How was the Market Economy Implanted in Developing Countries? The Cases of Chile and Indonesia*

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I. Introduction

In the last two decades liberal, market-oriented economic reforms became a generalized tendency not only in the western capitalist nations but also in the developing areas. Virtually all the countries of Asia, Latin America and East Europe left behind state-led and inward development strategy and set up reforms toward more open market economies. One of the remarkable features in this process has been the growing role played by technocrats, many of whom have had their graduate studies in economics in renowned universities abroad.

Among others, Chile has been considered as the emblematic case of technocrat-led successful economic reforms. After the economic collapse under the leftist government, the Chilean military government abandoned the decades-long dirigisme and took a decisive step to a sweeping economic liberalization in the mid-1970s. Despite a short return to interventionism in the mid-1980s, economic reforms were retaken and consolidated afterward, resulting in sustained growth combined with decrescent rate of inflation. The architects of the reform were frequently called “Chicago Boys,” since most of them had done their graduate studies in the University of Chicago through an academic program signed in 1956.

Analogous to the Chilean technocrats are those of Indonesia, commonly called “Berkeley Mafia” by their critics. They were also a group of economists who did their graduate studies in American universities through a same kind of academic agreement as the Chilean. They ascended to important governmental positions in the late 1960s with the advent of Soeharto’s New Order government after the breakdown of Sukarno regime in the middle of economic turmoil. They quickly took a set of stabilization measures while subsequently implementing a series of liberalizing policies. As a result, by the early 1970s, they succeeded to restore macroeconomic stability with satisfactorily high growth rate.

In both cases, these economists remained in crucial posts in economic policymaking for a considerably long time, only to be succeeded by younger generation of economic technocrats. However, the long-term evolution of economic liberalization has been fairly different in two countries. While Chile continued and consolidated market-oriented reforms by the end of 1980s, the liberalizing process in Indonesia has been rather intermittent and often combined with interventionist measures.

The aim of this paper is to examine how the market economy was introduced, implemented and, eventually, consolidated in these two countries. Firstly, it focuses on the role of the university agreements

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promoted as part of the post-war US aid policy, which were the origin of the economic technocrats. Secondly, the process through which these US-trained economists reached the crucial positions in the economic policymaking in each country is explored. Just as seeds need time enough to grow and foolish, it took several years for the US-trained economists to ascend to the decision making positions. Lastly, it examines a series of political factors that conditioned the course of economic liberalization taken in each country, some of which would explain the difference between two cases.

It has been often claimed that market reform has prevailed among developing nations just because it provides a correct set of measures. According to this view, these countries finally encountered the "good economics" after repeating erroneous policies based on unfounded economic thought.[1] Opposite to this view was that of dependentistas, who qualified the Chilean and Indonesian technocrats as a symbol of dependence, accomplices of human abuses and even as authors of an "economic genocide." They emphasized the role of the United States in the establishment of authoritarian rule as well as in the shift in economic policy orientation in those countries.[2] These two positions might contain some of the truth. However, they tend to fall into a simplistic view and overlook the peculiarity of each case.

Later on, as the trend toward market-oriented reforms prevailed in the developing areas, it have been claimed that comprehensive studies on the role of economic technocrats who are in charge of these reforms are vital. They embarked on comparative studies of interrelationship between the reform implementation and the ascent of technocrats, especially in Latin American countries. They also shared interests in institutional and political conditions that allowed these technocrats to rise and exert continuous influence on economic policymaking.[3] This paper intends to contribute to these studies by comparing two paradigmatic cases of Asia and Latin America.

It also emphasizes the role of ideas in political changes, particularly that of imported ideas in the shift in economic policy orientation in the developing countries.[4] On the one hand, the university agreements are analyzed as a concrete case of ideational transfer from the center to the periphery. On the other hand, it argues that the way ideas are internalized varies from one political setting to another.

II. Training economists through university agreements: the birth of "Chicago Boys"[5] and "Berkeley Mafia"[6]

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1 For example, see Harberger (1997).

2 For example, see Frank (1976), O'Brien (1981) and Ransom (1975).

3 See Markoff & Montecinos (1994) and Centero and Silva (1998). About the Chilean technocrats see Silva Patricio (1991) and Huneeus (2000). For studies on the technocrats in Southeast Asia, see Milne (1982) and the special issue of *Asian* Survey on the topic. *Asian Survey*, Vol.XVI, No.12, December 1976.

4 See, for example, Hall (1989), Sikkink (1991) and Goldstein & Keohane (1993).

5 Some of the representative figures of the so-called "Chicago Boys" are **Sergio de Castro** (M.A. and Ph.D. in Economics, University of Chicago; Minister of Economy, 1975-76; Minister of Finance, 1976-82), **Pablo Baraona** (M.A. in Economics, University of Chicago; President of the Central Bank, 1975-76; Minister of Economy, 1976-78), **Sergio de la Cuadra** (M.A. in Economics, University of Chicago; President of the Advisory Committee on Tariff Policy, 1975; President of the Central Bank, 1982; Minister of Finance, 1982), **Alvaro Bardón** (M.A. in Economics, University of Chicago; President of the Central Bank, 1976-81), **Rolf Lüders** (M.A. and Ph.D. in Economics, University of Chicago, Bi-minister of Hacienda and Economy, 1982-83) and **Miguel Kast** (M.A. in Economics, University of Chicago; Minister Director of the National Planning Agency

U.S. Foreign Aid Policy in the 1950s and the role of university agreements

The postwar American aid policy to the development areas started with President Truman's enunciation of the Fourth Point of his inaugural address of January 1949.[7] Immediately after the end of the World War II, the priority of the U.S. foreign policy was placed on the reconstruction of the European nations while the concerns for the developing nations was relatively low. However the outbreak of the Korean War in 1950 changed the perception of American policymakers, convincing them the necessity to engage actively in developing areas to counteract the communist expansion.

American aid policy toward developing areas was based both on the cold-war ideology and on its peculiar liberal tradition.[8] During the 1950s substantial part of the American aid to developing countries was targeted to military assistant programs and only minor part was oriented to programs with no military purposes. The economic aid and the technical assistant program were considered as the complement to the military assistant programs. American policymakers feared that growing dissatisfaction of the people of Asia, Africa and Latin America owing to the insufficient economic development could make them vulnerable to communist temptation. To improve their socioeconomic conditions, it was considered necessary to disseminate the American modernity with its advanced knowledge and technology as well as its liberal ideals to those areas, thus diminishing the communist threat.

University agreements were considered as an appropriate tool for these purposes. From 1950s on, U.S. official aid agency, with the cooperation of private foundations (such as the Ford, the Rockefeller and the Carnegie),[9] promoted fellowship programs between selected American universities and the core universities in developing countries to train the leadership cadre who would carry out the modernization project of their home countries in an ordered manner. From 1953 on, a bunch of university agreements

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(ODEPLAN), 1978-80; Minister of Labor, 1980-82; President of the Central Bank, 1982).

6 The main figures of the so-called "Berkeley Mafia," who were invited as economic advisors of Soeharto in 1966, are **Widjojo Nitisastro** (Ph.D. in Economics, University of California, Berkeley, 1961; Chairman of the National Planning Board (BAPPENAS), 1967-71; Minister of State for National Development Planning, 1971-73; Coordinating Minister for Economics and Industry and Chairman of BAPPENAS, 1973-83), **Ali Wardhana** (Ph.D. in Economics, University of California, Berkeley, 1962; Minister of Finance, 1968-83; Coordinating Minister for Economics, Industry and Supervision of Development, 1983-88), **Mohammad Sadli** (M.E. in MIT, 1956; study at the University of California, Berkeley, 1956-57; Ph.D. in Economics, University of Indonesia, 1957; Minister of Manpower, 1971-73; Minister of Mining, 1973-78), **Emil Salim** (Ph.D. in Economics, University of California, Berkeley, 1964; Vice Chairman of Bappenas, 1969-73; Minister of State for the Improvement of the State Apparatus, 1971-73; Minister of Communication, 1973-78; Minister of state for Development Supervision and the Environment, 1978-83; Minister of State for Population and the Environment, 1983-93) and **Subroto** (M.A. in Economics, McGill University, Montreal, 1956; Director General of Marketing, Department of Trade, 1968-71; Minister of Transmigration and Cooperatives, 1971-73; Minister of Manpower, Transmigration and Cooperatives, 1973-78; Minister of Mining and Energy, 1978-88).

7 "Fourth. We must embark on a bold new program for making the benefits of our scientific advantages and industrial progress available for the improvement and growth of underdeveloped areas." "Inaugural Address of Harry S. Truman, January, 1949".

8 About the American "liberal tradition," see Packenham (1973), pp. 18-22.

9 About the relationship between the U.S. foreign policy and these American private foundations see Berman (1983).

were given birth as a consequence of the triangular cooperation between the aid agency, private foundations and representative American universities. Behind these agreements was the conviction of both the officials of the aid agency and the staff of the foundations that the progress in developing nations should be achieved in an ordered process. Thus it was preferable that the change should be headed by a group of elites with technical capability and not by revolutionaries supported by mass movement.

The basic model of these university-to-university agreements had following two dimensions. On the one hand, each year a group of student from the recipient university of the developing country was granted fellowship to study in American universities. On the other hand, a contingent of American professors were sent to the recipient university to bring about institutional reforms, which could include the revision of curriculum and the creation of research centers. The objective was to implant American-type educational programs in order to assure the reproduction of American-style experts after the conclusion of the agreement. The returnees were often employed in their home institution for that purpose. The two cases treated below are the typical cases of these university-to-university agreements described above.[10]

Agreement between the University of Chicago and the Catholic University of Chile (1956)[11]

In the 1950s the prevalent economic thought in Chile was the so-called structuralism that was advocated then by the U.N. Economic Commission for Latin America (ECLA), with its headquarters in Santiago. The world economic slump of 1930s hit hard the Chilean economy based fundamentally on the mining exportation, forcing the country to change its economic strategy. Toward the end of that decade Chilean government took a firm step to propel the ongoing process of import substitution industrialization (ISI), increasing progressively the role of the state in economic matters. The new economic strategy was accordant with the structuralist economic thought, originated with Prebisch and his colleagues in the ECLA, which insisted on the necessity of industrialization to overcome underdevelopment and attribute a substantial role to the State. Form the 1950s on, this school prevailed among Chilean academic circles as well as among the emerging political forces.

The purpose of the agreement between the University of Chicago and the Catholic University of Chile was to introduce advanced knowledge of mainstream economics to Chile, countervailing, in the long run, this predominance of structuralist economic thought. The agreement was promoted by the ICA officers, with the cooperation of the personnel of the U.S. Embassy in Santiago, who were concerned about the negative effect of dirigiste tendency in Chile for the American interests. The Catholic

[10] However, apparently the economists-training was not a priority in ICA University Contracts programs at least during the 1950s. For example, in December 1959 there were 96 programs of such kind in operation, within which Chicago-Chile project was the only economics program. Humphrey, ed. (1960)

[11] The most thorough and penetrating study about this agreement can be found in Valdés (1995). About the "Chicago Boys, " see Figueroa (1984), Fontaine (1988) and Cavallo et al. (1997)..

University of Chile showed great interest in the program, so as to reinforce its economic school which was in a feeble situation.[12] The program was also welcomed by Department of Economics of the University of Chicago, as a means to disseminate its liberal economic principles to underdeveloped world as well as to recruit promising graduate students.[13]

The agreement was signed in March 1956 between two parties as an ICA's Point-Four program with the financial support of the Rockefeller and Ford foundations. Originally it had duration of three years from 1956 to 1959, but it was extended two times to finish ultimately in June 1964. The academic contract was consisted in two elements. On the one hand, the Department of Economics of the University of Chicago received every year several Chilean students to matriculate in the graduate courses. On the other hand, the Department sent teaching and administrative staff to effectuate the reorganization of the Economic school of the Catholic University as well as to give classes. With their effort, the curriculum was changed into more American-style one and a new center for economic research was created.

Through the agreement a group of Chilean students went to realize their graduate study in economics at Chicago and many others have done it after the termination of the agreement. When they returned to Chile many of these Chicago-trained economists were hired in the Faculty of Economic and Social Science of the Catholic University as full-time professors.[14]

The shared experiences of hard graduate studies in Chicago as well as those of founding work of the economic school in the Catholic University[15] cultivated the esprít de corps among the economists, which helped them to overcome their adversaries and to accomplish their program as a coherent team under the military rule. Among them, the leadership of De Castro has been considered an important factor of their success.[16] From mid-1970s they would monopolize principal posts in the economic authorities.

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[12] At first, they proposed this agreement to the University of Chile, which was the leading national university of the country. But its Faculty of Economics, controlled by both structuralist and leftist economists, rejected the idea. Then they turned to the Catholic University, the second important university at that moment, where the idea was welcomed. Before the signing of the agreement with the University of Chicago, the Catholic University of Chile "had only a School of Commerce, imparting the principles of accounting, administration, and mathematics, but not economics." Valdés (1995) pp. 114-117 and Fontaine (1988), pp. 23-24.

[13] Valdés (1995), pp. 93-99.

[14] By 1959, A total of twenty-one young Chilean economists had been sent to the University of Chicago and eleven have returned to Chile. Of that number four have been given full-time positions in the Catholic University. ICA. *Review of Mutual Cooperation in Public Administration for 1959*. These returnees accomplished their mission to consolidate the reorganization of the School of Economics and gained the control of the entire faculty in the mid-1960s, when Sergio de Castro was designated the Dean of the faculty, while Pablo Baraona and Rolf Lüders were assigned the Directors of the economic school and the center for economic research of the faculty, respectively.

[15] In the 1960s Chile saw a boost of student movement like any other part of the world. Catholic University was not an exception. In August 1967 the university's student organization (FEUC) controlled by Christian democrats occupied all the buildings of the faculty except for the Economic School controlled by the Chicago-trained professors. Years later the right wing student organization, called *gremisalistas*, seized the controlled of the FEUC, with whom some of the "Chicago Boys" maintained a comradeship. The close relationship between the "Chicago Boys" and the *gremialistas* continued under the military regime with the former as economic advisers and the latter as political advisers.

[16] Harberger (1993), p.345.

Agreement between the University of California-Berkeley and the University of Indonesia[17]

In the 1950s Indonesia lacked professional economists in the strict sense of the word. Although separate faculty of economics was established in the University of Indonesia in 1950, it suffered from permanent shortage of specialized professors in economics.[18] This is why Sumitro Djojohadikusumo, the dean of the faculty between 1951 and 1957, was looking for the possibility to have some kind of academic agreement with foreign universities to transform the faculty in an advanced center for economic education. Sumitro got acquainted with Michael Harris, representative of the Ford Foundation in Jakarta, who eventually arranged the agreement between the University of California and the University of Indonesia.

The other factor that promoted the signing of the agreement was the U.S. officials' concern about the economic nationalism embraced by the Indonesian political leaders. Indonesia had just achieved its independence from Holland officially in 1949 and like other newly independent countries Indonesian political and military leaders in the 1950s had a strong nationalist bias. In the economic field, the nationalist sentiment was reflected in the prostate, anti-foreign, and anti-capitalist tendencies of the Indonesian statesmen, which would exacerbate under the "guided democracy" of Sukarno in the late 1950s and the first half of the 1960s.

The contents of the agreement are identical with that between the University of Chicago and the Catholic University of Chile signed in the same year.[19] The duration of the contracts was two years from July 1956 to June 1958, which was extended until 1960. Through the agreement dozens of Indonesian young economists went to Berkeley to dedicate themselves in the graduate study of economics. At the same time, a group of American professors were sent to the University of Indonesia to be engaged in the modernization of the Faculty of Economics (FEUI).

Some of the young economists who studied in the USA returned to the University of Indonesia, where they devoted themselves in consolidating the FEUI as an advanced center for economic studies. As their Chilean counterparts, they had to fight against the leftist campaign for the control of the faculty. Through the shared experience in Berkeley and FEUI as well as in the New Order governments as members of the economic advisor team, they gradually transformed into a cohesive group. The leadership of Widjojo Nitisastro also played an important role in this process.[20]

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[17] Ransom (1975) describes this agreement and the "Berkeley Mafia" in a critical perspective from a leftist view, while Makita (1999) examines the agreement in detail using the Ford Foundation documents. Glassburner (1978, 1991) Sadli (1993), Salim (1997) and Subroto (1998) offer views from the actors who participated directly in the process. For an overview of this process, see Bresnan (1993), pp.51-85.

[18] See, Koentjaraningrat, ed.,(1979), Higgins (1990), p.44 and Wie (2001).

[19] However, there were some differences. On the one hand, the program was financed fully by the Ford Foundation and the ICA didn't finally participate. On the other hand, the Indonesian government also participated as one of the signers.

[20] In Berkeley Widjojo organized discussion group among the Indonesian economics student on Saturday, in which "they always revolved around the theme of how Indonesia should be developed." One "could perhaps say that the origins of the

III. The rise of technocrats and the process of economic liberalization

Chile

When the group of Chicago-trained economists was called to serve as the economic advisors of the military junta in 1973, seventeen years had passed since the signing of the academic agreement between the University of Chicago and the Catholic University of Chile. During this period they gained the control of the Faculty of Economics of the Catholic University and subsequently built up relations with conservative political groups, a sector of entrepreneurs and some naval officers.

At first, their social influence was minimal because of the predominance of the structuralist economic thinking in the academic institutions as well as in the governmental sphere. Parallel to the structuralism, theories of dependence, which was a derivation of the structuralist doctrine, privailed among the left-wing social scientists. There was little room for the Chicagoan monetarist thought in Chile during the 1960s.

As for the business sector, the bulk of Chilean entrepreneurs still accepted the necessity of state-led industrialization in the mid-1960s. Even the entrepreneurs who supported the political right accepted a kind of mixed economy. Only the most internationalized segment of entrepreneurs who had strong ties with financial sectors stood up for market economy. It was the latter group who gave support to the Chicago-trained economists in the Catholic University. Especially the *Banco Edwards* Group, one of Chile's oldest conglomerates, played an active role to connect the economists with outer world and to disseminate their writings through the influential newspaper *El Mercurio*.[21]

In 1963, the *Banco Edwards* Group created the Center for Social and Economic Studies (CESEC) with the participation of Chicago-trained economists. Its main objective was to overcome "the lack of economic ideas in the rightwing sectors" and to enlighten Chilean entrepreneurs about the merits of market economy.[22] The economists gathered in the CESEC were invited to participate in the elaboration of economic program of rightist candidate Jorge Alessandri for the 1970 presidential campaign. The draft they prepared proposed "swiftly opening up the country to foreign trade, the immediate and total

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'Berkely Mafia' could be traced to this Saturday discussion group." Salim (1997), p.54. Salim also admits the leading role of Widjojo within the team of economists when they were in government posts. He says, "Looking back on my experience as a cabinet minister for over two decades, I would like to point out that it was Widjojo who was the real architect of the New Order. Widjojo was able to carry out his economic policies because Soeharto trusted him; … Widjojo was also able to rely on us, his fellow economists, because we all shared similar views on the need to pursue sound economic policies." On the other hand, Mohammad Sadli points out the existence of "a bond of mutual loyalty" among the group, which, according to him, "was never duplicated in the other Southeast Asian counties- not in Philippines and not in Thailand." Sadli (1993), pp.48-49.

[21] The *Banco Edwards* Group controlled a large number of important corporations such as the *Empresa "El Mercurio"* and the *Compañía Cervecerías Unidas* besides the bank. *El Mercurio* is the most traditional and influencial newspaper in the country. It is well-known that the CIA financed the newspaper for anti-Allende campaign before and after his electoral victory.

[22] Valdés (1995), pp.227-228.

elimination of price controls, and establishing market mechanisms for all sectors."[23] However their proposal failed to convince pro-Alessandri entrepreneurs who still believed in the validity of mixed economy.

After the victory of Allende in 1970, some of the Chicago-trained economists joined a working group, dedicating themselves in the elaboration of an alternative economic program for an eventual new government. The group was financed by the Society for Industrial Development (SFF) and possibly by the CIA. Through the working group, these economists established their first contact with some naval personnel. The final version of their "Program for Economic Development" was handed over to the navy just after the military coup.[24] Soon after the coup they were called to the military government as economic advisors.

Process of economic liberalization (1973-1990)

The economic liberalization process in Chile under the military regime can be divided in four periods: (i) gradual liberalization (1973-1974); (ii) radical liberalization (1974-1981); (iii) economic crisis and suspension of liberalization (1981-85); and (iv) consolidation of market reform (1985-89).

The first one and a half year after the military coup was characterized by certain indecision within the regime concerning the intensity of the processes of stabilization and liberalization. The Chicago-trained economists had not yet gained the hegemony in economic policymaking and a gradual approach was taken as a consequence. Partly because of the unfavorable external conditions, the result was the persistence and deepening of the economic imbalances, which pave the way to the application of a more radical reform.

In the second period the "Chicago Boys" acquired almost total control of economic policymaking. After the announcement of shock policies in April 1975,[25] an avalanche of new measures came into being to accelerate the liberalization process. In the external sector, the multiple exchange rates was unified in a single rate, while complex tariff system with an average of almost 100% before 1973 was fixed in a uniform tariff of 10% by the end of 1970s, with the exception of automobiles. Also quotas and other non-tariff barriers were abolished. At the same time, restrictions on foreign investment were lifted and the discrimination from domestic investment was eliminated.

In the domestic spheres, interest rates were freed and restrictions on private loans were eliminated, while the state-owned banks were privatized. In addition to the liberalization of capital market, also prices were freed except for salaries. As for fiscal policy, wealth and profit taxes were removed and a

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[23] *Ibid.* pp.239-240.

[24] About the detail on the first contacts between the economists and the military, see Fontaine (1988), pp.11-20. This "program for development" was later published with its nickname, "El Ladrillo," by the Centro de Estudios Públicos with an introduction written by Sergio de Castro. Centro de Estudios Públicos (1992).

[25] In April 24, 1975 the Finance Minister Jorge Cauas announced the Economic Recuperation Plan, whose main points were: (i) curtailment of annual expenditure in every governmental branch; (ii) temporal increase of 10% in income taxes; (iii) acceleration of privatization; and (iv) strict monetary policy. Edwards & Edwards (1992), pp.46-47.

value-added tax of 20% was introduced, while public personnel were drastically reduced to curtail the fiscal expenditure. In the social sector, a new labor plan was introduced in the 1979, which flexibilized significantly the labor market in favor of the employers. In 1981 a new social security system came into effect. Private pension funds (AFPs) were created to administer pension funds on individual contribution basis. Also the health care system was partially privatized in the early-1980s. As for the privatization, the bulk of firms nationalized during the government of Allende were re-privatized in the first years after the coup and subsequently stocks of more than a hundred companies were sold through auction in accordance with the financial and trade liberalization.

In consequence, Chile achieved an annual average growth rate of 8% between 1976 and 1981 while the rate of inflation lowered from more than 600% in 1973 to less than 10% in 1981. Fiscal balance was reestablished and reserve of foreign currency increased from US$167 millions in 1973 to US$4,074 millions in 1980.[26]

But the "Chilean Miracle" didn't last for long. In the biennium1982-1983 Chilean economy experienced the worst crisis after the economic slump of the 1930s. In the 1982 the GNP fell by 14.4% and it was still negative in 1983. External debt reached approximately 113% of GNP and the unemployment rate soared.[27] The economic authorities forced to intervene in important banks and financial institutions to secure the entire financial system. The Chilean peso, which had been fixed at 39 per dollar from 1979, was revalued by 18% in July 1982. The uniform tariff was raised to 35% in 1984.

From the 1985 onward the liberalization process was resumed by the so-called "second generation of Chicago Boys," who consolidated and deepened the economic reform initiated by their predecessors. While the latter were famous for their orthodox rigidity the former were considered to be more "pragmatic" in their economic management. They established a series of measures to promote exportation, especially that of "no traditional goods," and further advanced in the privatization. The banks and firms intervened during the economic crisis were re-privatized, while advance was made in the privatization of large core state firms, such as telephones and electricity.

The economic authority after 1985 not only succeeded in overcoming the economic crisis but also laid the foundation for sustained economic growth. The GDP growth averaged 6.2% a year in the 1983-92 period,[28] while the rate of inflation was gradually decreased. Their success contributed to the continuation of the basic orientation in economic policies by the democratic government led by a center-left coalition in the 1990s.

Indonesia

Like their Chilean counterparts, the Indonesian economists built up their social links based on the

[26] Meller (1996), p.195.
[27] *Ibid*. pp.198-99.
[28] Bosworth, Dornbusch & Labán, eds. (1994), p.9.

Faculty of Economics of the University of Indonesia (FEUI).[29] Although there was a political and ideological struggle with leftist group within the faculty, those economists united against external pressures. In the university, besides teaching in the FEUI they worked in the National Institute of Economic and Social Research (Lecnas), where they often "discussed the burning issues of the day."[30] However the most remarkable episode was the fact that some of the FEUI economists were teaching at the Staff and Command School of the Army (Seskoad) in Bandung, where they cultivated close relationship with some military officers including Soeharto himself.[31] Thanks to this experience they were invited as Presidential economic advisors soon after the establishment of the New Order regime.

Other important events in which the FEUI economists played an outstanding role were three seminars celebrated in 1966, i.e., during the transition period from the Sukarno's Old Order to the Soeharto's New Order. The first and second seminars were held in January and May by the Indonesian Students Action Association (KAMI) and the Association of Indonesian University Graduates (KASI) with the participation of number of prominent political and military figures. In these seminars, the FEUI economists criticized the erroneous economic policies under Sukarno government and proposed their own recipes to deal with the economic difficulties the country was facing. Their clear-cut explanation won the recognition of the audience. However, it was their participation at the Second Army Seminar on August 25, when the FEUI economists attracted Soeharto's attention. In these seminars, the FEUI economists discussed extensively on economic stabilization and rehabilitation, through which a 'cookbook' of 'recipes' for dealing with Indonesia's serious economic problems" was forged.[32]

The FEUI economists were invited as the economic advisors of the new government and the economic program they elaborated was incorporated in the Decree of the Provisional People's Consultative Assembly No.23 of July 1966. After reaching an agreement with Western creditors on the new concessionary loans in September, the government announced a series of new policies for economic stabilization and rehabilitation prepared by those economists on October 3 of the same year. In March 1968, Soeharto formally assumed the presidency and assigned the FEUI economic advisors to the key positions of the economic authorities in the subsequent years. Many of these economists, now called technocrats, remained in the government until early-1990s and saved the country from severe economic difficulties on repeated occasions.

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[29] Indonesia in the late 1950s and early 1960s was not quite receptive to the US-trained economists, since the discipline of economics was not so appreciated by political leaders. Particularly, Sukarno himself publicly announced that he didn't believe in economists. Glassburner (1991), p.51 and Subroto (1998), p.73.

[30] Salim (1997), p.55.

[31] "At first the relationship between the military and the academics was exploratory, but over time the bond became institutional because of the regularity of the courses, which were later given at Seskoau and Seskoal (the air force and navy academies) as well. ... The institutional links between the military and the academics which developed as a result of these courses at Seskoad, Seskoau and Seskoal became an important part of the military-civilian alliance which in 1966 overthrew the Old Order (Orla) government and established the New Order (Orba)." Sadli (1993), p.39.

[32] "The Second Army Seminar in Bandung … presented to the Army leadership a 'cookbook' of 'recipes' for dealing with Indonesia's serious economic problems. General Soeharto as the top Army commander not only accepted the cookbook, but also wanted the authors of the 'recipes as his economic advisors.'" Sadli (1993), pp.40-41.

Process of economic liberalization (1966-1993)

During the period concerned here,[33] Indonesia experienced two phases of comprehensive economic liberalization combined with the stabilization measures targeted at redressing a series of macroeconomic imbalances. The first phase (1966-74) came as a reaction to the economic crisis characterized by the hyperinflation of 1965 and 1966 left by the previous regime. While the second (1983-89) took place to deal with the decline of prices of primary export products particularly that of the oil.

Beginning with the policy package of October 1966 aimed at economic stabilization and rehabilitation, a series of measures oriented to an open market economy were announced in the first years of the New Order government. In the area of external trade, the entire system of quantitative restrictions, including the import licensing system, was eliminated. An export bonus scheme was introduced while the tariff system was simplified, although the trend toward lower tariff suffered a setback soon after the initiation of the reform.[34] As for the exchange rate system, the complex multiple rates were dismantled and unified in a single rate by 1970. In the financial sector, monetary policy was tightened and the interest rates were raised. Meanwhile the restriction on the Central Bank credits to state enterprise was reinforced to keep the fiscal discipline. Restrictions on international capital flows were loosened by the Foreign Investment Law passed in January 1967,[35] while a domestic investment law was promulgated in the next year.

The upshot of these policies was successful in general. The rate of inflation fell from more than 600 percent in 1966 to 4.4 percent in 1971, while the fiscal deficit stabilized in a low level during this period. Despite the application of rigid stabilization policies, the GDP grew by almost 8 percent annually from 1968 to 1974. In addition, the export earnings increased by about 10 percent annually in the quinquennium 1966-70,[36] while the percentage of the exports in GDP increased from 4.2% in 1965 to 29.0%.[37]

However, the pace of reform began to slow down entering the 1970s, as the claim for economic nationalism arose. After the 1974 Malari riots, the pendulum swung back to more nationalistic and inward orientation.[38] The technocrats stayed in the cabinet but the economic nationalists, who controlled

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[33] It comprises the period between the ascent of the FEUI economists to the economic advisors of the New Order government in 1966 and the replacement of the original technocrats from the cabinet in 1993.

[34] "Protectionist pressures culminated in the tariff revisions of April 1968. The tariff was increased for 1,292 items and marginally lowered for 43 'essential' items. The unweighted average tariff rate rose from 58 to 65 percent. The 'good news', was that the government did not impose any new quantitative restrictions." Woo, Glassburner & Nasution (1994), p.49.

[35] The law specified that the government would not nationalize without due compensation and gave immediate benefits in the form of tax holidays to private firms.

[36] *Ibid.*, p.49.

[37] *Ibid.* Table A.3., p.168. It has to be added that the economic success of this period owed not only to the correct set of policies implemented by the technocratic teams but also supported by a large flow of foreign aid and external credit. As for the foreign aid, it "accounted for over 30 percent of government expenditure in 1967, 19 percent in 1968, 27 percent in 1969, and 24 percent in 1970." *Ibid.* p.47.

[38] "Foreign investment regulations were once again tightened. Trade and industry policy was redirected as the country set off on a state-led drive for import substituting industrialization. Armed with the revenue from oil taxes, the government began investing

the ministries in charge of sectoral policies and the state-owned enterprises, took lead over them during almost a decade. Ehe economic bonanza caused by the first oil shock enabled Indonesia to take an import-substituting industrialization (ISI) strategy with large-scale investments.

The second phase of comprehensive economic liberalization appeared as reactions to the recurrent economic difficulties during the 1980s caused by a series of adverse external conditions, particularly the low price of petroleum. Policy packages of structural adjustments were launched several times, which included financial reforms, tax reforms, measures for promoting non-oil export and further relaxation for external investment. Especially the deregulation process was accelerated after the downturn of the oil price in 1986. Although these reforms were not so far-reaching as the Chilean structural adjustment during the 1970s and 1980s, they transformed the Indonesian economy from state-led and inward economy to a more market-oriented and outward one. Market reforms continued intermittently during the 1990s but more hesitantly than 1986-89 period.

IV. US-Trained Economists and Authoritarian Rulers: Politics of Economic Liberalization under Pinochet's Chile and Soeharto's Indonesia

The "relative autonomy" of the authoritarian ruler and the "relative insulation" of economic team

What are the political conditions which enabled market reforms? Although there hasn't been a consensus among academics concerning this question, some tentative hypotheses have been raised. In a comparative study on economic reforms in thirteen countries, Williamson and Haggard concluded that following three hypotheses were the most applicable among successful reforms: the need for a strong political base, for visionary leadership, and for a coherent economic team.[39] It implies that the execution of such reforms presupposes the presence of both coherent group of economists and strong political leaders who can give enduring support to them. Furthermore, since the shift to a market-oriented reform entails a drastic change in the distribution of resources among social sectors it often requires certain degree of coercion, which presupposes considerable "autonomy" of the state and its political leaders as well as the insulation of the economic authorities from the immediate social demands.

Authoritarian Chile and Indonesia fairly satisfied these conditions. Unlike democratic regimes in which political decisions are taken as a result of compromises among distinct political and social sectors, in authoritarian regimes the political leader didn't act necessarily in accordance with such compromises but often enjoyed considerable freedom to choose policies they prefer with little regard to social pressures. In the first years of their regimes both Pinochet and Soeharto succeeded to concentrate the

heavily in state enterprises and basic infrastructure in a bid to develop an integrated industrial base." Hill ed. (1994), p.37.

[39] Williamson and Haggard (1994), p.589.

power in their hands purging their adversaries within the regime, while heavily oppressing the opposition to the regime, which gave them considerable autonomy in making important political decisions. Since both Pinochet and Soeharto came to power in the middle of profound economic crisis, one of their immediate necessities was to overcome it as soon as possible. Also they needed to achieve a sustainable economic growth to legitimate their long stay in power. It was in that moment that the teams of economists with specialized knowledge appeared as an only possible choice to achieve these objectives.[40]

It was the support of these authoritarian rulers that permitted the technocratic team to carry out economic reforms as their discretion without caring so much about the reaction of social sectors affected by those reforms. In some sense, the "relative autonomy" of the former functioned as a guarantee for the "political insulation" of the latter. The technocrats, by themselves, lacked political power enough to impose the costs of reforms to social sectors. Therefore, they deadly needed "the visible and consistent support of the head of state" to carry the reform forward.[41] In the case of Chile and Indonesia, the consistency of the technocrats' projects in the absence of other projects, together with the initial success of the policies they implemented, were crucial for their persuasiveness to the authoritarian ruler. Both Pinochet and Soeharto gave enduring confidence to their technocratic advisors and often protected them from external interventions.

However, there were some important differences in political and institutional conditions between two countries, which resulted in divergent paths in their economic liberalization process. In the following, we will examine some of these political factors.

Chile

Chilean military regime was established as a result of a coup d'état supported mainly by rather traditional entrepreneurial sector and by the bulk of middle class. So it was expected that the new government would adapt a moderate economic liberalization under a certain kind of corporatist political system. However, to the surprise of many the regime opted for an economic model that required significant cost of the social sectors which supported the regime.

"How could a business-friendly government afford to follow such policies?" According to Velasco there are two reasons. First, "the breakdown of traditional politics and the fragmentation of civil society in the aftermath of the upheaval of the late 1960s and early 1970s afforded the military and their advisors unusual autonomy in designing and implementing policy." Neither the business sector nor the traditional political Right couldn't offer a viable alternative projects, while the oppositions such as the trade unions and leftist groups were completely demobilized during the 1970s. Second, "the shock of the Allende

[40] It goes without saying that the appointment of these economists to the heads of economic authorities was also a gesture to the international financial community to obtain necessary finance as well as to carry the negotiation on the rescheduling of external debt in favorable terms.

[41] Waterbury (1992), p.191. Cf. Glassburner (1978), pp.32-33.

experience made large portions of the country's establishment particularly receptive to policies intended to institute drastic changes in the rules of the resource-allocation game."[42] In addition, it was the business sectors and the traditional right who begged and persuaded the military to intervene the political arena and not vice versa. Therefore the military felt that they owed nothing to its supporters, while for these giving support to the military regime was the only guarantee not to return to the insecurity under the previous governments.

Within the military regime, Pinochet gained an increasing hegemony in the first years after the coup. Besides his political astuteness, the source of his power was the fact that he was on the highest rank of the army and that he was the president of the military junta and then that of the republic. He made the most of his legal and de facto position to consolidate and institutionalized his one-man rule[43]. The ascent of the Chicago-trained economists went side by side with the monopolization of power by Pinochet.

There was an internal conflict in the first years of the military regime between those who insisted on the acceleration of liberalization and the application of drastic stabilization measures, represented by the Chicago-trained economists, and those who advocated a gradual and flexible application of the liberalization measures. But after the announcement of the shock treatment in May 1975, the former increasingly gained the advantage over the latter, monopolizing the main posts of the economic authorities almost throughout the military rule.

A reciprocal relation arose between Pinochet and the economists. Pinochet, as well as his military collaborators, had little knowledge about economy. So once he was convinced of the ability of the Chicago-trained economists, he gave them a free hand to manage the economic policies while inhibiting interference of other sectors. A kind of symbiosis or division of labor was established. Pinochet, with his military and civil collaborators, dedicated in maintaining the political stability, precondition for economic development, while technocrats were in charge of economic affairs. Since the technocrats were not elected by ballot but appointed by Pinochet, they feel accountable only to him and pay little attention to the sectoral demands. That is why the Chilean technocrats could pursue long-run objectives without thinking of immediate effects of their measures. Although the team of Chicago-trained economists was removed from the economic authorities momentarily in the mid-1980s, the so-called "second generation of Chicago Boys," led by Hernán Büchi, were designated to occupy those posts in 1985.[44]

One of the most remarkable features of the Chilean reform process was the transformation of entrepreneurial sectors. The traumatic experiences of radical land reform and nationalization under the previous governments and the subsequent adoption of the radical economic liberalization under military

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[42] Velasco (1994), pp.381-383. Also see Martínez & Díaz (1996), pp.2-3.

[43] About the process of concentration of power in the hands of Pinochet, see Moulián & Vergara (1980), Remmer (1989a), Constable & Valenzuela (1991), pp. 40-89, and Cavallo, et al. (1997).

[44] Hernán Büchi graduated from the University of Chile and then got his master's degree in economics from the University of Columbia. But he is considered as one of the "Chicago Boys" since he had closely collaborated with the team of De Castro in early years of the military regime.

regime resulted in the emergence of a new and competitive group of entrepreneurs. Together with the large conglomerates, they supported the regime and its market reform even in the difficult moment following the economic collapse in 1982-83 and contributed to the consolidation of market economy in the country.

With the economic recuperation of the latter half of the 1980s, market economy gradually acquired acceptance of a broad range of the Chilean middle sector. By the end of that decade, centrist political parties and an important part of the left came to recognize the validity of market economy, which facilitated the democratic transition to civilian regime. Achievement of satisfying macroeconomic performance under democratic regime ha contributed to the consolidation of market economy in the country.

Indonesia

As for the Indonesian case, Soeharto supplanted Sukarno and gained power taking full advantage of the political vacuum caused by an attempted coup of October 1965, in which many of his superiors were victims. A multitude of communists were massacred after the coup and the military acquired an unchallengeable political influence.[45] Soeharto seize the power with the backing of the military. As a politician he was distinguished by his ability in balancing various factors to make political decisions, which had saved him from various critical situations. In consequence, under the Soeharto's New Order regime "many actions of the state are determined through presidential brokering of compromises among the principal social groups."[46]

This Soeharto's political style of brokering or balancing had been manifest also in the sphere of economic policy making. Various authors have explained economic policymaking in the New Order Indonesia as contending or "see-sawing"[47] process between two groups, i.e., the technocrats, on the one hand, and the economic nationalists, on the other hand.[48] The principal figures of the former were the economists of the University of Indonesia, who occupied important posts of economic authorities like the Ministry of Finance, Trade, the National Planning Board (BAPPENAS), and the Central Bank. They favored deregulation measures as well as outward-oriented development policies. Meanwhile the latter included military and non-military bureaucrats, who were often in the head of the state-owned enterprises and that of ministries of productive sectors, such as Industry.[49] They advocated state-led

[45] The last years under Sukarno's Old Regime was characterized by the contention between the Indonesian Communist Party (PKI) with more than two million militants, on the one hand, and the military, on the other hand, situation which barely managed by charismatic leadership of Sukarno.

[46] Woo, Glassburner & Nasution (1994), p.36.

[47] Hira (1994), p.36.

[48] See Robison (1988), pp.68-69, Liddle (1991), pp.406, 416-418, Hill (1994), pp.35-36, Woo, Glassburner & Nastuion (1994), pp.40-41 and Bowie & Unger (1997), p.47, and Chalmers (1997), pp.27-29. While technocrats were supported by international financial organizations such as the IMF and the World Bank and by Western multinational enterprises, the economic nationalists (or politico-bureaucrats) dominated the domestic political sphere. They also had important connections with Japanese capital in seek of stable energy supply.

[49] According to Liddle, "The so-called economic nationalists, like the economists a group of high-level officials, have favored

industrialization with large-scale capital and opposed market-oriented reforms.

In a kind of "dualistic decision-making structure"[50] of economic policies described above, Soeharto played the part of arbitrator between two contending groups. In general, in the periods of economic crisis he relied on the technocrats giving them complete authority to effectuate severe stabilization programs, as well as a series of deregulating and liberalizing measures.[51] However, once the critical situation was overcome and the abundant capital returned, Soeharto allowed the economic nationalists pursuing their goals. State-owned companies often escaped from the control of the economic authorities managed by technocrats and engaged in a series of big projects of dubious feasibility. During the oil boom of the 1970s after the successful stabilization of the late 1960s, economic liberalism retrograded and inward state-led import-substituting industrialization (ISI) was pursued in Indonesia.

On the one hand, Soeharto had the highest confidence in the technocrats' capacity in macroeconomic administration as well as in crisis management. On the other hand, for the necessity to distribute political patronage he also advocated interventionist tendency of the economic nationalists, with whom he had patrimonial relationship.[52] Thus, in the periods of prosperity he used to let the latter take the initiative, whereas facing economic difficulties he turned to the former letting them lead the economic management.[53] It explains why the periods of liberalization and deregulation have lasted relatively short time and interventionist periods have resurged repeatedly despite the technocrat's continuance in economic authorities.[54]

Furthermore, although market reform was supported by the external actors such as the IMF, World

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rapid state-led development, usually involving very large capital investments without much prospect of short -or even medium-term return. Most of them have had little formal training in economics. Their projects have been opposed by the economists, who prefer to limit the direct involvement of the state in production and in general to guide economic activity through manipulation of the price mechanism." Liddle (1991), pp.416-417. Some of the principal figures of this tendency were Ibnu Sutowo, the former head of Pertamina (National Oil Company) and Habibie, the former Minister for Research and Technology. Economic nationalists are also called engineers or technicians. Woo, Glassburner & Nasution (1994), pp.40-41; Bowie & Unger (1997), p.47.

50 I borrowed this term from Kahler, Miles, 1992, "External Influence, Conditionality, and the Politics of Adjustment" in Haggard & Kaufman, ed. (1992), p128.

51 This happened several times during his rule. Most remarkable cases were: (i) after the crisis left by the Sukarno regime in the mid-1960s; (ii) after the near default of the state oil company, Pertamina, in 1975; (iii) the price fall of oil in the early 1980s; and (iv) another price fall of oil and other primary goods in the mid-1980s.

52 Various authors mention the patrimonial character of the Indonesian political structure. Under the Soeharto regime, networks of patronage were created through "politically conferred licenses, concessions, trade monopolies, bank credit, state contracts and joint ventures rather than by sets of regulations based in law that provide common rules for business operation." Robison (1997), p. 30. Such networks go all the way from top bureaucrats to villagers, forming informal but important aspect of the Indonesian society.

53 Mohammad Sadli, one of the first economic advisors of Soeharto, described it as "good times make bad policy." That is, "if the economy was bad, …, Suharto sought the help of the technocrats; and the Javanese autocrat was willing to back up their programs to a great extent as long as they delivered renewed growth. But once the economic condition rebounded and the burden lifted, Suharto would reduce the role of the technocrats again and do some other things they might not agree with. It had happened in the 1970s and 1980s." Mallarangeng (2000), pp.238-241.

54 Woo, et al. points out following seven variables in the economic policymaking equation that constrained the resulting policy orientation: (i) the institutional memory of Sukarno's disastrous economic policies; (ii) agrarian radicalism; (iii) the history of secessions (regionalism, ethnicity and religion); (iv) economic nationalism; (v) *pribumi*-ism; (vi) political patronage; and (vii) personal element of Soeharto. Woo, Glassburner & Nasution (1994), pp.35-41.

Bank, the United States and other creditor nations, it lacked domestic political base vis-à-vis economic nationalism. Not only the politico-bureaucrats who controlled the big state enterprises opposed to the technocrats, but also domestic entrepreneurs claimed for protection as well as state subsidies for their industry.[55] On the other hand, although the urban middle class and the masses were largely depoliticized, their eventual mobilization could run counter to the economic liberalization.[56]

Thus, the presence of the western-trained technocrats in top governmental positions did not guarantee the realization of thoroughgoing economic liberalization. However, they had contributed to maintain the relatively stable macroeconomic fundamentals during three decades of the New Order government, especially, in keeping the competitive exchange rate as well as the balanced budget.

Conclusion

As we have seen in the previous sections, the university-to-university agreement signed between the Chicago University and the Catholic University of Chile, as well as that between the University of California and the University of Indonesia, had the aim of implanting liberal economic thinking in those countries in order to reverse the prevailing nationalist and protectionist tendencies in the long run. These agreements provided with a contingent of specialized economists to the countries where the influence of the mainstream economics was minimal. They shared beliefs in the superiority of the market mechanism with the open economy in the resource allocation, the subsidiary role of the state and the applicability of the economic theories. Designation of them to the crucial positions of economic policymaking under the authoritarian regimes marked the beginning of the market reforms in each country. Their continuance in governmental posts contributed to the implementation and consolidation of market economy in each country.

However, the pace and the contents of the reform have varied significantly between two countries. While Chile has experimented one of the most radical and enduring market reforms, economic liberalization in Indonesia has been rather hesitating and intermittent. In the latter part of this paper, I pointed out some of the factors that resulted in the differences between two cases.

In the case of Chile, Pinochet delegated almost completely the helm of economic policymaking to the so-called “Chicago Boys,” guaranteeing them substantial insulation from the immediate social demands. More nationalistic and gradualist approaches were eliminated in the first years of the military regime. It enabled Chile to accomplish one of the most thoroughgoing structural adjustment programs in the developing world. On the one hand, the severe repression prevented the

[55] Domestic private capital was still weak when the New Order government was established. During the oil boom of the 1970s some of the domestic corporations, mainly Chinese, grew remarkably through joint ventures with foreign corporations as well as with state enterprises, gaining major political influence.

[56] In 1974, the riots in Bandung and Jakarta lead by students and Muslims resulted in the reorientation of the economic policy toward more closed one

popular sector from organizing opposition to the new economic policy effectively. On the other hand, the traumatic experience of radical reforms under previous governments and the legacy of hyperinflation made entrepreneurial sector and the middle class extremely receptive to the economic policy change.

Whereas, in Indonesia, the designation of the FEUI economists didn't necessarily meant the elimination of economic nationalists from the government. Soeharto maintained patrimonial political structure, trying to keep appropriate balance between the role of liberal technocrats and that of the economic nationalists in economic policymaking. Complexity of power basis of his regime required him to manage delicate balance among political forces. The tendency was that, in the periods of crisis, the technocrats were delegated mayor responsibility to effectuate stabilization program as well as a series of deregulation and liberalizing measures, while during economic booms, their role was limited to the most basic macroeconomic management. As a result, economic liberalization in Indonesia has been rather meandering compared with the Chilean case. However, it shouldn't be overlooked that the presence of the US-trained economists considerably improved macroeconomic fundamental, such as the keeping of fiscal discipline, and contributed to maintain the Indonesian economy basically stable during three decades of the "New Order" government until the outbreak of the Asian crisis in 1997.

It might be true, in a longer perspective, that market reform has prevailed among developing nations because it provides a correct set of measures. However its dissemination process is far from being spontaneous. Efforts to disseminate liberal market economic thinking had been made at various fronts, from various perspectives, and with different motives. Ideas rarely float freely, but rather deliberately. Conversely, an overemphasis on the conspiratorial nature of dissemination process could result in overlooking the peculiarities of each case.

Once a new economic thinking is introduced successfully in a certain country, the way it is internalized and institutionalized differs from one political setting to another. Normally, market economy has been consolidated only after repeating trial and error. As we saw above, even in Chile, which has been considered as one of the most successful cases of market reform, experienced a serious setback in the mid-1980s.

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