonization; colonization and the independence have colorized the Indonesian economic history. The historical perspective shows that there have been relationships between politic and economic performances. Those can be seen from the growth of GDP, export volume, export price and government expenditure in Cultivation system, Liberal, Ethical, Old Order and New Order periods.

There was a close relationship between the development (history) of economic thought in Europe especially the Dutch and the policy implemented during the colonization era. In the case of colony Indonesia, it was reflected by the establishment of VOC by the Dutch (British Indices Company in British Mercantilism), Cultivation System, Ethic politic, and Liberalism. In the case of the Dutch, the mercantilists in the 17<sup>th</sup> and 18<sup>th</sup> century were quite supportive on the issue of holding an unilateral monopoly on a country, they often disapproved of one singular commercial entity holding titular rights to trade with another country. Mercantilist thought was primarily focused on the goal of advancing one's country and did not necessarily reflect undue devotion to capitalist policies.

In the future, Indonesia needs to fight the label 'missed opportunity economy' by implementing good governance in natural resources and cultural tradition management. During colonization era, Indonesia missed the opportunity to have high economic performance in the late 1930s and in the early 1930s. It might be acceptable situation under the colonization government. However in the independence era, Indonesia missed opportunity to have high economic performance financed by 'oil boom' (1973-81). Bad governance (institutional or political spheres) in managing the opportunity of 'oil boom' had created other problems in following years such as: protectionism in international trade, infant industry, cronyism, conglomeration, corruption and nepotism in the New Order era. The same opportunity might not rise in the future. Sharp increase in international oil price (oil boom) currently in the middle of 2005-2006 did not give an 'opportunity' for Indonesia to have high economic performances. In contrast, it had created new social and economic problems such subsidies, distribution, compensation and so on. Opportunity is becoming threats to our economy.

Indonesian economic history has shown that the New Order government followed 'good condition means bad policy, bad condition means good policy'. Oil boom (1973-81) had given huge amount of government revenues which –to some extent were misallocated. Good condition (in term of government revenue) had encouraged the implementation of inward looking policies (bad policies: international trade restriction, protection infant industry, undesired capital intensive industry, state owned enterprise intervention, etc.). Currently, Indonesia has got healthy situations such as legitimated government, regional autonomy, international liberalization, recovery from the economic crisis, political stability, etc. Now, Indonesia must wait for 'another opportunity' and then must prove 'good condition means good policies'.

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