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# How do crises lead to change?: liberalizing capital controls in the early years of new order Indonesia

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# HOW DO CRISES LEAD TO CHANGE?

## Liberalizing Capital Controls in the Early Years of New Order Indonesia

By JEFFREY M. CHWIEROTH*

ECONOMIC crises often bring about remarkable transformations. Periods of hard times such as the Great Depression, the oil and inflationary crises of the 1970s, the debt crises of the 1980s, the emerging market crises of the 1990s, and the global financial crisis of 2007–09, are commonly believed to be associated with dramatic change. These periods of dramatic change reveal the importance of economic structures, distributive preferences, strategic agency, uncertainty, and belief systems. Not surprisingly, the significance of these periods has led a number of scholars to ask: How do crises lead to change?

One prominent rationalist view is that crises induce change as some inexorable structural response.[1] Rationalists working with open economy models of politics (OEP) depict crises as exogenous shocks that reshape the distribution of domestic political power and permit the newly dominant coalition to pursue reforms that reflect its distributive preferences.[2] Constructivists argue that crisis politics is about the endogenous construction of new intersubjective beliefs that necessitate change.[3]

There are important limitations to each perspective. First, crises, no matter how visible or severe, do not induce an automatic response. Crises alter the domestic balance of power and ideas in varying ways that bring bargaining, negotiation, and persuasion to the forefront of the crisis resolution process. OEP models, while sensible, can often be too sparse and too far removed from specific national circumstances to be

* I am grateful for helpful comments on earlier drafts provided by Vedi Hadiz, John Sidel, and Andrew Walter.

[1] Stallings 1992.

[2] Gourevitch 1986; Haggard and Maxfield 1996.

[3] Blyth 2002; Widmaier et al. 2007.

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a useful guide for understanding crisis politics. OEP models also remain wanting to the extent that crisis resolution cannot be understood simply in terms of the domestic power balance and the process of bargaining and negotiation. Because crises induce uncertainty that constrains actors from fully grasping their distributive preferences, how actors interpret and debate the meaning of material events and incentives as giving rise to particular courses of action must also be considered. While not denying the influence of distributive preferences at particular stages of the crisis resolution process, I argue that until uncertainty is reduced, the influence of persuasion relative to bargaining and negotiation is heightened as a mechanism of change, as constructivists contend.

Although intersubjective belief change shapes the crisis resolution process, constructivists have thus far not adequately specified the scope conditions under which a new idea is likely to win out over others. In cases where constructivists do consider this issue, they typically point to the need for a new idea to resonate with the preexisting beliefs of domestic elites and the mass public. In other words, they argue that a new idea must be perceived as legitimate within the context of existing belief systems.

While capturing the role of belief systems, this work suffers from two shortcomings. First, it obscures the influence of external actors and thus fails to consider the often decisive impact the perceived need to establish credibility with these actors has on the crisis resolution process. Second, it tends to be overly static and structural, focusing on the possibility of congruence to the neglect of possibilities for congruence-building. This article seeks to rectify these shortcomings.

Crises lead to change through a three-stage process: crisis, experimentation, and consolidation.[4] In the crisis stage, norm entrepreneurs employ their ideas to implicate the status quo as flawed, usually due to a severe economic downturn or dramatic failure, and as necessitating change. This construction of a crisis generates uncertainty as to what has gone wrong and how it can be remedied.

As actors struggle with uncertainty in the experimentation stage, persuasion and argumentation take center stage as rival norm entrepreneurs and defenders of the status quo offer competing diagnoses. Only after actors have reduced uncertainty by settling on a common diagnosis and blueprints for action have been developed, do distributive preferences assert themselves. The consolidation stage begins only after a new set of policies and institutions has been created.

[4] Culpepper 2008.

Crisis resolution thus happens largely in the crisis and experimentation stages; this is where I focus my attention. The ideas most likely to form the basis of new beliefs depend on four features: the carriers of the ideas, the composition of the group advocating the ideas, the crossover appeal of the ideas, and their credibility with external actors—what I call the "four Cs" of crisis resolution. Briefly stated, whenever a prominent and cohesive group of advocates promotes a new idea that has sufficient distributive and ideational appeal and the endorsement of external actors whose seal of approval is perceived as important, intersubjective belief change is more likely.

I develop these arguments in the section below and then examine them empirically in the case of the early years of New Order Indonesia. I employ this case to illustrate the mechanisms through which crises induce change. A severe economic downturn in Indonesia in the mid-1960s led to reforms that culminated in capital account liberalization in 1970. At the time, the decision to liberalize the capital account was remarkable since, with the exception of Mexico, there were hardly any developing countries, or even developed countries, that had taken such a dramatic step.

These reforms have been well documented in studies conducted by Indonesianists, many of which I rely upon in this analysis.[5] While there are potential shortcomings to relying extensively on secondary sources, much of my analysis also employs interviews with and primary documents from individuals who were prominent policymakers at the time. Surprisingly few of the accounts offered by Indonesianists make use of these sources, perhaps because many of the sources were not made available until the late 1990s—after much of the Indonesianist work on the early years of the New Order had already been published. More importantly, the central goal of this article is not to offer a novel comprehensive account of the New Order, but rather to use the empirical evidence from the case to offer a broader argument about crisis politics—one that considers a fuller array of factors together, rather than separately, and that demonstrates how these factors in conjunction lead to particular outcomes.

There has been much recent work on the strengths and weaknesses of case-study analysis relative to statistical and comparative analysis.[6] A key goal of my analysis is to investigate the causal mechanisms through which crises produce change, a goal for which case-study analysis is

[5] See, for instance, Bresnan 1993; Cole and Slade 1996; Liddle 1991; MacIntyre 1993; Pincus and Ramli 1998; Robison 1986; Winters 1996.

[6] Gerring 2007; George and Bennett 2005.

well-suited but statistical and comparative analysis are not. Case-study analysis permits intensive investigation of a particular outcome, though it comes at the expense of extensive generalizability. However, because the focus of my inquiry is in understanding why and how crises generate change in the way that they do rather than in understanding the magnitude and relative precision of the causal relationship between crises and change, I chose not to engage in cross-national comparison. Still, the analysis highlights some spatial and temporal variation within the case as well as several comparative applications of the argument, and the conclusion considers its potential scope.

## Crisis Resolution: Carriers, Composition, Crossover Appeal, and Credibility

In normal times, intersubjective beliefs, or common knowledge, converge on a shared account of the workings of the economy and the way they should interrelate. These beliefs permit actors to diagnose dysfunctions and identify remedies for them. Normal politics may consist of bargaining, negotiation, and debates over changes to the instruments and settings of policy, but the intersubjective beliefs remain unchanged.[7] However, even normal politics is characterized by norm entrepreneurs operating as voices in the wilderness and waiting for opportunities to promote their preferred alternative to the status quo through a process of "strategic social construction."[8]

In the crisis stage, the declining performance of status quo institutions and policies destabilizes the intersubjective beliefs underlying them. But material events, however, cannot be reduced solely to automatic incentives for change. Actors' intersubjective beliefs must first interpret and construct events as a crisis for the status quo that necessitates change.[9]

Norm entrepreneurs play an influential role during the crisis phase through naming and framing practices. They use ideas instrumentally as weapons to contest the status quo and delegitimize the beliefs supporting it. When norm entrepreneurs successfully construct a crisis, the result is uncertainty.[10] When the old rules of the game can no longer be taken for granted, actors seek guidance as to how to understand and behave in an unfamiliar situation.

[7] Hall 1993.
[8] Finnemore and Sikkink 1998, 888.
[9] Widmaier, Blyth, and Seabrooke. 2007.
[10] Blyth 2002.

The experimentation stage begins with uncertainty as a binding constraint that leads actors to be more receptive to persuasion. With precrisis beliefs destabilized, actors seek a new way first to interpret their situation and then to remedy it. Crisis politics becomes focused on creating new intersubjective beliefs. Here the same ideas employed as weapons to implicate the precrisis status quo as responsible for the crisis can reduce uncertainty by narrowing possible causes of the crisis to a significant degree.

In some accounts the experimentation stage is depicted as one where the newly dominant coalition has stable distributive preferences that it implements through changes to the precrisis status quo.[11] Yet these accounts also reveal this process as characterized by uncertainty. Pepper Culpepper offers one potential solution, positing that even as actors struggle with uncertainty they have "some idea of the distributive consequences of any given institutional choice."[12] But this view is not entirely convincing. While distributive preferences do influence particular stages of the process, such preferences can come into play only *after* uncertainty has been reduced and alternative remedies have been identified.

Uncertainty reduction is temporally prior to any negotiation or bargaining over remedies since actors must first have some idea what the crisis is and what caused it. Absent such ideas, actors cannot rank alternative remedies. There is, as Culpepper observes, "a real game of figuring out what is going on in the world."[13] Even following uncertainty reduction, it is not clear that distributive preferences will be decisive, since without any a priori experience with the new institutions and policies, actor interests in such institutions and policies will be necessarily underdetermined.[14] Persuasion, rather than bargaining and negotiation, thus becomes increasingly important as a mechanism for change.

After uncertainty is reduced, actors rely on ideas to serve as a blueprint for action and as a coalition-building resource.[15] By providing a common goal for action, these ideas also provide the basis for the formation of a coalition among entrepreneurs pursuing change. The third and final stage, consolidation, emerges only after a new set of policies and institutions has been created. To understand how actors resolve crises I therefore focus on the set of scope conditions that facilitates intersubjective change in the crisis and experimentation stages.

[11] Gourevitch 1986; Haggard and Maxfield 1996.
[12] Culpepper 2008, 6–7.
[13] Culpepper 2008, 6.
[14] Blyth 2007.
[15] Blyth 2002.

Winning ideas will have the features related to the four Cs of crisis resolution. First, the quality of the carrier advocating the idea matters. The appeal of a new idea is enhanced when it is carried by an entrepreneur perceived as prominent or authoritative.[16] Hence, expertise derived from experience, knowledge, training, and credentials can prove to be an important asset. Uncertain as to what has gone wrong, actors turn to experts, which permits norm entrepreneurs with expert authority to draw on this asset to mobilize crisis arguments that implicate the status quo as necessitating change. Because success breeds success, the clout and authority of experts can increase (or potentially decrease) when their prescriptions are perceived to have generated success (or failure).

Second, the composition of the advocacy group matters. In promoting their beliefs, norm entrepreneurs typically confront resistance from defenders of the status quo as well as from advocates of alternative beliefs. In confronting this resistance, a cohesive group characterized by like-minded members is in a stronger position than a heterogeneous group to persuade, negotiate, and bargain with other actors.[17] Cohesion can enhance the persuasive power of an advocacy group by ensuring consistent advice from its members. Cohesion can also shape negotiations and bargaining over distributional consequences by helping to insulate the decision-making process from opposing beliefs and demands.

Third, crossover appeal matters. Following uncertainty reduction, ideas can serve as important coalition-building resources. The likelihood that an actor will find an idea appealing is partly shaped by its resonance with that actor's distributive and ideational preferences. Much of the work on resonance has focused on the extent to which an idea fits with the preferences of domestic elites and the mass public.[18] While insightful, this work suffers from two shortcomings.

The first of these is that it obscures the influence of external actors. As such, it fails to give adequate attention to the fourth feature of winning ideas—that credibility matters. Resonance cannot be defined simply in terms of domestic elites and the mass public; how remedies fit with the preferences of official and private-market actors must also be considered. The perceived need to establish credibility with external actors can thus trump the perceived need to establish legitimacy with domestic actors.

When a government sends a signal, it seeks to communicate to external actors that it shares and is committed to their policy beliefs. But by dealing with these beliefs by assumption and focusing on the incen-

[16] Finnemore and Sikkink 1998.
[17] Chwieroth 2007.
[18] Culpepper 2008; Hall 1989; Seabrooke 2007a.

tives for action, rationalists often miss out on how these beliefs affect the type of incentives that are generated. Sociological institutionalists understand signalling as a form of "ceremonial conformity."[19] But while the perceived need for external legitimacy or resources may be what creates incentives for conformity, the beliefs that external actors share determine what ceremony must be performed. These beliefs privilege certain actions over others, ultimately leading the behavior preferred by external actors to be perceived as the sole credible action, even if in theory other actions are equally sustainable.[20]

Official and market sentiments thus create severe policy constraints, particularly when the perceived need for their approval is high. Policies that go against these sentiments will not be judged as credible and will jeopardize access to external legitimacy and resources. Norm entrepreneurs recognize that the beliefs of external actors can be useful assets and thus often deliberately ally themselves with these actors to push for reforms. When the perceived need for credibility is high, such as during an economic crisis, domestic norm entrepreneurs whose prescriptions resonate with the beliefs of relevant external actors will be empowered. In debates with their opponents, these domestic norm entrepreneurs can employ this resonance to present themselves and their policy blueprint as the only way to establish credibility and resolve the crisis.

A second shortcoming of the work on resonance is that it much of is overly static and structural and it describes, as Amitav Acharya observes, "an existential match…rather than a dynamic process of *match-matching*."[21] This static view obscures the processes of naming, framing, and grafting that are at the very heart of strategic social construction. The static focus on congruence thus misses the dynamic processes of congruence-building that reveal the role of strategic agency and how norm entrepreneurs can overcome barriers to change. Instead of treating norm resonance as simply a static match, I stress a more dynamic process with emphasis on the strategic agency of norm entrepreneurs.

## Indonesia: The Guided Economy, Economic Deterioration, and Crisis Resolution

In the 1960s most Indonesians subscribed to nationalist, statist, and collectivist beliefs, creating a significant obstacle to market reforms.[22] Capitalism and openness to foreign capital, in particular, were equated

[19] Meyer and Rowan 1977.
[20] Kirshner 2003.
[21] Acharya 2004, 243.
[22] Feith and Castles 1970; Liddle 1988.

with colonialism and exploitation, while support for collectivist forms of social organization reinforced this deep suspicion of free markets. Ethnic politics also created obstacles to market reforms. Chinese Indonesians are a minority of the population, and while most are not wealthy, some did become enormously rich and as a group owned the largest share of private domestic capital. This generated widespread resentment among indigenous Indonesians (pribumi) and was a key reason behind the state intervention in the economy that provided them with preferential access to state resources.

Tensions between the two ethnic groups often spilled over into violence. As a result, some well-placed Chinese businessmen relied on their connections to develop large conglomerates under military protection. In exchange for physical protection, these businessmen enriched their military patrons as well as added to their own wealth—often through the formation of joint ventures.

In the late 1950s, President Sukarno launched an intensive drive for state-led industrialization under the rubric of what he called the guided economy. Economic considerations were effectively subordinated to the government's political priorities. Many foreign firms were nationalized, had their licenses revoked, or ceased operations. In sectors where foreign direct investment (FDI) could not be avoided, such as the oil sector, the government required joint ventures and production-sharing agreements.

For industrial policy and patronage purposes, the government intervened extensively in the financial system.[23] The central bank's limited autonomy was revoked as the government relied on it to finance unprecedented fiscal deficits. The government also took control over the allocation of credit by largely centralizing disbursement in state banks. Capital flows were tightly restricted.

Sukarnoist policies resulted in rapid expansion of the money supply and hyperinflation. Following an abortive orthodox stabilization program in 1963, monetary growth continued largely unabated. Reckless fiscal and monetary policies, hyperinflation, and an overvalued exchange rate produced recurring balance-of-payments crises. By mid-1965 the government faced forecasts showing an insufficient amount of reserves to cover debt-service costs and import requirements.[24]

## Constructing a Crisis and the New Order

The Sukarno regime collapsed in late 1965. In the ensuing months, the army, led by Suharto, increasingly seized control. The need for change

[23] MacIntyre 1993.
[24] Palmer 1978, 7; Woo, Glassburner, and Nasution 1994, 29.

was apparent, but the direction of change was not determined by an inexorable structural response.

Of particular importance was norm entrepreneurship from a group of Western-trained University of Indonesia (UI) economists: Widjojo Nitisastro, Ali Wardhana, Mohammad Sadli, Emil Salim, Subroto, Johannes B. Sumarlin, and Radius Prawiro.[25] For some time members of this group had operated as voices in the wilderness, waiting for an opportunity to promote an alternative to Sukarnoism. The deteriorating situation in late 1965 offered the opportunity and they seized it.

The UI economists, due to their common professional training, shared a common diagnosis of the causes of Indonesia's deterioration and a belief that market reforms would remedy it. Their common training, along with personal relationships of trust and friendship, helped to forge the group into a cohesive team. As Prawiro reported, "The esprit de corps among the economic team was exceptional. This was possible because we were all economists with similar training and shared a common set of beliefs regarding principles of sound economic management. [We] all spoke the same economic language. All of the team members shared very similar assumptions on the economy and used the same abbreviated economic jargon."[26] Widjojo served as the unofficial but acknowledged leader, helping to forge the economists into a cohesive group.[27]

The UI economists believed in neoclassical economics and the capacity of markets to stir growth and efficiency. Wielding these beliefs as weapons, they implicated Sukarnoist policies as producing a dramatic failure in the form of hyperinflation. In their diagnosis, Surkarno's elevation of political priorities over economic considerations had resulted in persistent and growing fiscal deficits and unchecked credit expansion. Bureaucratic expansion, which further strained the budget and invited corruption by giving bureaucrats discretionary control over the distribution of state resources, was also identified as contributing to hyperinflation. A new policy-making process was required, Widjojo argued, one that gave due consideration to prices and material incentives and that was insulated from political interference.[28]

[25] It is not my intention to equate this group of economists with membership in the "Berkeley Mafia," though there is a significant degree of overlap. The crucial difference is the inclusion of Prawiro, who did not receive training at Berkeley but did receive some economics training in the West (the Netherlands) and was critical in advocating similar ideas as those trained at Berkeley. It is for this reason that I opt for the label "UI economists" as opposed to "Berkeley Mafia."

[26] Prawiro 1998, 83. See also Salim 1997, 65.

[27] Prawiro 1998, 83; Salim 1997, 54, 65; Sadli 1993, 41.

[28] Bresnan 1993, 53–54.

The UI economists' blueprint presented orthodox stabilization, openness to foreign capital, and financial assistance from official creditors as the only way out of the crisis.[29] Liberalizing capital controls, they argued, would stir growth and competition. As Sadli insisted, "Indigenous firms will flourish in such a climate. The existence of foreign firms will have a catalytic effect upon further growth of the national economy. The charge frequently heard in ex-colonial economies that foreign business stifles the growth of indigenous business will be avoided."[30]

Capital account liberalization stands out among the reforms in the UI economists' plan. It did not resonate with the beliefs and interests of the pribumi elite and mass public who saw inward FDI as harming domestic firms and distorting development and the removal of restrictions on outflows as undermining capital accumulation. The opposition of these actors to liberalization is at odds with expectations derived from OEP models.[31] OEP models would expect these actors to support greater openness because inward FDI would presumably raise the real earnings of local landowners and labor, while the increase in the supply of finance would presumably lower borrowing costs for owners of specific capital in a capital-scarce country.

There are several reasons why this was not the case. To begin with, OEP models overstate the likely support for openness from the tradables and nontradables sectors in developing economies. In many developing economies, capital controls impose higher borrowing costs only on firms in the nontradables sector because they lack access to foreign currency revenues to service their debt.[32] However, firms in the tradables sector are typically less affected. Even if greater openness lowers borrowing costs by stirring domestic financial development, the shift would be virtually irrelevant in the tradables sector, especially in economies open to trade, since this sector relies less on domestic financing.[33] Thus, contrary to common assumptions in OEP models, the tradables sector in developing economies may have weak incentives to favor liberalization or will be indifferent to it.

In some cases, the nontradables sector in developing countries will also be indifferent to liberalization or may have weak incentives to support it. In developing economies, most small- and medium-sized domestic firms in the nontradables sector—such as those owned by many

[29] Bresnan 1993, 54, 58, 60. See also Prawiro 1998: 4–7, 22, 32.
[30] As cited in Robison 1986, 133, 136.
[31] Frieden 1991.
[32] Prati, Schindler, and Valenzuela 2009.
[33] Braun and Raddatz 2007.

of Indonesia's pribumi—do not benefit greatly from any increase in the supply of finance that comes from openness. Historically, private sources of finance, especially foreign ones, were reluctant to lend to these firms, and the firms therefore found themselves dependent on state banks. Openness thus offered these firms little potential benefit—at least in the short to medium term—because few, if any, foreign private creditors would likely lend to them.[34] In addition to material incentives, in a number of developing economies, as in Indonesia, nationalist and statist beliefs fuelled popular opposition to openness despite any income effects that it potentially induced.

OEP models also understate likely support for liberalization in many developing economies. A number of these models assume that openness harms liquid-asset holders in capital-scarce countries because of the lower returns they face on their investments. This assumption misses out on the substantial risks and vulnerabilities that characterize investment in these developing economies. In the specific case of Indonesia, Chinese businesses saw openness as a hedge against their political vulnerability. Openness enabled them to send their assets abroad at the first sign of political instability, overriding concerns about the depressed rate of return.[35]

Taken together, these considerations created a configuration of interests within Indonesia that bare little resemblance to OEP expectations. Indeed, as Jeffry Frieden concedes: "It is worth emphasizing again that these conclusions [derived from OEP] abstract from many specifics that may indeed override them.... Clearly, other characteristics [can] outweigh the tendencies discussed here."[36]

The process of destabilizing the Sukarnoist status quo was not automatic. Sukarno had been forced to yield much authority to the army, but he retained the nominal title of president—a position he would hold until March 1967. He could still count on significant support from leftists within the army and segments of the mass public to whom he appealed through revolutionary and anti-Western rhetoric and a confrontational approach with official creditors. October 1965 to March 1967 was thus a transition period, with great uncertainty over who would prevail politically.

[34] As noted, some large conglomerates owned by pribumi had developed close connections with well-placed Chinese businessmen, which the conglomerates relied upon for credit in exchange for providing physical protection. To the extent that liberalization lowered borrowing costs for these Chinese businessmen, it would indirectly benefit large and politically influential pribumi conglomerates.

[35] Winters 1996. In addition, in many developing economies financial repression lowered the returns to liquid-asset holders, which provided these actors another incentive to favor openness.

[36] Frieden 1991, 440–44, fn . 29.

In the late 1950s and early 1960s, a number of the UI economists had served as lecturers at the army training school in Bandung where they forged ties with some senior army officials, including Suharto.[37] This experience gave the UI economists the opportunity to cultivate among the army officials an appreciation for how important economic considerations were for Indonesia's future as well as to introduce those officials to their beliefs about the causes of Indonesia's deterioration. When the Sukarno regime collapsed, the UI economists were thus already well known and respected by the army as authoritative sources of information on economic matters. Determined to persuade army officials to support their arguments, the UI economists convened several public seminars on the state of the economy.

The first, known as the New Path seminar because it was the first time that policies of the guided economy were criticized openly, was convened in January 1966. Several of the UI economists spoke at it. Sadli offered the most notable critique of Sukarnoism, attacking the problems of inflation, imbalances in price relationships, the size of the bureaucracy, declining exports, and the prioritization of political goals to the detriment of economic considerations. He argued strongly for liberalizing capital controls. "We must recognize," he said, "that we lack the capital to improve the economy and develop the nation. We need capital, yet we cannot raise capital internally. We must look for capital from abroad."[38]

The New Order under Suharto was formed in March 1966. A triumvirate of deputy premiers was created with Suharto in charge of defense and security; Adam Malik, a prominent nationalist, in charge of foreign affairs; and Sultan Hamengkubuwono IX, a respected Javanese aristocrat, in charge of economic affairs. With army training and a limited education, Suharto was unschooled in and unsure about economic matters, but he and other actors had to deal with the uncertainty that resulted from destabilization of the precrisis status quo. As actors sought new ways to interpret the environment and to remedy the situation, the UI economists relied on and articulated a set of arguments based on neoclassical models and assumptions. As Prawiro reports, "At the time…nothing was clear. The policies were complex and the crisis was deep. Working in an atmosphere of frenzy, the team took a leap of faith that the free market and the power of prudent macroeconomic policy would prevail. In the end, because of the cohesiveness of team

[37] Sadli 1993, 39; Salim 1997, 56.

[38] As cited in Ford Foundation 2003, 59. See also Sadli 1993, 40.

and the essential correctness of their economic positions, the gamble paid off."[39]

At the time, however, a number of alternatives presented themselves for selection. Certainly, Indonesia's economic deterioration had revealed a need for change, but it is implausible to claim that this alone forced Suharto to move in the direction he did. Alternative models were available from regional neighbors, such as Burma and South Korea, where army governments had also recently seized power.

In Burma, the socialist-leaning army government moved toward greater closure and implemented Soviet-style nationalization and central planning. This alternative did not appeal to Suharto primarily because of his right-wing and pro-American orientation. According to Sarbini Sumawinata, a member of the University of Indonesia economics faculty (but not part of the foreign-trained group advocating market reforms) and a key political advisor to Suharto, "The army knew what it did not want, for example, communism, but was less sure about where to go from there."[40] They were, as one source notes, "in great need of new and large ideas."[41]

South Korea offered an alternative that aligned more closely with Suharto's ideological and geopolitical orientation. Indeed, a materialist explanation would expect governments with similar ideological and geopolitical orientations and a similar degree of dependence on the West to pursue similar development strategies. But while these material incentives seemingly led South Korea and Indonesia down a similar path, the ideas embraced by the army in each country pushed them in different directions. On one hand, the army regime in South Korea chose a set of interventionist policies inspired by Japan and that marginalized the influence of Western-trained economists.[42] Suharto, on the other hand, moved in the direction of neoliberalism, and the UI economists secured greater influence (though in the end Indonesia combined neoliberalism and interventionism). That Indonesia settled upon the policy course it did was primarily due to the selection of the UI economists' ideas over alternatives, a process that was in turn shaped by the four Cs of crisis resolution.

As actors struggled with uncertainty, the UI economists, as part of their advocacy, helped craft the New Order's first major statement on the economy, which the sultan delivered in April 1966.[43] The state-

[39] Prawiro 1998, 84. See also 26–28.

[40] Sumawinata 1992, 50.

[41] Bresnan 1993, 52.

[42] Haggard 1990.

[43] Hamengkubuwono IX 1997 [1966].

ment indicated that Indonesia would rejoin the International Monetary Fund (IMF) and the World Bank, which Sukarno had withdrawn from in 1965, and would approach official creditors to discuss debt rescheduling and new financing. In a further departure from Sukarnoism, the statement also revealed that the private sector's role in the economy would be expanded and foreign capital welcomed.

However, these general public commitments masked the fact that privately the army had yet to make any decisions on specific measures. The UI economists therefore continued to press their views. Another seminar was convened in May 1966. There Subroto unleashed a notable attack on the guided economy and the UI economists elaborated their blueprint for action: a new track based on orthodox stabilization, openness to foreign capital, and assistance from official creditors.[44]

By early summer 1966, the direction of change was becoming clearer. Although much of Sukarno's de facto power had been transferred to Suharto by virtue of an earlier decree (the Supersemar), Suharto needed to maintain the appearance of legality so as not to alienate Sukarno's supporters before consolidating power. The general session of parliament, which began in late June, furthered Suharto's consolidation of power by ratifying the Supersemar and commissioning him to form a new cabinet. The parliament also supported the UI economists' blueprint, approving a statement the group had drafted—left virtually unchanged by Suharto—that committed to orthodox stabilization, expansion of the private sector, and greater openness to foreign capital.

A new cabinet was appointed in July and represented a compromise among various competing forces. For some observers, the new cabinet had "unmistakenly abandoned the leftist mystique of Sukarno's Guided Democracy."[45] Yet for others, most prominently U.S. intelligence operatives, the cabinet choices had "compromised [the] chances for an effective approach to economic problems" in order to appease Sukarno and his supporters, and indicated that the generals had "no basic interest in economic affairs."[46]

While the New Order offered the first sign of its intentions with the sultan's April statement, many observers at the time were skeptical and dismissed the generals as indifferent to and ignorant of economic realities.[47] When the cabinet was appointed in July, Suharto still had not fully bought into the blueprint of the UI economists, which, due to its emphasis on stabilization and liberalization, would adversely affect

[44] Bresnan 1993, 54; Prawiro 1998, 4–7, 22, 32; Subroto1998, 74.
[45] Anderson et al. 1966, 186.
[46] Simpson 2008, 218.
[47] Elson 2001, 139; Simpson 2008, 220.

the army—an organization riddled with corruption and entrenched in state enterprises. As one source notes, the generals "would need tutoring from the technocrats."[48]

The crucial turning point occurred in August during a seminar held at the army training school in Bandung. It was the first time that most of the UI economists met Suharto and by all accounts it was when they won him over to their plan. "That particular seminar," notes one New Order cabinet official, "was the main source, if not the only source, of inspiration for the New Order.…The New Order originated in Bandung."[49] Indeed, Suharto later remarked that the seminar had "formulated the New Order."[50]

At the seminar Widjojo, Sadli, and Salim met with the generals to argue in person for their ideas. Sarbini was set to argue for an alternative plan and at the start of the seminar, stood an equal chance of winning over Suharto. The great impression he had made on of one of Suharto's advisers had resulted in an invitation to serve as vice chair of one of the seminar sessions. In addition, his plan was broadly congruent with the beliefs of important members of Suharto's cabinet, including Malik and the sultan, as well as with popular sentiment.[51] The principal debate took place between Widjojo and Sarbini. Although their diagnoses were quite similar, their blueprints were rather different. Sarbini's plan, while recognizing the short-run importance of reducing inflation and seeking foreign assistance, was generally inward oriented. He argued that over the long run Indonesia's development should come to rely more upon domestic than foreign capital. To accomplish this goal, the plan called for a massive program of compulsory domestic saving and renewed government assistance to pribumi firms.[52]

Despite Sarbini's close links to Suharto and the appeal of his blueprint to key cabinet members and popular sentiment, Widjojo won the argument. He criticized Sarbini's plan for its failure to explain how compulsory domestic saving could produce sufficient investment in a country suffering from a shortage of capital and reiterated his blueprint of orthodox stabilization, liberalization, and assistance from official creditors.

The success of the UI economists in arguing for their plan undermines the alternative materialist explanation that emphasizes the primacy of the logic of consequentialism and distributive preferences.

[48] Simpson 2008, 220.
[49] Elson 2001, 148.
[50] As cited in Elson 2001, 148.
[51] Winters 1996, 64.
[52] Liddle 1991, 412.

Many pribumi firms and members of the mass public opposed the UI economists' blueprint because, in their view, it would deepen the recession and foster greater foreign dependence. These actors held out hope that expansionary policies could be used to increase productivity.[53] But Widjojo, in laying out the blueprint, did not bow to these distributive preferences and neither did Suharto when he selected it.

At the seminar, Suharto engaged in a dialogue with the UI economists about their diagnosis and plan. According to Sadli, the seminar presented "the Army leadership with a 'cookbook' of 'recipes' for dealing with Indonesia's serious economic problems. General Suharto as the top Army commander not only accepted the cookbook, but also wanted the authors of the 'recipes' as his economic advisors."[54]

Soon after the seminar the UI economists were appointed as Suharto's team of experts in the field of economics and finance. The close relationship between Suharto and the UI economists would persist until the disintegration of the New Order in 1998. During this period the UI economists took on a number of cabinet posts, beginning with the appointment of Prawiro as central bank governor in 1966, followed by the appointments of Widjojo and Salim as chair and deputy chair of the National Development Planning Agency (Bappenas) in 1967, and, in 1968, the appointment of Ali Wardhana as finance minister. Over the years, this cohesive team was joined by other foreign-trained Indonesian economists, many of whom also received their training at Berkeley.

Why were the arguments of the UI economists selected? Contradicting much of the work on norm resonance, the UI economists' arguments did not fit well with the beliefs or interests of the vast majority of the domestic actors, particularly pribumi firms and the mass public. However, consistent with the theory developed here, a crucial feature of the UI economists' arguments was that they resonated with the beliefs and interests of key external actors with whom the new regime perceived a need to establish credibility. Ultimately, these arguments won out over various alternatives because of the quality and composition of their carriers, the coalitions they enabled, and the way the arguments fit with the new regime's perceived need for credibility with external actors.

The quality of the UI economists as unrivalled sources of economic expertise was undoubtedly important. Like many military regimes, much of Suharto's legitimacy depended on delivering development. This legitimating principle, particularly during times of economic de-

[53] Bresnan 1993, 71.
[54] Sadli 1993, 40–41.

terioration, elevated the importance of the UI economists because it meant that Suharto, who was uncertain about economic matters, would be predisposed to rely upon them as having the strongest claim to economic expertise. The UI economists' expertise enabled them to wield analytical tools that could explain Indonesia's inflation, shortage of capital, low productivity, and recurring balance of payments crises. Their arguments were persuasive in part because, as Peter Hall suggests, they could "relate to the economic and political problems of the day."[55]

The composition of the group of UI economists and their cohesion, in particular, was also important. According to one source, Suharto "was deeply impressed with the clarity of their ideas, the unanimity with which they were presented, and their pragmatic sense."[56] The UI economists also discursively framed their arguments, despite their distributional implications, as based on objective expertise, not political considerations. They pursued what one source calls a "straight economics" approach, offering their prescriptions as transcending politics and formed on the basis of objective and universal criteria while casting the arguments of their opponents as sectional in nature.[57]

The decision to seek out assistance from external actors meant that establishing credibility with those actors became of utmost importance, as it would whenever Suharto perceived a need for their support. But this decision was not automatic. Popular nationalist sentiment meant that many Indonesians saw external assistance as deepening dependence. Indeed, Sukarno's confrontational approach to external actors, epitomized by his nationalist rhetoric telling the West to "go to hell with your aid" and castigating the New Order for its "begging," was aimed at cultivating this sentiment.[58]

Yet Suharto was convinced of the need to gain external assistance. Their command of much needed resources gave these external actors and their domestic allies, in this case the UI economists, enormous leverage and, more significantly, it meant that these external actors' beliefs would highly influence the direction of change. During the Kennedy and Johnson administrations, U.S. officials set out to forge close ties with the UI economists, helping them, for instance, to secure private foundation study grants in the U.S. and faculty exchanges with American universities. As Sukarno's grip on power gradually slipped away, Washington made it clear that assistance would be conditional on stabilization and liberalization. The resonance of the UI economists'

[55] Hall 1989, 369–70.
[56] Elson 2001, 149.
[57] Azis 1994, 399.
[58] As cited in Hill 2000, 79: "go to hell with your aid"; and Winters 1996, 58: "begging.".

arguments with the beliefs of external actors provided the economists with an important asset to employ in their struggles with their domestic opponents. In fact, the U.S. embassy in Jakarta consistently sent clear signals to army leaders "that Indonesia would not get aid until they went the way the economists advised."[59]

In addition, the IMF and the World Bank played an active part in strengthening the impetus for market reforms. They deliberately supported the UI economists, who shared their policy beliefs but were not yet in government, and bypassed those actors within the government who opposed their policy beliefs. In July 1966, with official creditors still withholding support, the IMF took the rather unusual step of sending a staff mission to Jakarta even though Indonesia would not formally rejoin the fund until February 1967. For its part, the World Bank sent a mission in August 1966 and later took the unprecedented step of creating a permanent mission in 1968. Informal discussions between the UI economists, the IMF, and the World Bank ensured that the UI economists could come forward with a blueprint that would command external support. Suharto recognized that to access financial resources, Indonesia needed to commit to policies that resonated with the beliefs of external actors regardless of how they fit with domestic beliefs and interests. Although official creditors extended some token emergency aid following the Bandung seminar, they made it clear that new financing and debt rescheduling would not be forthcoming until their preferred policies were implemented.

A final crucial factor underpinning the selection of the UI economists' arguments was the way they could be used to appeal to the broad coalition of actors upon whom Suharto depended for political survival. Suharto faced a dilemma. On one hand, stabilization and liberalization, if successful, would foster macroeconomic stability and stir development and thus establish credibility with external actors and enhance the regime's legitimacy with the mass public. On the other hand, these same reforms would adversely affect the army, pribumi firms, and the mass public as well as constrain the use of patron-client networks to maintain political support. Also weighing in on this dilemma were Suharto's own beliefs, which aligned closely with nationalists in the army and government who were united by their rejection of free markets, support for infant industry arguments, and opposition to foreign capital.

Although on the surface there appeared to be no easy way to reconcile this dilemma, in fact, part of the appeal of the UI economists' blueprint was that there was sufficient scope for Suharto to prune it—that

[59] Simpson 2008, 219.

is, adjust it so that it better fit with his beliefs and interests and those of his political supporters.[60] Suharto realized early on that he could reconcile his dilemma by balancing the arguments of the UI economists and the nationalists.[61] By confining the influence of the UI economists to agencies in charge of macroeconomic issues (the finance ministry, the central bank, and Bappenas), and the influence of the nationalists to agencies responsible for trade and industrial policy, a complex mix of liberalization and interventionism could be implemented. Suharto also grasped early on that he could rely on profitable state-owned firms—particularly the oil firm Permina (which became Pertamina in 1968)—to provide an unscrutinized, off-budget source of revenue that could be cordoned off from the control of the UI economists and used to build political support.

Sufficiently pruned, the UI economists' plan clearly fit with Suharto's perceived need to foster macroeconomic stability and development, establish credibility with external actors, and secure state resources to distribute to his political supporters. While the UI economists never intended for their arguments to be pruned in such a manner, they quickly realized that to find common ground with Suharto and their opponents, some elements of their blueprint would have to put on hold, at least until a new opportunity presented itself. This meant that the UI economists often saw any liberalization, regardless of its sequence, as better than no liberalization at all.[62]

It also explains why their influence was often confined to a narrow subset of issues—the capital account and the financial sector for example—such confinement enabled Suharto and the nationalists to insulate the real economy from market reforms. Market reforms that threatened the use of state resources for industrial policy and patronage purposes had insufficient crossover appeal to be selected. When backed by the UI economists, these market reforms may have had quality carriers and cohesion, but without crossover appeal or the perceived need for credibility, they were unlikely to be implemented.

The pruning of their arguments and their lack of an independent political base did not mean the UI economists were powerless without the support of external actors. On the contrary, in addition to the influence they garnered from their expertise and cohesion, the UI economists also proved capable of strategically framing and grafting their arguments so that they better fit with Suharto's belief system. While sharing the na-

[60] On pruning, see Acharya 2004.
[61] Robison 1988; Liddle 1991.
[62] Pincus and Ramli 1998.

tionalist, collectivist, and statist beliefs of most Indonesians, Suharto's belief system was also informed by the specter, and later the memory, of hyperinflation and economic deterioration in the 1960s, an experience that he was convinced had to be avoided in the future at all costs.[63]

In advocating their ideas, the UI economists understood, as William Liddle suggests, "how to package their explanations and proposals within a nationalist, populist, collectivist, and even anti-imperialist rhetorical wrapper, associating themselves with the mainstream goals of modern Indonesian culture."[64] Rejecting Sukarno's statism and "free fight [unfettered] capitalism," the UI economists offered their blueprint as helping to create a "*Pancasila* economy," that is, an economy based on the principles enshrined in the country's constitution, especially nationalism and social justice.[65] These discursive strategies helped the UI economists present themselves not as Western stooges seeking to displace widespread beliefs, but rather as upholders of indigenous beliefs who sought to strengthen them without undermining them significantly. This strategy helped further strengthen their clout as carriers of new ideas.

Over the years, the UI economists also routinely exploited Suharto's fear of hyperinflation and economic deterioration as well as their own success and strong track record in staving off Indonesia's collapse. "They were," as one official close to Suharto observes, "very good at scaring the old man [Suharto]. They kept him on a razor's edge, and that's how they got their way. They told him that if he didn't follow their suggestions the people would be without food or clothes, or the economy wouldn't grow."[66] With their clout and authority effectively enhanced by their success in the late 1960s, the UI economists helped ensure Suharto would call upon them again in times of economic distress. In addition, Widjojo's deferential communicative style, which Suharto preferred in his advisors, was also important. On a number of crucial issues over the years, Widjojo employed a combination of Javanese manners and an ability to present complex issues clearly in order to bring Suharto around to his point of view.[67]

### Stabilizing and Liberalizing Indonesia

The arguments of the UI economists informed how the reform process unfolded. In October 1966 an orthodox stabilization program designed with IMF assistance was put in place. The program imposed a drastic

[63] Elson 2001; Liddle 1991, 409–10; Woo, Glassburner, and Nasution 1994, 36, 38.
[64] Liddle 1991, 408.
[65] Salim 1997 [1966].
[66] As cited in Ford Foundation 2003, 51.
[67] Liddle 1991, 408–409.

reduction in the fiscal deficit and significant restraints on central bank credit creation. The UI economists also secured passage of additional measures such as a balanced-budget law, a limit on deficit financing, and greater operational autonomy for the central bank, that were aimed at limiting what they diagnosed as the key causes of hyperinflation. These measures also fit with their arguments for insulating monetary and fiscal policy-making from political interference.

Politically, the stabilization program was a huge gamble, as its adverse effects threatened to undermine Suharto's efforts to consolidate his rule. But the gamble paid off. Inflation decelerated from an annual rate of over 600 percent in 1966, to about 150 percent in 1967, to only 4 percent in 1971.[68]

Although in principle the UI economists wanted to create a free foreign-exchange market, they recognized that in practice Indonesia's significant debt burden and shortage of foreign reserves made complete freedom unsustainable in the short run.[69] Still, in October 1966, the government took important first steps in liberalizing foreign-exchange markets. Later, in May 1967, the creation of foreign-exchange bourses marked a major departure from Sukarnoist policies, since it was possible, for the first time, to trade foreign currencies against the rupiah freely and legally.

With debt rescheduling and significant new financing extended in December 1966, official creditors sent clear signals that they supported these actions. Although orthodox stabilization adversely affected the army, pribumi firms, and the mass public, the success of the UI economists in taming inflation, managing the debt burden, and unlocking external resources bolstered their position against their opponents. The enhanced clout provided the UI economists with valuable assets as they pushed through additional reforms.

In 1967 restrictions on inward FDI were radically liberalized, including greater freedom to remit profits and dividends and to repatriate capital. Salim outlined the radical nature of the law: "At this stage all sorts of investments are welcome, except in the excluded defense industries. The important thing is not in what sector private investment comes but rather when it comes. The time dimension is more important than all others."[70] New banking laws that overturned some of Sukarno's interventionism were also introduced. Restrictions were eased on foreign bank entry, though state banks continued to dominate the financial system.

[68] Cole and Slade 1996, 16–18.
[69] Prawiro 1998, 48.
[70] As cited in Winters 1996, 64–65.

Measures were also taken to attract foreign and domestic savings into the banking system. Residents and nonresidents were permitted to attain loans or open accounts denominated in dollars and to convert them into rupiah.[71] In September 1968 the government implemented a significant increase in deposit interest rates offered by state banks.[72] These measures attracted large capital inflows into the banking system, which subsequently generated new concerns about excess liquidity and renewed inflationary pressures. Ironically, after years of facing a persistent shortage of capital, Indonesia now found itself facing a "capital inflows problem."[73] In response, the government temporarily suspended the ability of banks to accept new deposits and over the next three years significantly lowered the rate on deposits.

Despite these measures, important selective restrictions remained. Some, such as the requirement that state banks and firms secure government approval to borrow abroad, reflected the UI economists' diagnosis that had raised concerns about debt-service obligations. Other restrictions, such as constraints on the operations of foreign banks and the provision of only a limited guarantee of nonnationalization to foreign investors, reflected Suharto's efforts to prune the UI economists' blueprint and ensure sufficient crossover appeal while maintaining sufficient credibility with external actors. Market reform and liberalization enabled Suharto to establish a sufficient amount of external credibility while selective interventionism enabled him to use the financial system for industrial policy and patronage purposes and to appeal to popular hostility toward foreign capital.[74]

Notwithstanding these restrictions, the economy was clearly moving toward greater openness. Liberalization in early New Order Indonesia culminated with the 1970 decision to abolish restrictions on capital outflows. The most prominent materialist explanation for this decision offers a crisis-induced model of policy change. Liberalization during the crisis, in this view, was necessary to attract capital, particularly FDI, and to send a positive signal to liquid-asset holders, particularly Chinese businessmen, that they could keep their assets onshore, safe in the knowledge that they were free to liquidate their investments.[75]

But those arguments are not fully convincing. There is little doubt that part of the initial impetus for liberalizing restrictions on FDI came from the perceived need to respond to official and market sentiment.

[71] Arndt and Suwidjana 1982.
[72] Cole and Slade 1996, 17.
[73] On the capital inflows problems, see Calvo, Liederman, and Reinhart 1994.
[74] MacIntyre 1993; Palmer 1978, 101–103, 157–58; Winters 1996, 65–66, 70–71.
[75] Haggard and Maxfield 1996.

There is little evidence, however, to support the claim that the crisis alone was responsible for the radical opening to FDI. More significantly, as discussed above, the decision to seek out financing from external sources was not automatic; on the contrary, it resulted from the efforts of the UI economists and Western creditors to convince Suharto that their diagnosis and blueprint were the only way out. In fact, even proponents of crisis-induced models of policy change make ad hoc concessions that stress such social processes. As Stephan Haggard and Sylvia Maxfield claim, "the proximate causal mechanism is politicians' *perception* that liberalization of the capital account will assure investors and thus ultimately induce capital inflows." Such perceptions do not float freely. In fact, at the time the decision was made the conventional wisdom was that governments should tighten capital controls during a crisis. That an alternative perception was inserted into the policymaking process was largely due to the mechanisms identified in the theory developed here.

Indeed, it is doubtful that radical liberalization of FDI was the only way out. Indonesia could have pursued an alternative development model such as one that relied on a selective opening to foreign capital, which arguably could have produced similar results. In fact, despite the radical opening, FDI never loomed large as a proportion of gross domestic product or gross capital formation.[76] Nevertheless, the government perceived radical liberalization as necessary. It should also be noted that while the FDI law grew out of a perceived need to attract foreign capital, its precise form was not simply a response to the official and market sentiment. It also reflected the UI economists' arguments against a selective opening, which they viewed as depressing growth and stifling the catalytic effect on domestic firms.[77]

In addition, there is not sufficient support for the claim that controls on outflows were abolished solely to attract capital. Although part of the initial impetus for liberalization in the late 1960s came from a perceived need to attract capital, by the 1970s the economy was no longer in dire straits. Stabilization had given way to recovery while improved export performance and strong capital inflows into the banking system enabled the government to replenish its foreign reserves.[78] It is therefore doubtful that the decision to abolish controls on outflows originated from some material need to attract capital to an economy that was already showing signs of a capital inflows problem.

[76] Hill 2000, 77–79.
[77] Palmer 1978, 18.
[78] Woo, Glassburner, and Nasution 1994, 185.

There is also much evidence undermining the claim that liberalization was simply an exercise in signalling. If the government was seeking to send unambiguously positive signals to owners of capital, it was not doing a particular good job. In 1968 and 1970, the government, due to strong objections from pribumi firms, refined the 1967 radical liberalization of FDI by excluding additional sectors from foreign participation.[79] In addition to these measures, the limited guarantee of nonnationalization also caused discomfort among foreign owners of capital.[80] Regarding the decision to abolish controls on outflows, without accompanying institutional reforms such as delegating authority for capital account policy to an independent central bank, it is unlikely the decision would have been interpreted by foreign or domestic owners of capital as a strong signal because liberalization could be easily reversed in the future.

There is, however, stronger support for the claim that the decision to abolish controls on outflows grew out of a perceived need to maintain the confidence of liquid-asset holders, particularly Chinese businessmen. Indeed, it is often said that this policy was part of an implicit contract between Suharto and the military on the one hand, and their political supporters among Chinese businessmen on the other. While liberalization clearly fits with the interest of Chinese businessmen in hedging against their political vulnerability, if capital controls were an ineffective policy instrument, then there is a risk in overstating the intensity of this interest.

Indeed, some scholars who claim liberalization was part of an implicit contract between Suhuarto and Chinese businessmen also argue that controls on outflows were abolished because they were ineffective.[81] This presents an inconsistency. One can explain the decision as an effort to appeal to the interests of Chinese businessmen in hedging their political vulnerability. Or one can attribute it to the fact that the controls were easily evaded. But it is inconsistent to claim that the controls were liberalized because they prevented Chinese businessmen from liquidating their assets and because they were ineffective.

This is not to deny that the idea to abolish controls on outflows was bolstered by its appeal to liquid-asset holders and other owners of capital. Even if controls could be easily evaded, liquid-asset holders might have seen liberalization as part of an implicit contract with

[79] Robison 1986, 146.

[80] Winters 1996, 65–66, 70–71.

[81] See, for instance, MacIntyre 1993, 140, who identifies "dual motives involved in the move" to capital account openness.

the regime that it took their interests seriously. In fact, as the theory developed here claims, ideas often win out because they serve as important coalition-building resources. Yet the above discussion suggests that liquid-asset holders may not have been held a very intense interest in liberalization.

There is also much evidence to support the view that much of the impetus for abolishing the controls came from the UI economists. While many scholars allude to the role of the UI economists, few devote serious attention to how their arguments and strategic actions helped to overcome resistance to it. The UI economists viewed abolishing controls as consistent with their belief in free markets and as a continuation of earlier steps taken to liberalize the foreign-exchange market. More significantly, they believed that liberalization would constrain the ability of politicians to make inflationary monetary and fiscal policy choices. However, nationalists and their business allies strongly opposed this position because it would deprive them of their preferential access to foreign exchange.[82] Bureaucrats within the Foreign Exchange Transaction Board (FETB) also were opposed, as it stood to eliminate one of their major activities.

As part of the 1970 policy decision, the exchange rate was unified with support from the IMF. Prawiro had favored exchange rate unification but concerns about the degree of discipline that capital account openness would impose on a fixed exchange rate regime led him to recommend a flexible rate that could be adjusted to changing market conditions.[83] But other UI economists argued for a fixed rate on the basis that it would stir exports and act as constraint on inflationary policy choices.[84]

On the issue of abolishing controls on outflows, the UI economists were in complete agreement. Controls, in their view, imposed significant administrative costs, created severe distortions, and bred corruption.[85] The UI economists also pointed to the failure of Sukarnoist controls to prevent capital flight as a clear demonstration of the difficulties of effectively controlling capital.[86]

Wardhana and Widjojo first worked to forge an internal compromise among the UI economists on the exchange rate regime and sought a way to mute some opposition to liberalization. In discussions among the UI economists, Prawiro, in seeking to lessen opposition from FETB

[82] Cole and Slade 1996, 330; Salim 1997 72.
[83] Prawiro 1998, 310, fn. 5.
[84] Cole and Slade 1996, 44–45.
[85] Salim 1997, 72; Djojohadikusumo 1986, 38–39.
[86] Hill 2000, 42, 66; Prawiro 1998, 290–91.

bureaucrats, suggested abolishing the bureaucracy and transferring the employees to the central bank at commensurate rank and salary and more favorable long-term prospects.[87] Wardhana and Widjojo backed this proposal while securing support for a fixed exchange rate regime. Widjojo and Salim then went to Suharto to convince him of the need to liberalize. Their arguments proved more influential than those of their opponents. Suharto, in a cabinet meeting, supported the proposal of the UI economists despite hearing many objections.

The decision was never reversed. Notwithstanding its potential appeal to liquid-asset holders, it is remarkable that the UI economists were able to implement this policy given their lack of an independent political base, opposition from nationalists, and popular hostility. Moreover, external actors such as the IMF, though supporting exchange rate unification, did not add much support. In addition, economic conditions at the time provided little urgent need to liberalize further to appease market (or official) sentiment.

However, the quality of the UI economists as ideational carriers proved to be an asset. Having achieved earlier success, they were in a stronger position to push for further reforms. Equally important were the strategic actions they took to mute opposition and win over Suharto. In addition to Prawiro's proposal to transfer FETB bureaucrats to the central bank, another important discursive strategy the UI economists employed was to focus on the corruption associated with capital controls.

By 1970, popular sentiment had begun to turn against elements of the New Order due to allegations of increasing authoritarianism, corruption, and government excesses, such as Pertamina's growing off-budget borrowing and distribution of funds.[88] Pertamina's activities also alarmed the UI economists, who thought the economy was still too weak to service nonconcessional debt. Because large debt-service payments would place a strain on foreign reserves, the UI economists believed that Pertamina's activities could jeopardize their commitment to capital account openness.[89]

Suharto had shrewdly positioned himself so as to not be implicated in Pertamina's activities, yet he had full knowledge of and benefitted from them all the while. Nonetheless, he proved sensitive to allegations of corruption, and in 1970 authorized a sweeping investigation of practices within the New Order, including those of Pertamina. Though

[87] Cole and Slade 1996, 349, fn. 44.
[88] Robison 1986, 160, 235.
[89] Winters 1996, 88.

Suharto permitted Pertamina's activities to continue until its near default in 1975, the decision to authorize the investigation represented a partial victory for the UI economists. It suggests that the economists were able to alert Suharto to the fact that whatever benefits he was garnering from Pertamina's activities, he was simultaneously jeopardizing economic and political stability by undermining the confidence of external actors in government policies and in the ability of the UI economists to direct them. By linking capital controls to corruption, the UI economists helped ensure their arguments for liberalization would resonate with Suharto's concerns about limiting, or at least appearing to limit, corruption.

The UI economists also strategically kept Suharto and the nationalists in the dark about the policy implications of maintaining an open capital account and a fixed exchange rate. By 1970 popular sentiment had turned against fiscal and monetary restraint and there was a strong possibility that future easing would be necessary to accommodate political demands. Yet capital account openness, along with the balanced-budget law, offered ways to constrain these demands.

The UI economists recognized the extraordinary discipline that openness would impose on fiscal and monetary policy. But they chose not to share this knowledge with Suharto or opponents who lacked their sophisticated understanding of open-economy macroeconomics. Indeed, most government officials did not fully appreciate the magnitude of the decision at the time.[90] Thus, by strategically shrouding their opponents in a veil of ignorance, the UI economists helped win acceptance of outflow liberalization.

## Conclusion

This article shows the limitations of rationalist depictions of crises. In Indonesia, the New Order's embrace of market reforms was not automatic and newly dominant political coalitions did not play a decisive role at each stage of the process. The Indonesian case shows that OEP models, despite their elegance, are often too sparse and too far removed from specific national circumstances to provide a useful guide to understanding crisis politics. Moreover, distributive preferences were not a prominent guide to action at all stages of the crisis resolution process. Even when distributive preferences did assert themselves, such as in the debate over the October 1966 stabilization program, key support-

[90] Cole and Slade 1996, 43, 329–30; Hill 2000, 42, 66; MacIntyre 1993, 140; Prawiro 1998, 291.

ers of Suharto often found themselves on the losing side of the argument. This is not to deny the impact of distributive preferences. Indeed, the crossover appeal, in both a distributive and ideational sense, was argued and found to be important. Yet much OEP work on crises overestimates the importance of bargaining and negotiation as mechanisms of change while giving insufficient attention to uncertainty and the intensity to which distributive preferences are held. In underestimating the role of persuasion, OEP work also obscures the influence of intersubjective beliefs on actors' interpretations of material events and incentives.

Constructivists, while stressing the role of belief systems, uncertainty, and persuasion, do not adequately theorize the scope conditions under which a new idea is likely to be selected. This article seeks to rectify this shortcoming by identifying the four Cs of crisis resolution: carriers, composition, crossover appeal, and credibility. It also strengthens extant constructivist work on resonance by considering a broader range of actors that shape intersubjective change and by developing a more agent-centered and strategic approach. Overall, the Indonesian case supports the contention that whenever a prominent and cohesive group of carriers advocates arguments with sufficient crossover appeal and externally sanctioned credibility, intersubjective change is more likely.

How can these arguments be extended? A research agenda that opens up the black box of the crisis resolution process could prove a useful starting point. An obvious first place to turn is the global financial crisis of 2007–09. Despite efforts to coordinate policies, this highly visible and intense crisis has nonetheless produced interesting policy divergence. This divergence provides researchers with a rich area for future empirical inquiry.

In pursuing this research agenda it is worth considering how well the arguments developed here apply to other issue areas and institutional settings. For instance, it could be the case that political mobilization was muted in the Indonesian case because capital account liberalization is a relatively technical area where the costs for the mass public are widely distributed, uncertain, and (when they appear) often very delayed. In such issue areas it may prove easier for norm entrepreneurs to obtain insulation from the mass public than in those areas where the costs are concentrated, clear, and immediate (i.e., fiscal subsidies for food or oil). It may also be the case that policy choices in relatively technical areas are more likely to depend on credibility with external actors than legitimacy with domestic ones. Notwithstanding these considerations, it should be noted that in the case of Indonesia, the mass public and members of the elite did have relatively clear and intense preferences about openness to foreign capital even if they did not fully grasp its implications.

In terms of institutional settings, it is worth considering whether the perceived need to establish credibility with external actors rather than legitimacy with domestic elites and the mass public is particularly intense in authoritarian settings. While the Indonesian case reveals that mass public demands can shape policy even in an authoritarian setting, democracy can often be at odds with market reform. It is therefore important to investigate whether the crisis-resolution process specified here also pertains to democratic institutional settings.

There are also strong links between the arguments made here and other ongoing debates. First, understanding the role of credibility in crisis resolution may provide additional insights into how legitimacy gaps open up for external actors, such as the IMF, and potentially undermine their efficiency.[91] In addition, understanding the role of resonance between the beliefs of domestic norm entrepreneurs and those of powerful external actors may provide insight into how the attributes of countries where international organizations operate influence their behavior, including their willingness to support countries where sympathetic interlocutors are present.[92]

Finally, a broader implication of the focus on credibility is that scholars need to be more attentive to the beliefs shared by external actors. It is insufficient for credibility-based explanations to simply assume that external actors share particular beliefs. Because the beliefs of these actors affect the type of incentives they exert for action, we need to be more sensitive to these beliefs to strengthen our explanations. This calls for a research agenda that explores more deeply the beliefs of official creditors, international organizations, financial-market participants, and regulatory and standard-setting bodies. Research into the common knowledge that informs the behavior of these actors and those that interact with them offers a genuine opportunity for synthesis between rationalism and constructivism.[93]

[91] Seabrooke 2007.
[92] Woods 2006.
[93] Katzenstein, Keohane, and Krasner 1998.

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