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THE FALL OF SUHARTO: THE ECONOMY; Experts Say Indonesia Can Boom, Long-Term

By PETER PASSELL

While no one disputes that the Indonesian economy has stumbled badly and shows few signs of imminent recovery, specialists are strikingly optimistic about its long-term prospects. Three decades of balanced development, they suggest, have positioned it for sustained growth.

Indeed, last summer as the financial crisis spread across Asia, many economists expected that Indonesia would dodge the bullet. With a balanced budget, low inflation and a healthy trade account, there seemed no good reason for speculators to attack the Indonesian currency.

"Of all the economies in Southeast Asia it seemed the least prone to disaster," said Steven Radelet of Harvard's Institute for International Development.

But when regional panic did engulf the economy last fall, high-flying banks and businesses found themselves with huge debts in dollars that they could not possibly repay with their severely depreciated rupiah. As in the rest of Asia, repair will require huge financial restructuring.

More fundamentally, the country must turn away from the crony capitalism that led to wasteful investments in everything from autos to airplanes. "Indonesia needs to go back to the roots of its success, using cheap, abundant labor to power a fresh export boom," said Albert Fishlow, an economist at the Council on Foreign Relations.

While oil, mining and plantation crops gave post-colonial Indonesia a toehold in the international economy, its take-off in the last few decades reflects a number of enlightened decisions.

Indonesia encouraged rural development in the 1960's and 70's, investing heavily in primary education, health care, family planning and roads linking isolated regions to markets. "Infrastructure -- physical and social -- made a huge difference,' said Iwan Azis, an economist at the University of Indonesia in Jakarta.

Perhaps most importantly, economic planners did not make the error of holding down food prices to pacify urban constituencies at the expense of peasant farmers. Rice production exploded, making the country self-sufficient in food by 1980. And high rice prices, along with the technological change that doubled and tripled productivity, did much to eradicate grinding rural poverty. "Two Indonesians in three lived below the poverty line in the 1960's," Mr. Radelet noted. "Last year the figure was below 15 percent."

In the 1970's, the technocrats in Jakarta made the rupiah convertible, allowing foreigners to repatriate profits earned in Indonesia and thus encouraging investment. And in the mid-1980's, after oil prices collapsed, planners made the critical decision to follow the lead of the Asian Tigers by focusing on manufactured exports. With duty-free access to industrial machinery and raw materials and an exchange rate set to make Indonesian exports competitive, the apparel industry boomed.

Shoe and toy manufacturing followed, and by the mid-1990's Indonesia had joined Thailand and Malaysia in electronics assembly. Among the results were sustained 7 percent growth and, by the mid-1990's, an average income level of about $3,500 in terms of purchasing power -- higher than China or the Philippines.

Despite rapid growth, inflation remained in abeyance, said Gustav Ranis, an economist at Yale University. When it came to macroeconomic stability issues, he said, "the Government always listened to the Berkeley mafia," referring to the American-trained economists responsible for much of the planning.

The economy's vulnerability to financial collapse can be traced to the mid-1980's, when Indonesia opened the banking industry to competition but never put modern bank regulations in place. "It's as if the Government had gotten rid of the policeman at every corner, but didn't bother to put up stop signs or lights," suggested Mr. Azis. "The traffic moved faster, but was prone to accidents."

One can also spot weaknesses in the late-1990's rush to move from labor-intensive industries to higher-tech industries including autos, petrochemicals and aircraft. Like the South Korean tycoons in the late 1970's, Indonesia's economic elite -- Mr. Suharto's family and friends -- -- had grandiose ideas for vaulting into modernity. And the cozy political system guaranteed them access to capital.

But Mr. Radelet points out that it requires 20-20 hindsight to discern the origins of current crisis in pre-crisis statistics. The budget was in balance, inflation was falling and the Indonesian economy actually grew at the then-standard 7 percent rate in the first half of 1997.

The proximate cause of the crisis, the flight of hard currencies like dollars and Japanese yen that cut by three-quarters the exchange value of the rupiah in a few weeks late last year and left Indonesian businesses unable to repay tens of billions of dollars in debts, had little to do with the crony capitalism.

Restoring Indonesia to the the growth path requires a recovery of investor confidence that allows the rupiah to appreciate to more realistic levels. That is where the demands by International

Monetary Fund for fiscal and monetary austerity, in return for hefty loans to restructure the banks, fit in.

But more basic reforms, forcing Indonesia to rely more on free market incentives and less on the corrupt and inefficient -- if sometimes benign -- ruling elite, may determine the long-term success. "Indonesia needs economic and well as political decentralization to make it," said Mr. Ranis.