ETHNIC INEQUALITY AND GROWTH IN INDONESIA UNDER THE NEW ORDER

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ETHNIC INEQUALITY AND GROWTH IN INDONESIA UNDER THE NEW ORDER

Abstract

This paper analyses the extent and sources of inter-ethnic inequality under the Soeharto's New Order government and explore what needs to be done in order to defuse the ethnic tension in future. The widespread view that ethnic Chinese dominates Indonesian economy is exaggerated. Their real share in Indonesian national income is about one-third instead of the much quoted 70 per cent. There are strong indications that inter-ethnic income gap during the last few years of the New Order government had been widened. Ethnic Chinese due to their extensive overseas business network benefited more than their indigenous counterparts from the export-oriented industrialisation strategy practiced during the last ten years of the New Order government. To rectify ethnic inequality, negative discrimination policies including racial occupational and capital market segregation as well as pure income and wealth transfer policy should be avoided as they are largely counterproductive. Positive discrimination policies such as redistribution based on growth and investment are much more effective (*JEL* O53, J15, J71).

INTRODUCTION

The riot against the ethnic Chinese in May this year in Indonesia is widely held as being triggered by widening economic gap between the Indonesian Chinese and their indigenous counterparts under the New Order government. The purpose of this paper is to find out to what extent this view is correct. Another purpose of this paper is to explore what needs to be done in order to prevent the tragedy from being repeated in the future. To achieve this latter objective, this paper, first, examines the causes of ethnic inequality. It then contrasts the Indonesian inter-ethnic redistribution policy with that of the Malaysia. Finally, it draws some policy conclusions as to what needs to be done to reduce the ethnic inequality and tension in the future.

I HOW RICH ARE THE INDONESIAN CHINESE?

Myths about the Indonesian Chinese spread like wild fire in the world press after the May riot. One of the myths is that most Indonesian Chinese are rich. This is obviously far from true. Income distribution within the ethnic Chinese community is just as unequal as that within their indigenous counterparts. The richest Indonesian Chinese consist of only about 40 families, who account for only 0.1 per cent of the ethnic Chinese population (*SST* , June 28th 1998). Most of them, like Liem Sioe Liong, Mochtar Riady, Pangestu, etc. are the so-called *totok* Chinese who are recent immigrants (Schwarz, 1994, p. 109). The majority of Indonesian Chinese are the so-called *peranakan* Chinese who have lived in Indonesia for generations, assimilated into Indonesian culture and have lost most of their Chinese identity. Most of these *peranakan* Chinese are small businessmen, shop keepers, traders and middlemen. Most of them are middle class; but many of them are very poor.

Another widely-publicised myth is that Indonesian Chinese making up 3.5 per cent of Indonesian population control 70 per cent of Indonesia's wealth. This myth has been spreading in Indonesia for sometime (Chalmers and Hadiz, 1997, p.208). But it was not until the publication of Michael Backman's book (1995) entitled *Overseas Chinese Business Networks* by East Asia Analytical Unit of the Australian Department of Foreign Affairs and Trade that this myth has become internationally eminent (Chavez, 1997). Shortly after the publication of this book, Wang Gangwu, an internationally renowned expert in overseas Chinese warned against the potential danger of racial riots triggered by such a glorification of overseas Chinese wealth. In retrospect, his prediction proved to be correct.

Like many books on Asian affairs published by East Asian Analytical Unit, Backman's book is not based on original research but on secondary sources. He simply reproduces the finding of Yamaguchi of Nomura Research Institute (1993) without scrutiny. This finding suggests that Indonesian Chinese control approximately 73 per cent of Indonesian listed firms by market capitalisation (Backman, 1995, p.41). Yamaguchi, however, qualified his finding by an important statement that " control by market capitalisation has been determined after listed firms controlled by the government or foreigners are discounted". Unfortunately Backman chose to delegate this important statement to a small footnote which hardly attracts the attention of most busy politicians and finance journalists. Thus, what Yamaguchi found is that Indonesian Chinese control 73 per cent of the corporate wealth within the Indonesian domestic private sector. Since Indonesia has a relatively large public sector as compared to other Asian developing nations and it has also a sizeable foreign sector, Indonesian Chinese share in Indonesia's wealth could hardly reach the the 70 percentage mark once the shares of these two sectors are accounted for.

So what is the actual Indonesian Chinese share in Indonesia's wealth? Unfortunately, a definitive answer to this question is not possible as there are no wealth distribution data in Indonesia. Income distribution data are available; but they are not classified according to ethnic groups. However, data on national income and its industrial and ownership composition are available. These can be used to make a reasonable estimate of ethnic Chinese share in Indonesia's national income.

To estimate the ethnic Chinese share in Indonesia's national income the following procedure is adopted: First, the industrial branches with significant Chinese presence are identified. Second, the private sector shares of value added in these branches are determined. Third, The Yamaguchi's Chinese domination factor of 73 percent is applied to these private sector shares to arrive at Indonesian Chinese share in total national income.

Table 1: Percentage of GDP by Industrial Origin, 1997

	% Share	**Presence of Chinese Ownership**
1. Agriculture, livestock, forestry and fisheries	16.1	little
2. Mining and quarrying	9.5	little
3. Manufacturing:		
a. Oil and gas	2.6	negligible
b. Non Oil and gas	23.0	substantial
4. Electricity, gas and water supply	1.2	none
5. Construction	7.5	heavy
6. Trade, hotel and restaurants	16.7	heavy
7. Transport and communication	6.8	heavy
8. Finance, ownership and business	7.9	heavy
9. Services	8.6	negligible
10. Total GDP	100.0	

Sources: BPS 1998; Mackie, 1988, pp.240-2 and Mackie, 1995, p.45

Table 1 shows the structure of Indonesian GDP by industrial origin in 1997 in column one. Column two indicates the extent of ethnic Chinese presence in these industries. The information in this column is culled form existing literature on Indonesian Chinese especially from Mackie's insightful studies (1988 and 1995). What these data show is that out of the nine industrial branches, ethnic Chinese ownership can be regarded as significant only in five branches, namely (a) trade, hotel and restaurants; (b) transport and communication; (c) construction; (d) non oil and gas manufacturing and (e) finance.

Table 2: Private, Foreign and State Share in Industries with a Significant Chinese Presence, Late 1980's (%)

	State	Foreign	Private
1. Trade, hotel and restaurant	5	5	90
2. Transport and communication	50		50
3. Construction	5	5	90
4. Non oil and gas manufacturing	24	17	59
5. Finance	65	5	30

Source: Hill, 1996a, p.98.

Table 2 presents the estimate of the state, foreign and private sector share of the value added of these industrial branches for late 1980s(Hill, 1996a, p.98). This shows that private sector dominates trade, hotel and restaurants as well as construction. It also features prominently in non-oil and gas manufacturing; but less so in transportation and communications as well as finance where state sector appears to dominate.

Table 3: Estimate of Approximate Chinese Ownership Share, 1997 (%)

	(1) Value added share	(2) Private sector share	(3) Yamaguchi's domination factor	(4) Chinese share
1. Trade, hotel and restaurant	16.7	0.90	0.73	11.0
2. Transport and communication	6.8	0.50	0.73	2.5
3. Construction	7.5	0.90	0.73	4.9
4. Non oil and gas manufacturing	23.0	0.59	0.73	9.9
5. Finance	7.9	0.30	0.73	1.7
6. Total				30.0

Note: Column (4) = Columns (1) × (2) × (3)
Source: see Table 1, 2 and Text.

In Table 3, the Yamaguchi's finding of Indonesian Chinese domination factor is applied to the private sector shares in these industrial branches to arrive at Indonesian Chinese aggregate share in Indonesian GDP. The result shows that ethnic Chinese share is most probably around 30 instead of the much quoted 70 percent.

However, it should be noted that the above figure might underestimate the ethnic Chinese actual share as it is based on Hill's estimate of private sector share for late 1980s. It is well known that since late 1980s there has been a rise of private sector share especially in the financial sector after the banking reform of 1988. Nonetheless, even if we assume that both the state and foreign sector have been completely extinguished, the ethnic Chinese share would be still be 45 per cent, far below the much-quoted 70 per cent. That this assumption is very unrealistic is obvious, as there has been very little privatisation in Indonesian State sector during this period. Furthermore foreign presence in Indonesian economy is visible to any Indonesian visitor. Thus, 45 per cent can be regarded as the upper and 30 per cent the lower end of the plausible range within which the real ethnic Chinese share lies.

II WHY ARE INDONESIAN CHINESE RICHER?

Ethnic Chinese may only control one-third instead of two-third of Indonesian economy, yet the fact remains that their income share is several times higher than their population share. So what account for their high income share and has their income gap with their indigenous counterparts been widened during the New Order period?

Many factors have been advanced to explain Indonesian Chinese economic success. But according to my view, the followings are the most important ones.

1. Environment

According to one theory, the reason why Indonesian Chinese are richer is because of their superior value system, namely the neo-Confucian value of hard work and thriftiness. I am sceptical about this explanation. The link between Confucian and Indonesian Chinese economic success is tenuous at best. First, the majority of Indonesian Chinese do not speak nor read Chinese let alone understand Confucian classics. Second, Confucius said many things; some are positive to wealth accumulation, such as his stress on hard work and thriftiness. Others, however, are harmful for wealth accumulation. For instance, once he said that "inequality is much more worrisome than poverty". In fact, in the wake of Asian crisis, some Westerners even blame Confucius for the corrupt business practice of Southeast Asian Chinese family firms, which allegedly triggered the financial crisis in Asia. Third, the drive for ethnic Chinese to work harder and save more derives not from their cultural heritage rather from their environment. Many are immigrants from famine-infested southern provinces of China where too many people try to make a living out of a tiny plots of land. Having tasted the bitterness of poverty, they vow not to be poor again and try to get rich as soon as possible. More importantly, they are living in a highly insecure environment because of constant riots and discrimination. Hence, they acquired the Hong Kong Chinese syndrome of living on" borrowed time and space" and attempt to accumulate enough wealth as soon as possible in order to flee the country.

2. Education, Experience and Network

Average ethnic Chinese and businessmen are likely to be more educated and receive more training than their indigenous counterparts given the old tradition of Chinese family which puts educating their children above everything. Furthermore, they are more experienced in commerce and skilful in dealing with complex organisation given that they came from a society, which is more commercialised and urbanised than the traditional Indonesian society (Perkins, 1975, p.6). Most important of all, they have close personal and business relations with their local and overseas counterparts especially in Singapore, Hong Kong, Taiwan, Mainland China, and Malaysia. This local and international networks give them access to markets information, sources of supply , credit, etc.. They also provide means for them to check the credit worthiness of their business associates and impose sanctions against them in case of default in contract and reduce, thereby their business transaction costs

3. Conglomerate Enterprise

Many big Indonesian Chinese business are conglomerates operating in diverse areas including trade, manufacturing, banking, real estate, transport and insurance, etc.. Conglomerate enterprise profits tend to be higher than non-conglomerate ones because of

a. risk pooling through diversification;
b. minimising transaction costs by internalising them within the group;
c. economies of scale; and
d. easier access to credit (Mackie, 1995, pp.53-4).

However, to establish a conglomerate enterprise requires a minimum amount of capital. Indigenous enterprise is more handicapped than their Chinese counterparts in this regard.

Though, Indonesian state enterprises may overcome this financial hurdle, they are, like many public enterprises in the world, hampered by inefficient management practice.

4. Discriminatory Practices

The government discriminatory policies against the ethnic Chinese are counter productive. Instead of protecting indigenous workers and business from unfair competition from their ethnic Chinese counterparts, it had enlarged the income gap between the two. The discrimination practices took the forms of occupational and capital market segregation. According to Mackie (1988, p. 243) ethnic Chinese are excluded almost completely from the following sectors: armed forces, civil services, professional services, entry to serveral leading universities, oil and minerals, plantation sectors, and several spheres of export and import trade. In theory, ethnic occupational and capital market segregation may either decrease or increase ethnic income inequality depending on the occupations and the economic sectors where the discriminated are excluded. But in the Indonesian context, they had definitively the opposite effect. Ethnic Chinese are barred from occupations which maximising non-income objectives (ie leisure, power, prestige etc.) as well as sector with low profit opportunities. They are forced to concentrate on moneymaking sectors such as trade and finance with high profit opportunity instead.

5. Rent Opportunities

The Soeharto regime and the industrialisation policy his government pursued created a lot of rent for ethnic Chinese to capture. Rent is defined here as the difference between the market value of a government favour and what the recipients pays to his benefactors in the government. The type of government and the kind of economic policies it adopts determines rent opportunities. Autocratic regime creates more rent opportunity than a democratic one because there is no check-and–balance for the government 's wide ranging power to dispose of economic resources and intervene in the economy such as granting a monopoly, a logging and mining concession, a large government contract, etc.(Yoshihara, 1988, p. 68)

Rent opportunities in Indonesia are also enhanced by the state-led industrialisation strategy financed by oil adopted from early 1970s to mid-1980s. Under this policy, the government created the following main incentives or rents to promote the targeted industries aiming at substituting imports:

a. Trade incentives. These involve the erection of tariff and non-tariff barriers to protect domestic industries. For example, car imports were banned during 1974-93. In 1993, this was replaced by a tariff ranging from 175 to 275 per cent. As a result, domestic prices were in general kept much higher than the world level. For example, the domestic price of steel was 40 to 50 per cent above the world level during mid-1970s to 1988 (Hills, 1996b, p.159).
b. Financial incentives. These involve the arrangement of policy loans by state banks at a concessionary interest rate which was only half of the private bank lending rate (Hill, 1996b, p.165)
c. Fiscal incentives. Income tax exemption and/or reduction were granted to private investment in targeted industries.

The above incentives or rents would not have been wasted if their allocation were performance based as in the case of the East Asian countries. Unfortunately in Indonesian case, the allocation of these rents was based on political discretion (Hills, 1996b, p.166). As a result, the main beneficiaries were foreign investors, the Indonesian politicians such as the First Family and their bureaucratic allies as well as their Indonesian Chinese partners (i.e. Liem and Bob Hasan etc.).

6. Export-Oriented Industrialisation

Since mid-1980s, due to serious decline of oil price, Indonesia, following the step of East Asian countries, switched its industrialisation policy from import substitution to an export-oriented one. To rid the economy of the anti-export bias generated by the old import substitution policy a reform package including a sharp devaluation of the exchange rate, liberalisation of the import regime and the deregulation of the financial sector had been introduced. These had reduced the rent opportunities significantly for the Indonesian Chinese business. But they benefited from the new industrialisation policy in other ways. To promote manufactured exports, the government needed not only capital, but also know-how and in particular the overseas market connection. Ethnic Chinese as mentioned earlier, have extensive networks with regional financial markets, manufacturers and exporters. Thus, the government had to rely heavily upon them to promote its export-oriented industrialisation strategy. This is evidenced from the strong presence of overseas Chinese factor in Indonesian twin engines of growth during this period, namely the manufactured exports and the inflow of foreign direct investment. Manufactured exports grew at an annual average rate of 30 per cent during 1982-93 (Hill, 1996b, p.76). The share of manufactured exports in total exports surged from 2 per cent in 1980 to 65 per cent in 1997(BPS 1998). As shown

Table 4: Japan and Overseas Chinese Share in Indonesian Exports (million USD)

	1986	1997
1. Hong Kong	345	1785
2. Mainland China	139	2294
3. Malaysia	82	1357
4. Singapore	1239	5467
5. Taiwan	317	1782
6. Total Share (%)	14.3	23.7
7. Japan Share (%)	44.8	23.3

Source: IMF, 1989 and BPS, 1998.

in Table 4, the market share of countries with heavy overseas Chinese presence such as Singapore, Hong Kong, Taiwan, Mainland China and Malaysia had shot up from 14 per cent in 1986 to 24 per cent in 1997. Japan used to be Indonesia's largest export market; but by 1997, the overseas Chinese market had taken over Japan and became Indonesia's largest export destination. Similar pattern can be observed in the foreign investment front. As shown in Table 5, in 1980 Japan was Indonesia's largest foreign investor accounting for 44 per cent of its total foreign direct investment intake in non-oil sector. In contrast the overseas Chinese share was only 15 per cent at that time. But by 1997, Japanese share in all sectors had slipped to 8 per cent whereas that of the overseas Chinese share from Singapore, Hong Kong, and Taiwan alone had rocketed to 22 per cent overtaking Japan and became Indonesia's largest foreign investor.

Table 5: Japan and Overseas Chinese Share in Indonesian FDI (%)

	1980[1]	1992[1]	1994-1995
1. Hong Kong	11.5	13.0	12.3
2. Singapore	2.5	5.1	4.9
3. Taiwan	1.3	9.9	4.8
4. Total	15.3	28.0	22.0
5. Japan	44.4	31.8	8.4

Note: [1] Non-oil FDI only. Data for 1994-1995 is total FDI.
Sources: Hill, 1996a,p.90 and BPS 1995,p.470

III HAS THE GAP WIDENED?

As mentioned earlier, Indonesia's income distribution statistics do not distinguish between indigenous and non-indigenous Indonesian. Hence, no direct evidence is available to confirm the much-suspected widened income gap between the two ethnic groups in the recent years. Nonetheless there are a few indirect evidences. In 1981 Wibisono's study based on the investment registration in government gazettes found that ethnic Chinese domination in Indonesian economy had declined; but the validity and reliability of his finding is contested by Lubis (Oetomo, 1989, p.52).

Another piece of indirect evidence is the trend in relative and absolute inequality in Indonesia. As shown in Table 6, relative inequality as measured in terms of Gini ratio

Table 6: Trend in Inequality

	Gini Ratio	Poverty Incidence (%)
1964-65	0.35	
1967		60.0
1969-70	0.34	
1976	0.34	40.1
1978	0.38	33.3
1980	0.34	28.6
1981	0.33	26.9
1984	0.33	21.6
1987	0.32	17.4
1990	0.32	15.1
1993	0.34	13.5
1996	0.36	
1997		11.0
1998		50.0*

Note: * preliminary estimate
Sources: Hill 1996a, pp.193-4; BPS 1998 and SBT 1998.

increased in 1978 at the height of the oil boom followed by a steady decline until 1990. Thereafter it increased again. This seems to suggest that inequality worsened during the liberalisation and export-oriented industrialisation period. However, the data is not detailed enough to infer that the inter-ethnic income gap had widened since the rise of overall inequality during this period may have been caused by increased intra-rather than inter – ethnic inequality.

Table 6 also confirms the international experience that growth definitely benefits the poor. The percentage of population under the poverty line fell from 60 per cent in 1967 to 11 per cent in 1997. It rose again to 50 per cent in mid-1998 as result of the financial crisis.

IV WHAT CAN BE DONE?

To reduce the ethnic income inequality valuable lessons can be learned from Indonesian past policy and the Malaysia experience.

1. Past Policy

Indonesia in the past had adopted both negative and positive discrimination policies against the ethnic Chinese in an attempt to rectify the ethnic income inequality. Negative discrimination policy persued in the past included ethnic occupational and capital market segregation. These policies apparently did not pay. As mentioned earlier, they led to social and economic stratification along the ethnic line.

Positive discrimination policy carried out in the past included the promotion of indigenous business group and the pure wealth and income transfer. Indigenous business group was promoted by two measures. First, they were given subsidized interest loans under the subsidized credit program introduced after the Malari riot in 1974 (Schwarz, 1994, p.119). Second, they were given preferential treatment when tendering state projects under the mechanism of KEPPRES (Presidential Decision 10 and 14a)(Chalmers and Hadiz, 1997, p. 206). The effectiveness of both policies was limited. They had created a lot of favours or rents instead which were captured manly by politically connected individuals (Schawrz, 1996, pp.118-9).

Pure wealth and income transfer aimed mainly at big ethnic Chinese conglomerates. In 1990, Soeharto in his summit with big Chinese business tycoons in his ranch in Tapos urged them to sell up to 25 per cent of their shares to cooperatives. As the transfer of shares was not compulsory but voluntary, only 200 companies signed up. Out of the 195 companies, which had actually agreed to transfer some of their shares, so far they agreed to transfer less than one per cent instead of the 25 per cent, requested. (Akram-Lodhi, 1997, p.24).

The limited progress of wealth transfer program prompted the President to issue a decree in 1995 which required Indonesian's largest taxpayers to contribute up to 2 per cent of their post tax income to a poverty alleviation fund. The money fed into this fund was to be distributed to some 11.5 million of the poorest families in amount of Rp20, 000 each - 2000 in form of saving deposit and 18,000 in form of loan at an interest rate of 6 per cent per annum. Rp20, 000 equal to less than $9 at then exchange rate. Hence it was mere a drop in the ocean. Furthermore most loans were allocated to the recipients according to needs with no security asked. Hence the default rates were very high (Macleod, 1997. P. 26).

2. The Malaysian Experience

Malaysia's inter-ethnic redistribution policy under the New Economic Policy (NEP) has been much more positive than that of Indonesia. There were two main prongs of Malaysia's redistribution policy. One is poverty alleviation regardless of race. To achieve this, both rural and urban poor were given greater access to productive assets, inputs, credits, training, processing and marketing facilities and basic social services (Joma and Ishak, 1997, p.614). The second prong of the policy is to eliminate the identification of ethnicity with economic function. This is to be achieved by two mechanisms. One is the preferential treatment of the indigenous in training (especially in university admission and scholarship allocation) and recruitment (especially in the state sector). The second mechanism aims at creating a Malay business class owning at least 30 per cent of the corporate sector by 1990 (Jomo and Ischak, 1997, p. 615).

Not all aspects of Malaysian policy had been implemented successfully. For example, in 1975, the Malaysia government introduced the Industrial Coordination Act (ICA) which required private-manufacturing firms beyond a certain size to ensure that at least the indigenous interests owned 30 per cent of equity. This act had let to sharp drop of both foreign and private investment. It is estimated that during 1976-1985 some M$30 billion from the Malaysian Chinese community had fled the country. This had partly contributed to the Malaysia's deep recession in mid-1908s. However, the government proved to be flexible enough in its policy implementation. Since 1987 it suspended and relaxed some of the rigid requirement of the ICA in order to attract new investment. And subsequently this had helped Malaysia to achieve rapid recovery (Jomo and Gomez, 1997, p.365).

Despite the above setback and widespread abuse of the favours or rents created by the government inter-ethnic redistribution policy, the Malaysian experience is generally held to be a success. The proportion of Malay professionals increased from 4.9 per cent in 1970 to 31.9 per cent in 1992. Their corporate wealth share increased from 2.4 per cent in 1970 to 18.2 per cent in 1992 (Jomo and Gomez, 1996, pp.358-9 and 361).

Why has Malaysian policy been successful? What lessons can be learned from its experience? One important lesson is that redistribution policy should be growth oriented. It is widely accepted that Malaysian policy had been successful because of its strong growth orientation (Jayasankaran, 1995). Why is growth important? First, it increases employment and income opportunities for the poor, most of which are indigenous people in Malaysia. Secondly, it provides increased business opportunities for indigenous business groups.

Another important lesson from Malaysian experience is that to connect redistribution and growth, redistribution policy should be investment-oriented instead pure transfer. Pure transfers merely mean robing the rich to pay the poor. Such a policy is likely to have serious negative impact on investment and work incentive and, hence growth. Consequently, the poor may end up being worse off.

Malaysian redistribution policy is not a simple transfer policy. This is evidenced from the fact that despite the rise of the share of Malay in corporate wealth, the Chinese share did not decline but actually increased from 27 percent in 1970 to 38 per cent in 1992 (see Table 7). The increase of the share of Malay occurred not at the cost of Chinese but at the expense of the foreign share. The state enterprises bought out foreign share. State enterprises were then privatised, the beneficiaries of which were mainly Malay private firms.

Table 7: Capital Ownership in Malaysia's Limited Companies (%)

	Malay	Chinese	Indian	Foreign
1970	2.4	27.0	1.1	63.4
1992	18.2	38.0	1.1	32.4

Source: Jomo & Gomez, 1996, pp.358-359.

Malaysia's redistribution policy centred on human capital investment among the indigenous people through preferential treatment in education and training. According to new growth theory, human capital is one of the most important factors for growth. It is true that many ethnic Chinese had much resentment against the favours given to Malay and other indigenous people in university admission and scholarship allocation as these violate the principle of meritocracy. But this policy is justified in the sense that it overcame the barriers the indigenous face to receive a decent education because of their home environment and inadequate financial resources.

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