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## **Aid and policy preference in oil-rich countries**

Comparing Indonesia and Nigeria

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**Abstract:** This paper analyses the role of foreign aid to assist development in two oil-rich countries: Indonesia and Nigeria. This paper seeks to understand the way foreign aid provided assistance to transform Indonesia from a ‘fragile’ state in the 1960s into one of the ‘Asian Tigers’ in the mid-1990s, and why it did not prevent Nigeria from falling into ‘African Tragedy’. This paper argues that foreign aid could help not only to finance development, but also to navigate policy makers’ policy choices. It shows how foreign aid could or could not help policy makers turn their policy preferences into action.

**Keywords:** aid, fragile state, policy, oil, Indonesia, Nigeria.

**JEL classification:** O130, O190, O570, H630

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## 1 Introduction

Indonesia and Nigeria have had contrasting experiences with foreign aid. Since the end of the 1960s, Indonesia has received substantial foreign aid to finance its development programmes and projects. Meanwhile, Nigeria has received only limited foreign aid and, therefore, has had to borrow short-term and high interest rate loans. This paper analyses the role of foreign aid in assisting development in two oil-rich countries: Indonesia and Nigeria. The two countries are similar in many respects, ranging from geography to economic, social, and political challenges, but Indonesia has developed 'better' than Nigeria since the end of the 1960s. This paper seeks to understand if and how foreign aid provided assistance to transform Indonesia from a 'fragile' state in the 1960s into one of the so-called 'Asian Miracles' in the mid-1990s, and why foreign assistance could not prevent Nigeria from falling into what some term as 'African Tragedy'.<sup>1</sup>

As two giant oil economies, the important role of oil in Indonesia and Nigeria has invited frequent comparisons between these two countries (see Pinto 1987; Scherr 1989; Chowdhury 2004; Bevan et al. 1999; Lewis 2007). In fact, most comparisons of these two countries start from the fact that Indonesia and Nigeria are two giant oil producers, particularly after the skyrocketing of oil prices in 1973 and 1979, linked to the Arab oil embargo and the Iranian Revolution respectively.

Institutional arrangement has been a dominant argument for why Nigeria has failed to achieve sustainable and equitable economic growth, despite its abundant natural resources. The institutional arrangement here usually refers to Nigeria's fragmented society based on ethnicity, religion, and factions within the military and the government (see also Daloz 2005; Iyoha and Oriakhi 2008; Lewis 2007; Osaghae and Suberu 2005; Thorbecke 1998). Lewis for instance, notes that Nigeria's economic tragedy is linked to the 'central problem of collective action'. In his view 'in a setting of weak formal institutions and myriad conflicts over distribution, the Nigerian state has succumbed to a social dilemma: individuals and groups focus on particular gains at the expense of collective goods and general welfare' (Lewis 2007: 78). Similarly, Bevan et al. (1999) argue that, unlike Indonesian politics, which is dominated by Javanese, there is no dominant ethnic group in Nigeria that is able to provide political stability and consensus.

An alternative view is that Nigerian policy makers were mistaken or misguided about what was necessary to achieve sustainable and equitable economic growth. Henley et al. (2012) note three contrasting policies that led to economic divergence. First, Indonesian policy makers put rural-agricultural development as their first priority, while Nigerian policy makers preferred industrialization at an early stage of development. Second, Indonesia's policy makers were very pragmatic in their way of thinking. They believed that market forces were necessary for the economy to progress, but they also realized the importance of government intervention to handle market failures. Meanwhile, since independence, Nigerian policy makers have continued to be obsessed with promoting value-added industries through an active role of government. Third, the contrast between a rural-based and an urban-based development vision, as well as between market-oriented pragmatism and regulatory nationalism, can be seen clearly in the two countries' macroeconomic, particularly exchange rate, policies. Indonesia's policy makers devalued the rupiah several times, which increased the competitiveness of Indonesia's exports on

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<sup>1</sup> The World Bank (1993) published *The East Asian Miracle*, highlighting rapid economic growth and impressive poverty reduction in Asian countries. Meanwhile, Easterly and Levine (1995) published *Africa's Growth Tragedy*, to show how Africa has 'potential unfulfilled, with disastrous consequences'. Predicted to grow ahead of East Asia, Africa's economy experienced a stagnation of per capita income from the 1960s (Easterly and Levine 1995, 1997).

the world market. In contrast, Nigeria's policy makers maintained the overvalued naira, which caused exports to deteriorate, and further stimulated import dependence as well as reliance on oil revenue.

The underlying assumption of this primacy of policy is that a contrast in economic performance arose under roughly similar institutional arrangements in Indonesia and Nigeria, and the contrast arose from the response of policy makers to institutional challenges. In the 1970s, when these two countries' economic trajectories started to diverge, there were groups of technocrats that dominated the economic policy arena in the two countries; what some have termed the 'Berkeley mafia' in Indonesia and the so-called 'Super Permanent Secretaries' in Nigeria. The economic policy elites in Indonesia and Nigeria were working under military regimes from 1966 to 1998, and were sufficiently insulated from military and political pressure. Indonesia's technocrats enjoyed Suharto's protection from interference in formulating economic policy. Similarly, the military masters in Nigeria (like Gowon, Buhari, Babangida and Abacha) shielded their technocrats from political interference so that they could have sufficient room to formulate their ideas into policies. Despite similar economic challenges during the oil boom and bust periods, they made contrasting agricultural and exchange rate policies.

The ability of the policy makers to act independently with free choice and their ability to manoeuvre within institutional arrangements should not be overlooked. Building to the primacy of policy argument, this paper aims to analyse the roles of foreign aid in the contrasting economic policies of the two countries. It argues that in critical periods, foreign aid could help not only to finance development, but also to assist policy makers to manoeuvre in order to turn their policy preferences into action.

The following section presents rationales for the comparative analysis of Indonesia and Nigeria. It then presents a brief narrative of how the two countries transformed their economy and politics. Finally, this paper presents the characteristics and the relative importance of foreign assistance for transformation.

## **2 Similar countries with diverging paths**

The fact that a contrast in economic performance arose under roughly similar institutional arrangements is the rationale for this paired comparison. Indonesia and Nigeria are rich in natural resources, particularly oil. Nigeria is one of the largest producers and exporters of petroleum, and the largest oil exporter in Africa (World Bank 2010b). Since the 1973 oil boom, oil has played an increasingly major role in Nigeria. Rising oil prices had increased export revenue from the oil sector by almost 300 per cent in 1974 compared to the previous year; in 1974 oil contributed 30 per cent of gross domestic product (GDP), 80 per cent of government revenue (Lewis 2007: 136), and 93 per cent of total merchandise exports (World Bank 2010a). On average, crude oil contributed more than 95 per cent of Nigerian merchandise exports from 1974 to 2009 annually, and never fell below 90 per cent within that period (World Bank 2010a). Oil contributed more than 70 per cent of the national government's revenue. Similarly, Indonesia was a major oil exporter, even though it is no longer a member of the Organization of Petroleum Exploring Countries (OPEC) since 2009. Like Nigeria, Indonesia enjoyed increased revenue from the oil boom in 1973. After the first oil boom, the oil sector became the main source of development financing. In 1974 the oil sector contribution to GDP doubled to 22 per cent, compared to the previous year, and provided 37 per cent of government revenue (Lewis 2007: 102). On average, oil contributed more than 70 per cent of Indonesian merchandise exports during 1973-85, reaching a high of 82 per cent in 1982 (World Bank 2010a).

These two countries also show similarities in many other respects, ranging from geographical features to social and political challenges. Both are located in the tropical area, have the largest population in their respective region, have an ethnically highly diverse population, have experienced a long history of colonialism, and were ruled by military leaders over 1966-98, the period under study (with two brief civilian administrations in Nigeria in 1979-83 and 1993). Both countries are also well-known for their high level of corruption. Terms like corruption, prebendalism, predation, clientelism, and kleptocracy have been widely used to describe the misuse of public power for the private gain of Nigeria's elites; corruption has reached a chronic level (see Akindele 2005; Joseph 1987; Lewis 1996; Nnamuchi 2008). Similarly, Indonesia under Suharto also acquired a reputation as one of the most corrupt countries on earth (King 2000: 603-4; McLeod 2000). Suharto's regime had been associated with *Korupsi*, *Kolusi*, *Nepotisme* (KKN)—corruption, collusion, and nepotism (Robertson-Snape 1999: 589).

Yet their economic performance shows a stark contrast. In the wake of independence in the 1960s, Nigeria was full of optimism about the future of the economy. Tragically, however, up to the end of the 1990s the economy grew very slowly and often contracted. Two thirds of the population remained below the poverty line and inequality increased considerably. By contrast, after years of pessimism and chaos in the 1960s, Indonesia's economy not only grew continuously at a high rate, but the proportion of the population living below the poverty line was also substantially reduced.

After emerging from the political turbulence and economic chaos of the mid-1960s, Indonesia embarked on a period of seemingly miraculous economic growth. In the period 1970-90, Indonesia's GDP grew robustly at 7 per cent annually on average. In contrast, Nigerian GDP in that period grew at only about 3 per cent annually (World Bank 2007). Moreover, the World Bank data shows that average growth of GDP per capita in Nigeria in the 1980s was -1.5 per cent annually. The portion of the population living below the poverty line in Indonesia decreased from 60 per cent in 1970 to 28 per cent in 1986 (World Bank 1990: xv, 2007).<sup>2</sup> In Nigeria, in contrast, the poverty headcount ratio increased from an estimated 40 or 50 per cent in 1973-85 to 65 per cent in 1986 (World Bank 1996: iv, 2007).<sup>3</sup> Life expectancy also reveals a contrast between the two countries. Data from the World Development Indicator shows that life expectancy in Indonesia continuously increased from less than 43 years in 1962 to more than 66 years in 2002. In Nigeria average life expectancy in 2002 was still less than 47 years. Taking into consideration that Nigeria started from a low (39 years) life expectancy in 1962, it only improved by around eight years over a 40-year period.

It is still debatable whether the Indonesian development trajectory in the mid-1990s was as good as has been portrayed by the World Bank. At least the Asian economic crisis, which hit the Indonesian economy in 1997, shows the vulnerability of the Indonesian economy. However, this does not prevent the comparability of these two countries. This paper is not designed to compare a failed state with a country that has a very good development performance. Rather, this pair of Indonesia and Nigeria is designed to compare countries that have more or less similar social, political and economic challenges.

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<sup>2</sup> Data for 1986 is based on the percentage of the population living on less than one dollar a day (PPP); while data for 1970 is based on national poverty lines, which are lower than one dollar a day. With a one dollar a day poverty line, the percentage of the population living in poverty in 1970 would be even higher than the figure presented.

<sup>3</sup> Data for 1986 is based on the percentage of the population living on less than one dollar a day (PPP). There is no reliable data available for the 1970s; the 1973-85 figures are based on national measurements.

### 3 Political and economic changes

#### 3.1 Indonesia

In the wake of independence in 1945, the first Indonesian president, Sukarno, had to build a strong basis for a stable national government. Whereas Indonesia had earlier had to struggle for recognition of independence, Sukarno now had to keep the country together. Separatist movements, such as Permesta (Perjuangan Semesta) in 1957 and Negara Islam Indonesia (Indonesian Islamic State) declared in 1949 by Sekarmadji Maridjan Kartosuwiryo, had shown how fragile the country's unity was. Sukarno was successful in bringing national solidarity to the newborn country and kept the country together during the critical period. However, as Rahmat Saleh says, Sukarno paid no attention to economic policies. At that time, the programme was clear, namely politics; it sought to unite Indonesia, to get Irian Jaya [nowadays Papua] from the Dutch, and then to be a world superpower. The priority was to solve political problems. Sukarno, in a way, was successful in this political development, so Indonesia was able to get Irian Jaya back, and also to propagate a new world order. However, the economy was not moving, since he ignored it (interview 30/10/2008).

Between 1959-65, GDP grew by only 1.8 per cent annually on average (this is lower than the population growth, which was 2.2 per cent annually), exports dropped by 24 per cent, and foreign exchange reserves dropped from US\$267 million to only US\$17 million, which was not enough to finance even one month of imports (Wing et al. 1994: 24). The cost of living also increased substantially, with an inflation rate often cited of 650 per cent for 1965. In short, the situation in the mid 1960s shows how fragile Indonesia was.

Frans Seda (2009) argues that the very poor economic conditions were due to an economic regime that concentrated economic activities in the hands of the state (etatism), with a high frequency of interventions, bureaucratic procedures, and controls on prices, production, and distribution. The economy was isolated from the rest of the world with Sukarno's 'go to hell with your aid' proclamation and the takeover of foreign companies, as well as limitations on investment by foreign and private sectors (Seda 2009). In addition, Seda notes the inflationary effects of credit expansion, budget deficits, and circulation of money without proper controls, as well as a regime of multiple exchange rates with unrealistic exchange rate management.

In this chaotic economic situation, the Indonesian Communist Party (PKI) allegedly attempted a coup d'état at the end of September 1965. The coup, however, was quickly suppressed by the military under Suharto's command. In the worsening political and economic conditions, Suharto took over power from Sukarno in March 1966 with the controversial 'Letter of Instruction of 11 March', also known as 'Supersemar' (Hooker 1999: 270). On 12 March 1967 Suharto was proclaimed president by the Provisional People's Representative Assembly (MPR Sementara). The Cold War against communism was an important factor behind the rise and development of the New Order, the term used to characterize Suharto's presidential period. The threat of communism was used not only to gain support from Western powers, particularly from the United States, but also to 'unite' and often to suppress political opposition groups in the country. Mass killings were reported in Central Java, East Java and Bali during the 1965-66 transition period (Vatikiotis 2003: 33; Wertheim 1966: 122).

Faced with the chaotic political and economic situation, Suharto relied on a team from the Faculty of Economics, University of Indonesia (FEUI), led by Widjojo Nitisastro, to manage economic affairs. In the beginning, the role of Widjojo and his friends was to be the navigators of the Indonesian economy. They were assigned to the personal staff (*staff pribadi*, or *spri*) of the

chairman of the presidium,<sup>4</sup> and were in charge of economic affairs. WidjojoNitisastro, Emil Salim, Subroto, Ali Wardhana, and Mohammad Sadli formed the team of experts for economics and finance that was coordinated by Colonel SudjonoHumardani by a decree on 12 September 1966 (Republik Indonesia 1966). In these positions, they were very powerful in economic policy-making, since any economic decisions had to follow their instructions.

The role of this group became stronger after the reshuffle of the first development cabinet in 1971 when group members gained full control over the economy after all of them were formally appointed to ministerial positions. In the 1971 reshuffle, Widjojo, chairman of the National Development Planning Board (*Badan Perencanaan Pembangunan Nasional*, Bappenas), was given ministerial rank, Sadli became minister of manpower, Subroto became minister of transmigration and cooperatives, and Emil Salim became minister of administrative reform.

The technocrats designed stabilization and rehabilitation programmes and started implementing them in October 1966 (Hong 1968: 135; Seda 2009). The programmes were particularly aimed at controlling hyperinflation, securing food provision, and rescheduling foreign debt. The government also opened the country to foreign investment, implemented balanced-budget principles, and introduced a simplified exchange rate regime, including making the rupiah freely convertible. Suharto's economists' team successfully managed stabilization and rehabilitation during a very critical period, giving legitimacy to the New Order government. Within a few years, the economy was stabilized, and inflation dropped to a more moderate level of 15 per cent in 1969. The economy also grew promisingly from 1968; in that year, GDP, total exports, and manufacturing value added grew by 12 per cent, 10 per cent, and 8.5 per cent respectively (World Bank 2010a). Since that period, the Indonesian economy grew miraculously by about 7 per cent annually for more than 25 years.

During the stabilization period, the role of the FEUI team in managing the Indonesian economy was almost unchallenged. However, in the wake of the Arab oil embargo in 1973, which increased Indonesia's oil revenue, the role of the Pertamina group under IbnuSutowo grew. Confidently, Pertamina expanded to various business activities, not only in the oil sector but also in other areas, such as a petrochemical complex, port facilities, hotels, a tourism complex, an airline, and several rice-growing plantations (Glassburner 1976: 1100). This expansion was not in line with the stabilization programmes designed by the economists' team. As a result, there was growing tension between the FEUI team and IbnuSutowo's group, which climaxed with the 1975 Pertamina scandal and the dismissal of IbnuSutowo in 1976 (Glassburner 1976: 1099, 1103). The removal of IbnuSutowo from Pertamina allowed the technocrats to regain full control over the country's economic management, including the oil money.

Besides the technocrats, the main pillars of the Indonesian New Order were bureaucrats and the military. William Liddle (1983) describes the political structure of the New Order as a pyramid of power, with Suharto at the apex, supported by the military and by the bureaucrats. The military, particularly the army, was the heart of the political system in the New Order (Liddle 1999: 26). With a chain of command from the central power in Jakarta to remote areas in the countryside, the military effectively performed its dual function (*dwi fungsi*) in addition to the usual security role, the military was also represented throughout the higher levels of government. Meanwhile, the bureaucracy, particularly through Golkar (*golongankarya*, functional groups), provided the

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<sup>4</sup> Following the arrest of Sukarno's cabinet ministers, the presidium cabinet, called Ampera Cabinet, was established, led by the triumvirate Suharto, Adam Malik and Sri Sultan Hamengkubuwono IX. Suharto, the chairman, was responsible for security affairs, Adam Malik for international affairs, and Sultan for economic affairs (Bresnan 1993: 51).

political machinery for the New Order. Formed in 1964 by the army to coordinate anti-communist groups during the Sukarno period (Elson 2001: 186), Golkar was then transformed into an unchallenged state party whose members were mainly civil servants. Starting with the first general elections (1971) under the New Order, Golkar always won the majority of seats in parliament and legitimized Suharto's presidency until the 1998 *Reformasi* pushed him out of office. The end of Suharto's power, which is called the reform era, brought Indonesia into a new democratic period. Since then Indonesia has had three general elections and four presidents, Bacharuddin Jusuf Habibie, Abdurrahman Wahid, Megawati Sukarnoputri, and Susilo Bambang Yudhoyono.

### 3.2 Nigeria

Similar to Indonesia, Nigeria also experienced military domination from 1966-98, with the exception of two periods of civilian administration in 1979-83 and in 1993. In January 1966 a bloody coup d'état led by Major Chukwuma Kaduna Nzeogwu ousted the government of Tafawa Balewa, who had been prime minister since independence (Ihonbere 1996: 193). During this period of political crisis, when Nigeria was deeply fragmented by ethnic and religious cleavages, a counter-coup made Major General Aguiyi Ironsi, an Igbo, the head of state of Nigeria on 16 January 1966. However, Ironsi was not in power for long. His decree proposing to end federal governance in favour of unitary governance led to the accusation that southerners were attempting to dominate the country and to sideline northerners (Feit 1968: 190-1). Northerners had the smallest number of positions in the civil service, primarily due to backwardness in education, and this caused them to fear being dominated on a national level by people from other regions, particularly Igbo (Uche 2008: 119). A coup on 29 July 1966 led by Danjuma, a junior military officer from the north, led to the killing of Ironsi (Elaigwu 1987: 64-5).

Lt. Colonel Yakubu Gowon, Ironsi's army chief of staff, took over power and became the head of the Federal Military Government. Gowon re-established federalism and divided the country into twelve states as a panacea for ethnic political problems (see Odetola 1978: 12). The coup, accompanied by ethnic violence against Igbo in the North, forced the Igbo to return to their eastern heartland. Lt. Colonel Chukwuma Odumegwu Ojukwu, then military governor of the eastern region, criticized the government in Lagos and declared the Biafran Republic independent of Nigeria in May 1967. This secession led to the Biafran war, which lasted until January 1970 (Uche 2008: 111).

During the Gowon period, the policy arena was dominated by three political groups, namely the military, bureaucrats, and politicians (Elaigwu 1976). However, policy was made by a small circle of bureaucrats known as 'super-permanent secretaries', including Allison Ayida, Philip Asiodu, and Ahmad Joda (Lewis 2007: 134-5). They steered the country during the civil war as well as during the reconstruction period. The Second National Development Plan (1970-74), for instance, was drawn up mainly by the Conference on Reconstruction and Development in Ibadan in 1969, which was led by the 'super-permanent secretaries' (Lewis 2007: 135).

The direction of economic policies during this period reflects the widespread criticism of the policies of the First Republic. The economy at the time was regarded as much too dependent on foreign ownership, did not produce enough value added, and discouraged indigenous business (Anyanwu, Oyefusi, Oaikhenan, and Dimowo 1997: 95). Therefore, sovereignty over the national economy was the main agenda of the regime after the civil war. The Indigenization Decree was announced in 1972 to create an economically independent country with increased opportunities for indigenous businessmen (Ogbuabu 1983: 250). Coincidentally, the oil boom in the 1970s also occurred in this reconstruction period. Increased oil revenue provided fuel for further shifting



the economy toward nationalism and *etatism*; the government expanded protection for import-substituting industries, enlarged the role of state-owned enterprises, and increased protectionist measures, as well as maintained an overvalued currency (Lewis 2007: 137).

Unfortunately, these nationalist projects failed to transform the country into a sovereign economy. Instead, they resulted in problems such as inflation, unemployment, widening social inequality, and rent-seeking behaviour (Lewis 2007: 138-9). In addition, corruption and the failure to turn power back to a civilian regime created more disappointment. In July 1975, while Gowon was travelling abroad, General Murtala Muhammad, who had been a central figure in the July 1966 coup, took over power and became the fourth Nigerian head of state (Turner 1978: 190).

Murtala pledged to fix the state that had been 'characterised by lack of consultation, indecision, indiscipline and even neglect' (Turner 1978: 190). However, just nine months later he was killed in a failed coup. General Olusegun Obasanjo, the second in command, replaced him as head of state and continued the Murtala–Obasanjo administration. Murtala not only dismissed the Gowon military regime, but also sacked a substantial tier of the upper bureaucracy, including the 'super-permanent secretaries'. More than ten thousand civil servants were ousted from the government (Lewis 2007: 145); this marked the decline of the power of the bureaucracy in Nigeria. The new policy arena was dominated by federal military officers, while the influence and autonomy of military governors was reduced (Lewis 2007: 145). A further seven states and a third tier of local government below the state level were introduced in 1976 (Lewis 2007: 151).

The Murtala–Obasanjo administration, however, continued the nationalist and *etatism* economic orientation of the previous regime. Fuelled with oil money, expenditure in the Third National Development Plan (1975-80) grew by more than thirteen times compared to the previous plan; it increased state investment and state ownership in economic activities (Lewis 2007: 146). The government also strengthened the previous Indigenization Decree with a 1977 decree that further limited foreign participation in the economy (see Ogbuabu 1983: 253). The economy, however, performed badly. Foreign debt increased significantly, the currency was overvalued, and investment was low due to monetary restraint and the indigenization programme. The overall picture of the economy could be seen in the drop of GDP in 1978 (Lewis 2007: 149). GDP dropped by 5.8 per cent from US\$119 billion in 1977 to US\$112 billion in 1978 (World Bank 2007).

The year 1979 brought new hope for Nigeria. In that year, power was transferred to a civilian administration through general elections, in which five parties participated. The National Party of Nigeria (NPN), with a large base of Hausa-Fulani voters, narrowly won the election (Lewis 2007: 152). Shehu Shagari, the NPN presidential candidate, was inaugurated as president of the Second Republic.

The second oil windfall in 1979 increased government revenue significantly, and led to a large surplus on the balance of payments and growing foreign reserves. This all stimulated higher spending and consumption. Like its military regime predecessors, this government spent heavily on manufacturing and infrastructure, such as the Ajokuta steel complex and the new Federal Capital Abuja project (Lewis 2007: 155). However, with the decrease in oil prices from 1981, the balance of payments started to deteriorate and foreign debt increased. This was made worse by chaotic competition among political parties, which led to corruption and economic mismanagement (Diamond 1985: 327). As Ihonvbere (1996: 196) describes it, 'Three years of civilian rule in the Second Republic had bled the nation dry, mismanaged huge oil "rent", more than doubled the foreign debt profile, destroyed the manufacturing and productive base, and

accentuated social tensions and conflicts to unprecedented proportions'. The aggregate index for the manufacturing sector, for instance, fell by 20.7 per cent in 1983, and employment in the construction industry fell by more than 62 per cent from 1980-83 (Forrest 1986: 18).

After a controversial victory by NPN in the elections of 1983, Shehu Shagari was inaugurated for a second term. However, on the last evening of 1983, Major General Muhammadu Buhari was installed as the new head of state after a coup d'état. The coup was welcomed by many Nigerians who no longer believed in the Shagari-led civilian administration. Buhari and his chief of staff, Major General Tunde Idiagbon, took dramatic steps to curtail corruption and impose discipline in the country. The government 'arrested hundreds of politicians, fired hundreds of public officials, and seized huge sums of cash from politicians' homes' (Diamond 1985: 327). However, there was not much improvement in economic management. Exacerbated by further decreases in oil prices, the economic situation was no better than it had been under the previous administration. Moreover, Buhari's anti-democratic behaviour, such as enacting the 'draconian' Decree Number 2/1984, allowing detention of any citizen and providing a blank cheque to arrest and intimidate critics, contributed to his downfall (Diamond 1985: 327-8).

On 27 August 1985, Major General Ibrahim Badamasi Babangida took over power from Buhari. Babangida declared an emergency in economic affairs and promised drastic measures to overcome the problems. He brought high-profile academics and technocrats, such as Chu Okongwu and Kalu Idika Kalu, into his cabinet. He introduced the International Monetary Fund's (IMF) structural adjustment programme to achieve budget restraint, exchange rate reform, trade, and financial liberalization, as well as privatization of state-owned enterprises. Prior to the enactment of the measures, Babangida opened a wide public debate on the need for the IMF to support the Nigerian economy. However, implementation of the structural adjustment programme did not provide much improvement for the Nigerian economy and may have made it worse (Ihonvbere 1996: 196). GDP grew by 6 to 9 per cent per year from 1988-90 (World Bank, 2007), but unemployment and inflation rose sharply (Lewis 2007: 165).

The political stalemate in the 1993 general elections worsened the situation. Chief M.K.O Abiola, a prominent Yoruba Muslim, won the election. However, Babangida declared the polls invalid and installed Chief Shonekan as caretaker of an interim national government. The annulment of the election results created dissatisfaction, since the election had held out hope for a transition to democracy, which Babangida had promised since 1986 (Ihonvbere 1996: 197). Protests turned into riots and violence. Moreover, an announcement of a sevenfold increase in fuel prices dictated by the agreement with the IMF ended Shonekan's administration. Major General Sani Abacha, former chief of staff and defence minister at the time, took over power, dissolved the elected national and state legislatures, and fired the state and local governors (Lewis 1994: 323), thus ending the dream of a democratic transition.

As for economic management, Abacha initially appointed Kalu Idika Kalu, former finance minister in Babangida's cabinet and the first architect of the structural adjustment programme (SAP) in Nigeria, in order to gain support from international donors. However, within a short time he dismissed Kalu to make more room for his own economists' team, who favoured more state intervention rather than following the SAP agenda. Currency controls were revived, as well as controls over finance and trade. The exchange rate was fixed at 22 naira per dollar, rather than adjusting it to the market price (interview 28/09/2009). As a result, the economy deteriorated and inflation skyrocketed. In addition, corruption was chronic. Abacha's period is considered to have been more predatory than previous military regimes. Lewis (1999: 151) notes that Abacha had created 'a virtual shadow government around his inner court' and had 'seriously undermined the civil service, the judiciary and the public education system'. It is estimated that over a billion

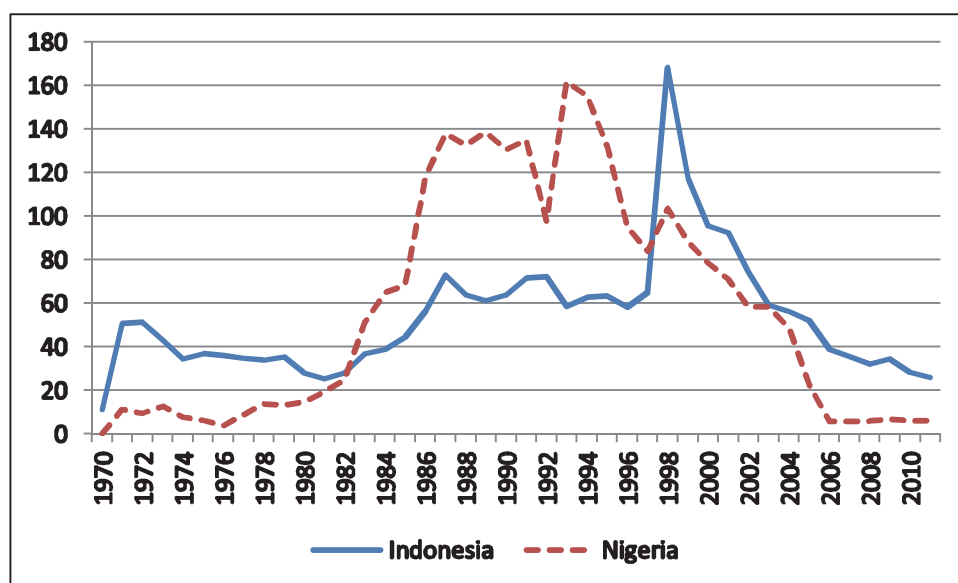
dollars were stolen from state funds by Abacha, and that hundreds of millions were looted by his cabinet members (Kraus 2002: 424). In June 1998, Abacha died, leaving the exact amount of money lost to corruption unrevealed.

From 1998-99 General Abdulsalami Abubakar led the transition to democracy. Since then the country has experienced three general elections and three presidents, namely Obasanjo, Umaru Yar'adua, and Goodluck Jonathan.

#### 4 Characteristics of foreign aid

Indonesia and Nigeria have both had episodes of imprudent foreign debt management. Figure 1 shows an increase in Indonesia's external debt since the beginning of the 1980s to the mid 1990s, when crisis hit Indonesia's economy badly. In the 1970s, the average ratio of foreign debt to gross domestic income (GDI) was about 35 per cent. The ratio of debt to GDI could be maintained around 35 per cent because the Indonesian government realized that above that point could hamper the economy, as happened in the 1960s. When the world oil price started to decrease at the beginning of the 1980s, however, the ratio of foreign debt increased to around 60 per cent of GDI. It was then stabilized around that point, thanks to increasing exports since the mid-1980s. Total external debt grew from US\$22.8 billion in 1981 to US\$79 billion in 1991. However, when the Asian economic crisis hit hard in 1997, the ratio of debt to GDI increased significantly to more than 160 per cent. First, the Indonesian government need more money to back up the budget and stabilize the economy. On 5 November 1997, for instance, the IMF approved more than US\$8.3 billion special drawing rights (SDR), for the Indonesian government 'to restore market confidence, orderly adjustment of the current account, limit the unavoidable decline in growth and contain the inflationary pressure of exchange rate depreciation' (Chowdhury and Sugema 2005: 16). Second, the depreciation of Indonesian rupiah, from 2,500 to 15,000 rupiah per US dollar, suddenly made the ratio of foreign debt to GDI increase more than threefold, because most of Indonesian income is in local currency. Realizing the imprudent external debt situation, the ratio of external debt to GDI was then decreased to 60 per cent in 2003 and less than 30 per cent in 2010.

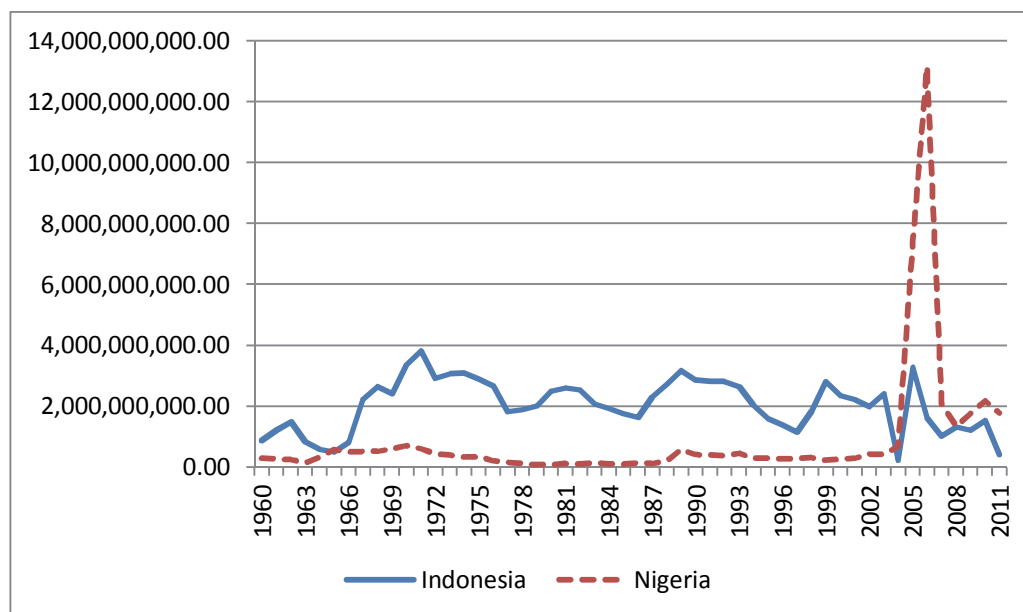
Figure 1: External debt stocks



Note: % of gross national income.

Source: World Bank (2013).

Figure 2: Net official development assistance received (constant 2011 US\$)



Source: World Bank (2013).

Figure 2 shows net official development assistance received by the two countries from 1960-2011. It shows that Indonesia received much higher net official development assistance compared to that received by Nigeria. Over 1960-2000, on average, Indonesia received more than US\$2 billion of net official development assistance annually. Meanwhile, at the same period, on average Nigeria received net official development assistance of less than US\$0.5 billion annually. The limited access to foreign aid that usually had a larger grant component and a lower interest rate meant Nigerian policy makers had to borrow a more expensive loan.

Table 1: External debt stock (billion US\$)

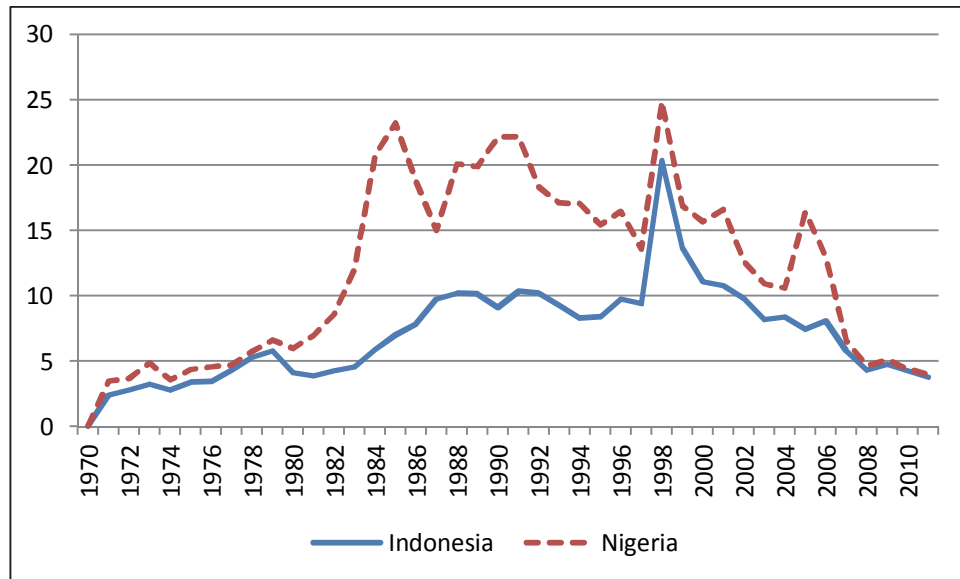
Indicator Name	1971	1976	1981	1986	1991	1996	2001	2006	2011
<b>Indonesia</b>									
External debt stocks (total)	5.0	14.0	22.8	42.9	79.5	129.0	132.3	136.0	213.5
External debt stocks (short term)	0.5	1.4	3.3	6.5	14.3	32.2	20.0	12.2	38.2
External debt stocks (long Term)	4.4	12.6	19.5	36.4	65.0	96.8	102.9	123.4	172.3
<b>Nigeria</b>									
External debt stocks (total)	1.0	1.3	11.4	22.2	33.5	31.4	31.3	8.0	13.1
External debt stocks (short term)	0.3	0.4	4.4	3.7	0.9	5.7	1.6	3.9	4.1
External debt stocks (long Term)	0.7	0.9	7.0	18.5	32.7	25.7	29.4	3.8	6.4

Source: World Bank (2013).

Nigeria did not borrow from external sources in huge amounts (relative to their GDI) until the late 1970s, when the world oil price started to decrease. Up to 1976 Nigerian external debt was only US\$1.3 billion (Table 1). A huge increase in oil revenue meant the Nigerian government had enough money to finance their programmes. During that period the ratio of foreign debt to gross national income (GNI) was less than 20 per cent (Figure 1), and the country was considered to be under-borrowing. When the world oil price declined Nigerian external debt increased significantly and the ratio of foreign debt to GNI reached more than 130 per cent in 1987. The increasing foreign debt was particularly triggered by the need to finance government

expenditure and also to finance structural adjustment programmes, adopted by the country in the mid 1980s. Unfortunately, unlike Indonesia, which was fully backed up by the World Bank and IMF and so was able to access concessional loans, Nigeria turned to the petrodollar market to borrow. Therefore, Nigerian foreign debt in the 1980s mainly consisted of short-term debt with high interest rates (Lewis 2007: 192). The chaotic political situation following the general election in 1992 led to another increase in the ratio of foreign debt to GDI; it reached more than 160 per cent in 1993. However, the ratio of debt to GNI decreased soon after General Sani Abacha took over the Nigerian presidency in a military coup, mainly because Abacha did not have access to international capital due to an international embargo.

Figure 3: Total debt service



Note: % of GNI.

Source: World Bank (2013).

Interestingly, even though the amount and ratio of foreign debt to GNI in Indonesia were relatively higher than Nigeria, Figure 3 shows that the debt service as a percentage of GNI in Indonesia was always lower than for Nigeria. It means that the principal and interest for Indonesia's annual debt repayment were relatively lower (as a percentage of GNI) than that for Nigeria. On average, from 1970-80, the debt service ratio to GNI in Indonesia was less than 5 per cent. Even during the period of decreasing oil price in the 1980s, when Indonesia's foreign debt increased significantly, the average debt service ratio to GNI could be maintained below 10 per cent. It was only during the Asian economic crisis in the second half of the 1990s that the debt service ratio to GNI was above 10 per cent. In 2002 the debt service ratio to GNI had decreased to 10 per cent and in 2011 it was only 4 per cent.

The situation of debt service ratio to GNI was in contrast to the Nigerian case. In the 1970s the debt service ratio to GNI in Nigeria was less than 5 per cent because Nigeria did not borrow much from the external sector. However, in the 1980s, during decreasing world oil prices, the debt service ratio to GNI was about 20 per cent on average, about twice that of Indonesia. In relative terms Nigeria's debt repayment was much more expensive because it got the debt from international financial markets with high interest rates rather than concessional debt with low interest rates. The Nigerian elites believed that the decreasing oil price would only be temporary, so they believed they could repay the debt soon after the oil price increased. Their confidence because of huge oil revenue in the 1970s had led to imprudent debt management in the 1980s to the early 1990s.

There was also a problem with conditionality, required by donor agencies, which did not fit with their programmes. Even more, there was a strong negative sentiment toward the World Bank and IMF in Nigeria. Onalapo Soleye, commissioner of finance 1983-85, recalls that when he went to the US Department of State asking for economic help, he was blamed for not cooperating with the IMF. There were always two requirements: to devalue the naira and to get out of OPEC. He recalls that Donald T. Regan, White House chief of staff, said: 'No IMF no credit, no IMF no aid' (Interview 12/05/2009). James Johnson Oluleye, Nigerian commissioner of finance 1976-79, also notes that policy guidance by international actors had neo-colonial overtones, which would prevent the country from being an independent economy. According to him 'resorting to the IMF could have meant walking into an economic ambush of which we could not get out for some years to come' (Oluleye 1985: 210). This contrasts with the relationship between Indonesian technocrats and the international organization officer. The Indonesian technocrats and the IMF and World Bank officers shared the language of economics that made it easier to build a partnership.

Table 2: Selected indicators

Indicator	Country	1971-80	1981-90	1991-00	2001-10	1971-2010
Average interest on new external debt commitments, official (%)	Indonesia	4.48	6.89	4.79	2.56	4.68
	Nigeria	6.71	8.34	4.43	1.18	5.17
Average maturity on new external debt commitments, official (years)	Indonesia	28.24	22.46	21.80	23.98	24.12
	Nigeria	20.70	17.32	25.39	33.88	24.32
Average grant element on new external debt commitments, official (%)	Indonesia	43.64	22.83	35.92	51.76	38.54
	Nigeria	21.88	10.34	43.34	72.14	36.92
Average grace period on new external debt commitments, official (years)	Indonesia	7.48	6.50	6.03	5.75	6.44
	Nigeria	5.54	4.86	7.27	9.17	6.71

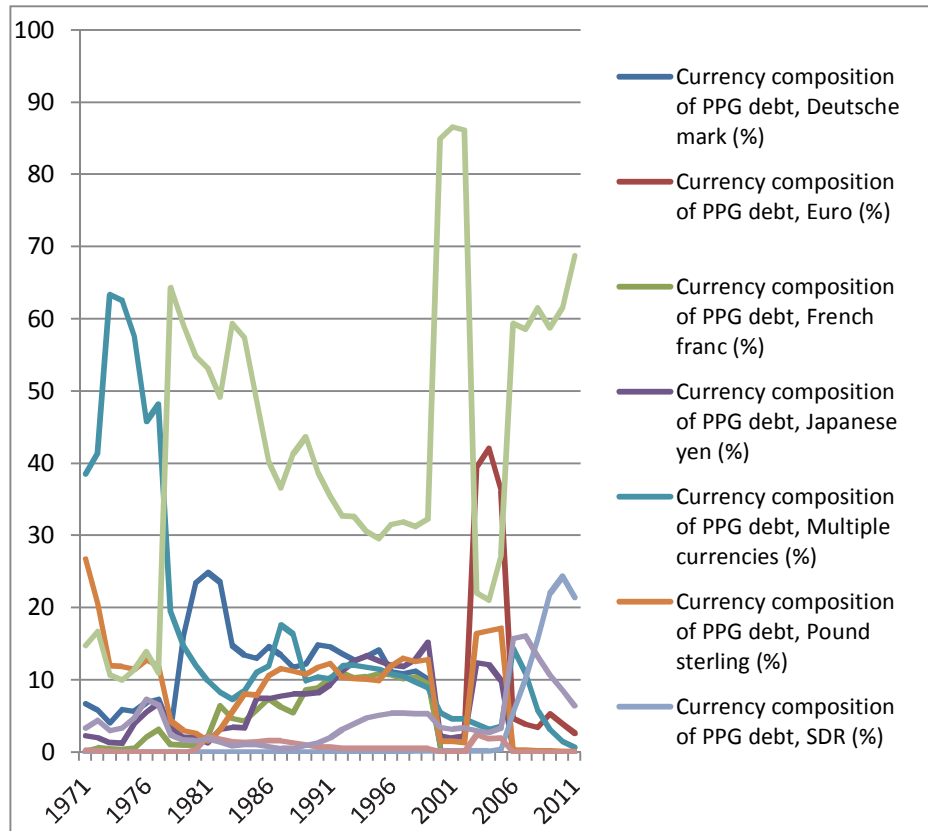
Source: World Bank (2013).

Selected indicators in Table 2, show why the debt service ratio to GNI in Indonesia was very low compared to Nigeria. First, the average interest rate was very low. In the 1970s on average it was 4.5 per cent, more than 2 per cent lower than that for Nigeria. Moreover, if we look in more detail, prior to the Pertamina scandal in 1975, the average interest rate for new public external debt in Indonesia was less than 3 per cent. Because of their experience with debt problems in the 1960s, the Indonesian policy elites had decided to only receive new foreign debt with an interest rate at a concessional discount of around 3 per cent. At a time of decreasing oil prices in the 1980s, even though the average interest rate for new public external debt in Indonesia was more than 6 per cent, it was still lower than that of Nigeria which reached more than 8 per cent. The heavy burden on Nigeria to meet annual repayment came also from the fact that the grant element in new debt commitment was very low in the 1970s and 1980s (see Table 2). Moreover, maturity and periods of grace for external debt commitment in Nigeria were much shorter than those for Indonesia and required Nigeria to repay principal debt at a higher rate annually.

The motives of lenders behind external debt are often associated with success and how the debt could be used. It is therefore, important to understand the sources of external debt. The currency composition of Public and Publicly Guaranteed (PPG) debt is a good indicator to know

about the sources. The composition could also help to predict debt vulnerability because of currency fluctuation. As can be seen from Figure 4, in Nigeria, before 1978, external debt was in multilateral currencies because it mainly came from multilateral donors. The US dollar only came to dominate the structure of Nigerian foreign debt since 1978. This not only demonstrated increasing relations with the US, but also the availability of the petrodollar in the market. Meanwhile, external debt from multilateral countries and the United Kingdom was declining.

Figure 4: Currency composition of PPG debt, Nigeria

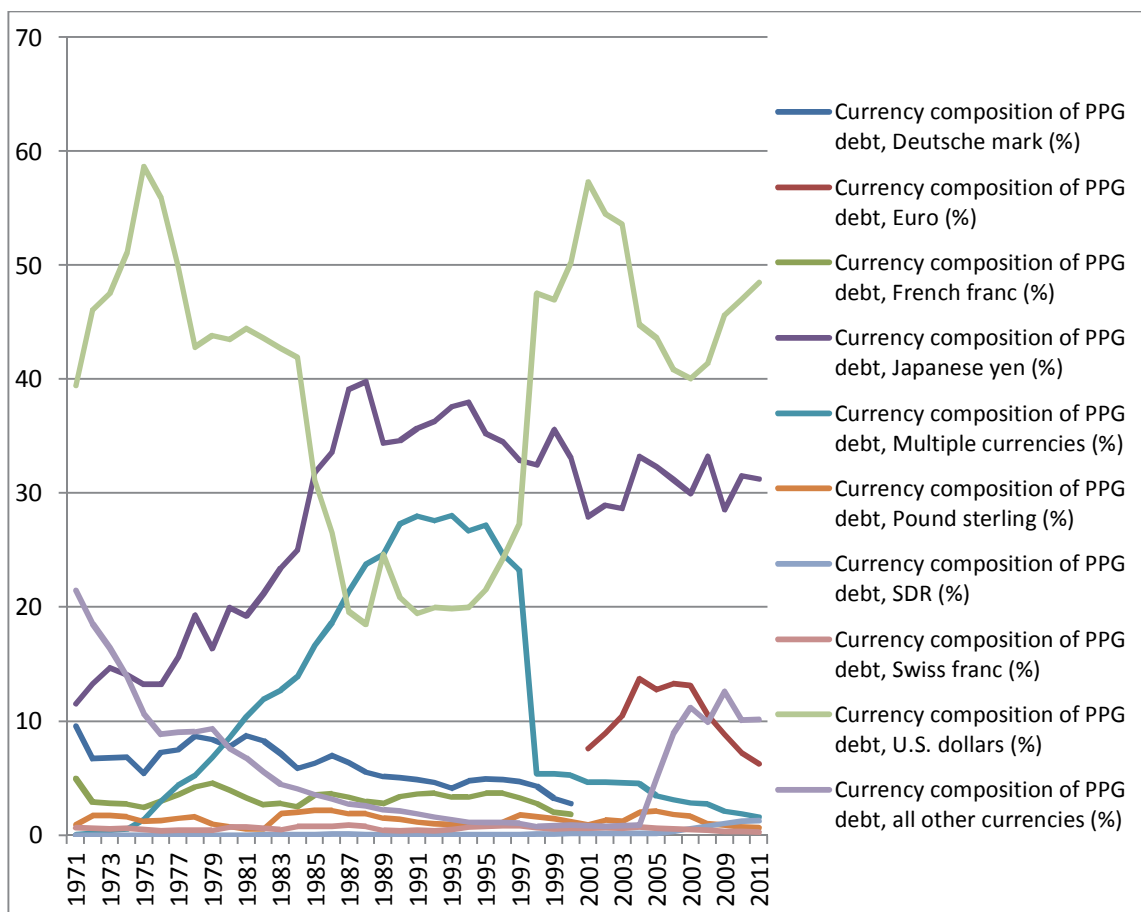


Source: World Bank (2013).

For Indonesia, about 40 per cent of external debt was denominated in US dollars. However, unlike Nigeria, alongside US domination of the Indonesian debt structure, the Japanese yen and multiple currencies were also prominent (Figure 5). Since the beginning of the 1970s, the role of the Japanese yen in Indonesian debt was increasing; since the beginning of the 1980s, at least 30 per cent of Indonesian external debt was in Japanese yen. Similarly, external debt from multilateral countries had also been increasing since the 1970s, with a peak in the early 1990s. The increasing role of multilateral countries was due to the role of the Inter-Governmental Group on Indonesia (IGGI). As part of debt negotiation at the end of the 1960s, there was an agreement that IGGI<sup>5</sup> should be consulted on any foreign debt to Indonesia. About 25 per cent of Indonesian external debt from 1980-97 came from members of IGGI (without US and Japan).

Figure 5: Currency composition of PPG debt, Indonesia

<sup>5</sup> More about IGGI will be discussed later.



Source: World Bank (2013).

## 5 The role of foreign aid

Foreign aid has played an important role since the beginning of the Indonesian New Order regime. To confront the economic crisis, the Indonesian technocrats realized the need for debt relief and new foreign aid. Postponing debt repayment and making new capital available were important to support Indonesia's new economic policies (Posthumus 1972: 57). The new government quickly established a close and supportive relationship with international donors such as by re-joining the IMF and the World Bank to attain support from these institutions. They also visited donor countries to negotiate debt relief.

During the mid 1960s crisis period, postponing debt repayments was crucial to ease the burden of the government to finance the country. Moreover, with limited foreign reserves, basically it was impossible for the Indonesian government to pay the debt. By 1966, besides debt for nationalization compensation to the Netherlands, Indonesia owed about US\$2.1 billion to more than 30 countries. Export revenue in 1966 was only US\$679 million, which was inadequate for debt repayment for that year, let alone to pay imports that reached US\$527 million (Prawiro 2004: 315).

The Indonesian technocrats then started negotiation with eastern European countries (such as the Soviet Union, Czechoslovakia, Hungary, and Poland) and with western European countries,



the United States and Japan.<sup>6</sup> Negotiation with the eastern European countries resulted in postponing debt repayment to those countries to 1969. After negotiation in Tokyo in September 1966, and in Paris in December 1966, western European countries, the United States and Japan gave a three-year grace period. Debt repayment to countries in the group could be started in 1971, and it could be paid in eight years. There was also a moratorium on interest payments with low interest rates (3 to 3.5 per cent) (Nitisastro 2010).

In February 1967, IGGI was established as a consultative forum on Indonesian development. The first members of IGGI were Australia, Belgium, France, West Germany, Italy, Japan, the Netherlands, the United Kingdom, and the United States. The forum also had representatives from the World Bank, the IMF, United Nations Development Programme (UNDP), Organization for Economic Cooperation and Development (OECD), the Asian Development Bank (ADB), New Zealand, Canada, Austria, Norway, and Switzerland. The forum calculated that to finance the budget deficit in 1967, the Indonesian government needed US\$200 million; one third would be provided by the US, one third by Japan, and another one third by the rest of the IGGI members (Prawiro 2004: 323). This 'one third' formula, according to Prawiro, was important to shape Indonesia's new debt structure for a few years.

These negotiations not only helped to ease the burden of repayment, they also helped the technocrats to realize the importance of designing a new structure for Indonesia's debt scheme. According to Nitisastro (2010: 409), there were then three rules for Indonesia to borrow: 3 per cent, 25 years and a 7 year grace period. Interest rates for new debts should be only around 3 per cent annually so that the annual interest rate repayment for the debt was not too high. The debt should not last longer than 25 years with a 7 year grace period, so that it would not be a heavy burden for the Indonesian budget.

Having learned from the chaotic economic situation and very bad debt management in the 1960s, Indonesian policy makers did not want to repeat the mistake. To guarantee prudent debt management, the external debt was channelled through the Bappenas. Since the beginning of New Order, Bappenas was responsible not only for development planning, but also for allocating money for development projects in every department. During the New Order period, Bappenas was a 'super' body that coordinated fiscal policy, macroeconomics, as well as budget allocation in Indonesia. It was led by WidjojoNitisastro, chief of the Indonesian New Order technocrats, who was also Coordinating Minister for Economy, Finance and Monitoring Development.

There was criticism that Bappenas was too powerful and centralized because every project was designed by the agency. In general, there were two types of foreign debt classification in the government budget arranged by Bappenas, namely programme aid and project aid (Prawiro 2004: 334). Programme aid was not related to specific projects; it was designed by the creditor to help Indonesia in maintaining its foreign reserves. Meanwhile project aid was designed for specific projects. All foreign aid was required to be administered in Bappenas. However, channelling the foreign debt through Bappenas at that time at least had two advantages. First, it guaranteed that the programme and project aid fitted with Indonesia's development plan and macroeconomic management because Bappenas was responsible for designing them. It could minimize coordination problems that could lead to inefficiency, for example because of project redundancy. The World Bank, for instance, allocated more than 30 per cent of its projects to agriculture, which was also the priority of the Indonesian government. As Posthumus (1972: 65)

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<sup>6</sup> Prawiro (2004: 317) notes that the negotiation with the East and the West did not only reflect the situation during the Cold War, but also the structure of Indonesia's debt.

noted, such design of integrating the development budget, project aid list and technical assistance would provide an opportunity 'for guiding both national development funds and foreign (project and technical) assistance funds to nationally designated social and economic development objectives'. Second, Bappenas had the best economic technocrats available in the country during that period. The capable technocrats would help in allocating foreign aid to projects that were really needed by the people, based on their urgency.

In Nigeria in the 1970s and 1980s, there was no agency that had the same authority as the Indonesian Bappenas, in managing foreign aid so that it could fit properly with Nigerian development objectives. The Nigerian National Planning Commission (NPC) was responsible during the military period for designing development plans, but it did not control development budget allocation which came under the commissioner of finance. It was, therefore, proposed to establish a ministry to be responsible for managing foreign aid and technical assistance (Olaniyan 1988: 121).

Foreign aid management under the Bappenas also shows how foreign aid helped Indonesian New Order technocrats to turn their development vision into reality. Without money from foreign aid in the 1960s, it was impossible to finance the plan. At that period, the Indonesian development budget came mainly from foreign debt. Chowdhury and Sugema (2005) for instance, note that foreign aid financed nearly 80 per cent of the development budget in 1969 and about 70 per cent in 1971.

## **6 Conclusion**

The difference in access to foreign aid as inexpensive capital to finance development is a possible explanation for the diverging economic trajectories. Indonesia and Nigeria have had different experiences with foreign aid. After the economic and political chaos in the mid 1960s, Indonesia not only rescheduled its old foreign debt, but also received long-term new loans with concessional rates, particularly from Japan and the US. With very limited foreign reserves, the Indonesian government could rely on foreign aid to finance development. The availability of foreign aid had provided capital for the Indonesian policy makers to finance development programmes and projects. At the beginning of the 1970s, for instance, more than 70 per cent of Indonesia's development budget came from foreign aid. Similarly, when the oil price declined in the mid 1980s and economic crisis hit the country in the mid 1990s, Indonesia's development budget also depended on the availability of foreign aid.

In contrast, Nigeria received only limited foreign aid from donor countries. Particularly at times of economic crisis, such as when oil prices declined in the 1980s, limited access to foreign aid meant the Nigerian policy makers had to borrow short term loans at market interest rates, believing that the loans could be paid when oil prices increased. Therefore, Nigeria's debt service ratio increased dramatically in the 1980s, which further deteriorated its budget deficit. This supports Pinto's (1987) argument that the borrowing strategies of the two countries were important for their economic trajectories.

The relationship between policy maker and international donor, such as the IMF and the World Bank, was important for access to foreign aid. The shared language of economics made it easier for Indonesia's policy makers to build a partnership with IMF and World Bank officers. In contrast, many of Nigeria's policy makers saw these international organizations as external powers representing a new form of colonialism. There was a common perception among Nigerians that policy guidance by international actors had neo-colonial overtones, which would prevent the country from being an independent economy.

Finally, this paper also shows that foreign aid helped Indonesian policy makers to manoeuvre in order to turn their policy preferences into action. In the New Order period (1966-98), foreign aid management was centralized in Bappenas, headed by Widjojo Nitisastro, the chief of Suharto's technocrats. With the centralization of loan management, the technocrats had leverage to decide on the programmes and projects necessary for development and also to minimise rent-seeking activities by other actors.

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