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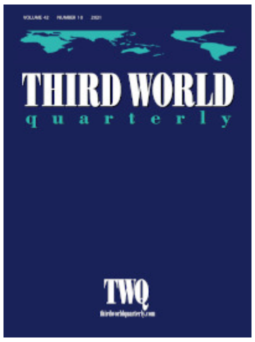

After authoritarian technocracy: the space for industrial policy-making in democratic developing countries

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After authoritarian technocracy: the space for industrial policy-making in democratic developing countries

Lukas Schlogl[a] and Kyunghoon Kim[b]

[a]Department of Political Science, University of Vienna, Vienna, Austria; [b]Department of International Development, King's College London, London, UK

ABSTRACT
Many developing countries have, in recent years, adopted structural transformation strategies and strengthened state economic activism. While prima facie reminiscent of the post-war era's developmentalist strategies, contemporary industrial policies have resurfaced in a different environment: they are often designed and implemented in (newly) democratic, rather than authoritarian, political regimes. This paper argues that when democratic developing countries seek to (re) deploy industrial policies, governments must navigate the specific demands arising in an institutional setting in which political power is constrained and contestable. Therefore, the focus of the classical industrial policy literature on instrumental-rational, top-down, technocratic policy-making, with centralised state–business relations, needs to adapt to this environment. This paper discusses how challenges to secure fiscal space, reach parliamentary consensus, and address diverse societal demands in a formal democratic institutional setting influence industrial policies in developing countries. We exemplify this using Indonesia as a case study.

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Introduction

State-led developmentalism is regaining strength in parts of the Global South – yet it faces different conditions and different expectations than previously. Growth-enhancing structural transformation has been weak in many developing countries in recent years. Key challenges of this weak structural transformation have been de-industrialisation and an expansion of informal low-productivity services (Rodrik 2016; Storm 2015). Because these trends have implications for economic and technological progress, they are an important rationale for the recent strengthening of state economic activism. It is in these circumstances that many countries look for clues in the experience of East Asian economies during the second half of the twentieth century. Yet the lessons of these countries have often tended to be reduced to the positive role of industrial policies in fixing market failures and in kick-starting new growth engines. The fact that these industrial policies were adopted at a specific time in

CONTACT Lukas Schlogl lukas.schloegl@univie.ac.at

history, addressing specific economic needs and implemented by particular regime types with limited political plurality and weak democratic institutions, is less salient. Indicatively, the champions of catch-up industrialisation of recent decades, often referred to as models to emulate, are China and Viet Nam. Both have highly centralised political power, which is increasingly rare in the developing world today.

Compared to the heydays of state-led developmentalism, there has been a fundamental shift in the political constellation in which developmentalist economic policies are re-emerging, namely that authoritarianism is no longer the dominant regime type in the developing world (Figure 1). Now, when democratic developing economies are seeking to foster the growth of high-value adding sectors and to stimulate growth-enhancing structural transformation using industrial policies, they do so within an increasingly constrained domestic policy space (DPS). While an ongoing weak structural transformation trend around the developing world is increasing 'demand' for greater DPS, the 'supply' of DPS is restricted given the more limited discretionary executive powers in democracies. Even recent literature has, however, largely focussed on economic goals, technocratic policy-making, state–business relations, and international policy space, rather than the political means. These research agendas are largely in continuity with how authoritarian developmental states have been studied for a long time.

Notable differences between democratically and autocratically constituted polities are the duration of political cycles and the temporal orientation of policy-making following from it. Typical top-down controlled economies can set long-term growth targets, and development strategies are rolled out systematically via multi-year plans. Democracies are by no means unplanned but do face more stringent temporal constraints, more frequent direct citizen feedback, and shorter, more momentous cycles of accountability and sanction mechanisms. However, industrial policies tend to have an impact with long temporal lags of potentially decades and often require significant resources up front. In competitive democracies, these projects are not impossible, but arguably more difficult. In light of these developments, this paper argues that understanding domestic political dynamics within a formal

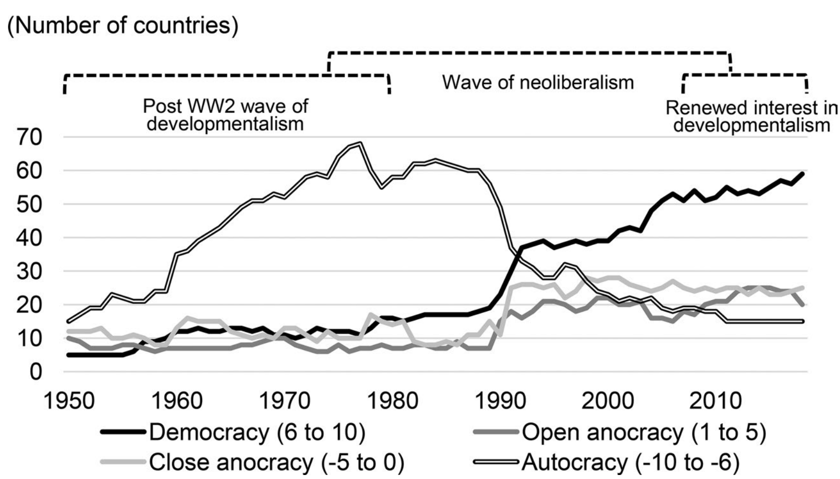

Figure 1. Developing countries by political regime type, 1950–2018.
Source: Polity IV Project database.

institutional setting is essential for analysing democratic developing countries' current structural transformation strategies and making recommendations on industrial policies that are politically and socially viable.

This paper is particularly interested in large middle-income countries where the drive to stimulate structural transformation using industrial policies has been notable over the past decade (UNCTAD 2018). These countries often consider finding and nurturing high-productivity, job-creating sectors a key mechanism to catch up with industrialised economies, or to escape the so-called 'middle-income trap'. In many middle-income countries, (1) structural transformation has begun, as reflected in a shrinking agricultural employment share, but remains incomplete; (2) the domestic market is substantial and growing; (3) a large percentage of the population has escaped extreme poverty; and (4) external aid is not a major source of government revenues (Glawe and Wagner 2016; Sumner 2016). All these factors offer middle-income countries policy wiggle room and opportunities to shift resources towards invigorating structural transformation. For many, these attempts are happening in a political environment that displays a marked difference to the past as the countries have democratised since the previous waves of state activism. Similar to Figure 1, Figure 2(a) illustrates that democratisation has gained strength since the 1980s in the 20 largest middle-income economies, with the number of democracies surpassing the number of non-democracies in 1997.

To take a closer look at some of the challenges linked to formal institutional mechanisms that democratic governments face when implementing industrial policies, this paper focuses on Indonesia, whose democratisation process has been relatively recent (unlike, for instance, India's) and has also been stable, as highlighted in Figure 2(b). Based on the World Bank's definition, Indonesia has been in the middle-income category since 2003. As the paper highlights later on, the Indonesian government has begun to take an active role in response to the decreasing dynamism of structural transformation. Taken together, this makes Indonesia a worthwhile case to study the implications for industrial policy-making of a middle-income country's transition to democracy.

The remainder of the paper is structured as follows. First, we argue that limited attention has been directed at developing countries' industrial policy-making in a formal democratic institutional setting. Second, we discuss three key factors that influence DPS, namely (1) fiscal room, (2) political contestation and (3) societal demands. Third, we study the case of Indonesia to discuss how these factors influencing DPS operate in practice. The final section concludes the paper.

Literature review

The notion of concentrated state power – of a 'Leviathan' of economic development – has been implicit in much thinking on manufacturing-led growth. When investigating the development potential of low-income countries, Myrdal (1968) was concerned with the weak policy-making capacity and a lack of responsiveness and authority in what he called 'soft states', i.e. states characterised by clientelism, corruption and a lack of law enforcement, central governance and societal support. Since Myrdal's research in the late 1960s, a paradigm of 'strong states', in some cases 'benevolent autocrats' (Easterly and Pennings 2018), has been a central theme in developmental state literature. This literature has foregrounded the importance of government-driven industrial policies in stimulating economic catch-up.

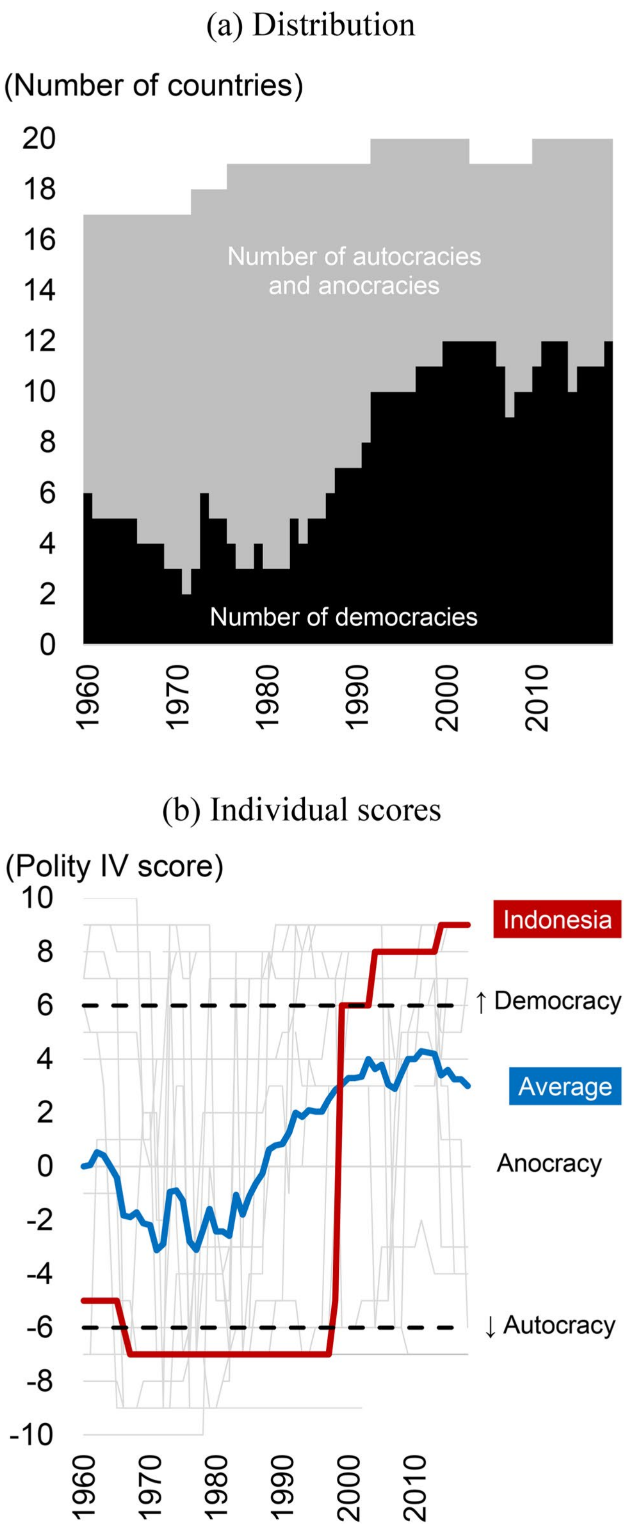

Figure 2. The political regime type of the 20 largest middle-income economies.
Note: Based on the middle-income countries as defined by the World Bank in 2021 and the largest gross domestic product in current prices.
Source: Polity IV Project database.

This paradigm has been used on numerous occasions. Using the cases of Brazil and Mexico from the 1930s to the 1980s, Schneider (1999) conceptualises Latin America's developmental states based on four characteristics, which had a crosscutting theme of the central role of powerful states. Amsden (1989), in research on South Korea's developmental state of the 1960s–1980s, identifies the authoritarian government as a key driving force of industrialisation. Amsden (1989, 147) argues that the distinctive features of South Korea's industrial policies, which were often absent in developing countries at the time, were not due to 'differential abilities among policy-makers', instead reflecting 'differences in state power'. To explain the differences in the performance of industrialisation strategies in exemplary East Asian and Latin American economies, scholars have more closely examined the bureaucratic and institutional features of authoritarian governments (Evans 1995; Haggard 1990).

The focus present in the literature thus far on 'strong states' is not surprising considering that while only a small fraction of authoritarian countries had developmental states, most developmental states were found in authoritarian developing countries prior to the 1990s (Johnson 1999, 52–54). Schneider (1999, 298, 303) observes that 'the association between the developmental state and authoritarianism seems historically to be a stable, if not necessary, combination', and goes on to suggest that 'democratic conflict makes developmentalism contentious'. Until recently, democratic developmental states were rare, and even relatively more democratic developmental states were characterised by the dominance of a single party (Leftwich 1995, 410).

The industrial policy literature has, of course, not been stagnant since the prime of developmentalism. With the spread of democratisation in the developmental states, the literature began to pay attention to the transformation of state authority, with a particular focus on the civil society's growing role through political mobilisation (Lee and Lee 1992). Moreover, Kang (2002) highlights the general strengthening of private businesses' influence vis-à-vis the state. Some major firms have gradually 'decoupled' from the national governments and strategically 'coupled' with extranational forces by joining global production networks (Yeung 2016). However, few studies have analysed developmental states' industrial policies from the perspective of political pluralism and participation. Instead, the literature's focus shifted to the effects of (neo)liberalisation on development policy space as market opening and deregulation accelerated in developmental states after economic crises and during the post-1990s hyper-globalisation (Wade 2003).

Over the past decade, weak economic structural transformation has become a key concern in the developing world. While industrial policies never disappeared (Rodrik 2004), this concern, along with the weakening faith in the neoliberal project and developing countries' stronger financial positions, awakened industrial policies from hibernation during the 2000s (UNCTAD 2018). Alongside these trends, literature on developing countries' industrial policies has grown. This literature has provided theoretical, case-specific rationales for state activism and suggested policy measures to support diverse high value-adding sectors (Noman and Stiglitz 2017; Oqubay et al. 2020). In much recent literature on developing countries' industrial policies, the analytical focus has been on understanding the government's economic motives, the characteristics of implemented measures, bureaucratic agencies and monitoring mechanisms, and the potential or actual effects of these policies, in continuity with the focus of earlier developmental state literature. However, less interest has been paid to the *political processes* through which industrial policies are implemented nowadays. As a result, studies have often assumed a simple translation of the government's economic goals into industrial policies and technocratic and bureaucratic capacities as the prime determinants of policy design and outcomes. These caricatures are surprising if one considers the significant political transformation, specifically the multiple 'waves' of democratisation (Gunitsky 2018; Huntington 1991), in the developing world from when industrial policies were last popular.

The literature on the politics of developing countries' industrial policy-making, has so far, largely focussed on informal state–business relations and the 'political survival of ruling elites' (Whitfield and Buur 2014) which have often been analysed from the perspective of 'deals' (Pritchett, Sen, and Werker 2017) and 'political settlements' (Khan 2010). This literature has provided important insights into growth-enhancing and growth-harming coalitions composed of political, bureaucratic and economic actors, which are powerful elites, in explaining how countries' economic goals and industrial policies are shaped. In comparison, however, much less attention has been afforded to the political challenges in the *processes* of allocating resources, making legislation and gaining societal support for implementing industrial policies in the formal political institutional setting of democratic developing countries.

In any analyses of rent allocation, it is important to consider *de jure* rules that shape political behaviour, processes and platforms in which collaboration and conflict occur. A mounting literature on 'political settlements' has been built on critiques of traditional institutional analysis, a form of analysis that often overlooked the importance of power structure and informal networks in the process of creating and managing rents. Nevertheless, the 'settlements' literature does not deny the importance of the formal institutional system (Khan 2019, 331–332). It suggests that analyses of regulations and enforcement mechanisms remain important in understanding how political demands are voiced and whether and how constraints on elites operate when democratic developing countries pursue structural transformation strategies. However, this literature tends to pay limited attention to formal institutions in empirical studies.

Our paper highlights the importance of tracing the institutional pathways by which structural transformation goals lead, or do not lead, to the adoption of industrial policies. To be sure, informal elite networks can explain the degree of control that formal institutions exert in most developing countries – but such informal institutions do not necessarily trump the existing formal regulations, laws and accountability mechanisms under democracy. MacIntyre (2003) criticises that many studies of developing economies neglect formal institutions. We would argue that, compared to authoritarian developmental states, this neglect is even more pertinent in the context of democratic developing countries and particularly so in the context of industrial policy-making. The executive of democratic countries faces diverse stakeholders in the cabinet, legislature and society as well as formal institutional devices that influence policy-making. Although the legal system may be weak, 'the basic elements of constitutional structure and party system that shape political life' can make formal institutional variables important (MacIntyre 2003, 5). In sum, a central argument of this paper is that literature on the political economy of industrial policies needs to redress a still prevalent imbalance between the analysis of formal institutional structures and the analysis of informal elite networks and technocratic policy-making.

Political challenges in implementing industrial policies in democratic developing countries

This section discusses formal institutional factors that may influence government implementation of structural transformation strategies in democratic developing countries.

Irrespective of how one judges the performance of industrial policies during post-war developmentalism, it is important to recognise that the political processes of implementing industrial policies are markedly different in developing countries that have since democratised. In this section, the implementation of industrial policies is analysed through the lens of fiscal allocation, parliamentary conflict and societal demands. There are various political-institutional hurdles to overcome when governments of developing countries, democratic ones in particular, pursue industrial policies. The goal of this section is to conceptualise, in a multi-dimensional way, the DPS with reference to industrial policies. DPS is defined as the ruling government's ability to determine economic goals and experiment with policy instruments to achieve said goals in a given domestic political environment. This section does not aim to make a causal link between DPS and industrialisation status. Instead, it acknowledges that industrial policies are political products of contestation and collaboration among diverse stakeholders in a formal institutional setting and highlights some ramifications.

Firstly, governments of democratic developing countries are often fiscally constrained in allocating budgetary resources when invigorating structural transformation. Governments have come to recognise that the sustainability of a structural transformation strategy depends on macroeconomic stability. Experiences during the 1980s and 1990s suggest that many economic projects in developing countries were disrupted during financial crises caused by high inflation and large fiscal debts. Not only did governments have to accept the conditionalities attached to external bailout packages, they also frequently lost domestic support for economic projects and were punished at elections in democratic countries (Armijo 2005). Furthermore, financialisation has led to domestic and international short-term capital playing a stronger role in monitoring, supervising and punishing developing countries' fiscal situation while placing a more significant burden on public capital to make productive investments (Agénor and Pereira da Silva 2019; Bonizzi 2013; Storm 2018). These factors explain why 'new developmentalism' has been characterised by simultaneous attention to state activism and macroeconomic stability, often being labelled 'neo-developmental liberalism' or 'liberal neo-developmentalism' (Ban 2013; Saad-Filho 2020; Sato 2019).

A specific formal mechanism that limits the government's capacity to divert fiscal resources for stimulating structural transformation is the institutional rules on fiscal management. With the aim of achieving macroeconomic stability, many developing countries have embraced and adopted fiscal rules over the past 20 years. The number of low- and middle-income countries with fiscal rules increased from two in 1990 to 53 in 2015. Fiscal rules take various forms, such as numerical targets on budget balances, debt, expenditures or revenue, and can impose direct or indirect constraints on government spending (Lledó et al. 2017). While some countries have adopted escape clauses and provisions for certain budget items, fiscal rules generally influence the amount of discretionary spending available to the government to stimulate economic structural transformation. The analysis of fiscal rules must be accompanied by the evaluation of the political regime to understand the government's discretionary power to overcome institutional constraints and the political consequences of or penalties for failing to comply with fiscal rules (Mihalyi and Fernández 2018; Figure 3).

Governments of democratic developing countries are also fiscally constrained as they are pressured to fulfil various developmental demands on top of stimulating structural transformation. One important consequence of democratisation has been increased pressure on governments to expand social spending in developing countries. In crisis-hit countries, health and educational spending was often cut drastically. However, as the fiscal situation

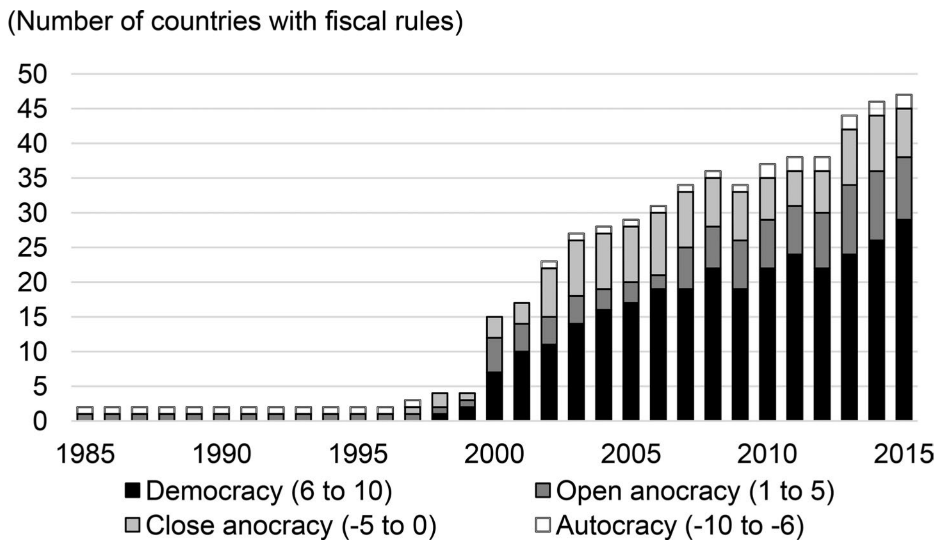

Figure 3. Number of developing countries with fiscal rules by political regime type, 1985–2015.
Note: The total number in the graph does not equal the numbers given in the text as this graph excludes countries that do not have a Polity IV score.
Source: International Monetary Fund Fiscal Rules Dataset 1985–2015; Polity IV Project database.

has improved over time, governments have become more responsive to voters' demands for the sustainable supply of basic necessities and the expansion of public health and education services (Ha 2015; Haggard and Kaufman 2008). Given the difficulties associated with increasing government revenues over a short period of time, the reallocation of government expenditure may be a more viable option that would immediately free fiscal resources for supporting economic projects (Abugattas and Paus 2011). However, there are political challenges in shifting budgetary resources from consumption spending to investment expenditure for stimulating structural transformation, and spending on economic projects is often the first to be reduced in difficult economic circumstances (Adam and Bevan 2005; Toye 2000). In sum, assessing the fiscal room for pursuing industrial policies requires a close examination of formal rules on fiscal policies, governments' financial situations, and budgetary composition.

In addition, industrial policies can become bargaining chips in the political marketplace (Tsebelis 2002). Even in situations in which the political rivals do not necessarily disagree with the potential economic benefits of particular industrial policies, they may have political concerns about the implementation of such policies. Opponents view these policies as the government's tools for protecting supporters' interests or aiding supporters in carrying out rent-seeking activities. Furthermore, opponents also view that, if the economic effects of these policies are positive, they could potentially satisfy the electorate and help the incumbent win votes.

Generally, democratisation goes hand in hand with a broadening of the political coalitions necessary to maintain power (Bueno de Mesquita et al. 2003). Pursuing active industrial policies may require legislative changes and large fiscal reallocation, therefore requiring support of political opponents in democracies. To gain veto players' backing, governments may have to make compromises by supporting policies or pork-barrel projects that favour political opponents. Side payments could also involve handing out government posts to political rivals. Therefore, governments need to consider the extent of side payments in a formal institutional setting when designing structural transformation strategies. If the potential cost of side payments is expected to outweigh the political benefits of industrial policies, which are likely to materialise only in the medium to long term, governments may be cautious in implementing active industrial policies. To assess executives' political power in driving industrial policies, a qualitative analysis of different political parties' attachment to the ideology of industrialisation should be accompanied by an analysis of the composition of government parties and formal mechanisms for making political compromises.

Finally, structural transformation strategies that foster creative destruction create winners and losers. Compared to authoritarian regimes, governments in democratic countries would find it more difficult to push forward an economic upgrading plan without appropriately persuading and compensating those expected to be adversely affected by this process of creative destruction. Consequently, democratic governments must exercise caution when considering the potential trade-offs between incentives of diverse actors with access to different types of formal institutional tools for organisation and mobilisation. We expect to find significant diversity in the contemporary developing world in terms of societal actors, values, perceptions and reactions relevant to government-led structural transformation strategies.

Structural transformation strategies may simultaneously offer both comparative advantage conforming and defying components (Lin and Chang 2009), but the emphases within policy packages may vary due to dissimilar sectoral situations and perceptions of capabilities. While there has been theoretical and historical debate on this issue, limited attention has been paid to the political ramifications of each strategy. Comparative advantage conforming policies would mean labour-intensive structural transformation for most developing countries, which may offer the benefit of job creation. However, as this strategy relies on maintaining low labour costs, the government may be incentivised to keep wage growth low and loosen labour regulations in the area of workers' safety, security and skills development. Comparative advantage-defying policies would usually involve developing capital-intensive sectors. This strategy could provide high-quality, highly skilled jobs but may struggle to absorb the large number of job seekers considering the developing world's growing young population. Furthermore, technological change in production, particularly automation and digitisation, means that developing countries with growing young labour forces may face greater pushback against capital-intensive development strategies in electoral democracies (Schlogl and Sumner 2020).

As these strategies affect the labour market in different ways, complex political calculations inevitably enter the decision-making process in democracies. Moreover, regardless of the strategy a government adopts, the provision of preferences to big businesses at the expense of other aspects of development, such as workers' rights, environmental protection, pollution, land rights, or small and medium enterprises, can be politically contentious.

To sum up, this section discussed a set of factors important in the analysis of DPS in pursuing industrial strategies: fiscal space, political contestation and societal demands. Considering the influence of these issues on DPS, the industrial policy literature needs to move beyond the prevalent technocratic paradigm and informal elite networks and extend the analysis to the political challenges acknowledging the contemporary formal institutional context of democratisation. The following section analyses the case of Indonesia to study how formal institutional features affect the implementation of a structural transformation strategy under democracy.

The case of Indonesia

Indonesia has experienced the revival of state activism in the economy over the past decade (Sato 2019; Warburton 2018). This section analyses the policy-making process behind this new developmentalist strategy aimed at strengthening growth-enhancing structural transformation. The Indonesian government under democracy has faced different political and social circumstances from the pre-Asian financial crisis period. Indonesia's electoral democracy has been institutionalised after uncertain years of the transition period, and government power and resources have been decentralised significantly. The importance of understanding Indonesia's new formal institutional architecture within which the new distribution of power operates has been discussed in a number of studies, while they also acknowledge the continued significance of informal networks.

In economic policy-making, the key characteristics of the democratic era in Indonesia have been a fragmented presidential cabinet; strengthened Parliament, judiciary and other public monitoring bodies; executive-constraining legislatives; and weak but existent civil society organisations. Therefore, to a larger extent than in the past, presidents must pay attention to party politics, inter-ministry conflicts and public opinion. In state–business relations, while there still exists a significant amount of behind-the-door informal deals, formal channels of negotiating, consulting and communicating have become prominent (Aswicahyono, Bird, and Hill 2009; Basri 2017b; Davidson 2015; Datta et al. 2011; Ford and Pepinsky 2014; McLeod 2005; Sato 2017). This new formal institutional architecture has been used in studies analysing pre-2010s' crisis-induced governance reform processes and redistributive measures, most of which fall short of being labelled industrial policies. This section explores how formal institutions have influenced industrial policies of the Joko Widodo (Jokowi) government (2014–2019, 2019–2024), whose implementation involved significant government resources and broad political consensus. Before moving on to this analysis, the section provides a brief description of key economic and political trends since the Asian financial crisis.

Indonesia experienced an economic crisis and political turmoil in the late 1990s. A sudden outflow of foreign investment and the collapse of the financial system resulted in a shrinking of the economy by 13% during the Asian financial crisis in 1998. The crisis and the subsequent social unrest brought down Suharto, who had ruled the country for over three decades. As Suharto's regime fell in 1998, the desire for political liberalisation led to the beginning of democratisation. The transition period saw significant modifications to Indonesia's formal institutions in terms of the constitution, elections, judiciary, media and civil society. These processes allowed for the involvement of new players and parties in politics, though the traditional ruling class remained influential and continued to shape the ways in which formal institutions evolved. Compared to the frequent leadership turnover involving three new presidents during the six years of the transition period, the executive position was finally institutionalised after the first direct presidential election in 2004 and when the president won re-election in 2009. From the mid-2000s, established parties employed exclusionary electoral rules to control the rise of new parties, though existing parties in Parliament were already numerous, meaning that the president needed the support of several parties to reach a parliamentary majority. With the influential parties, old and new, established in the new formal democratic system, coalition building, rent sharing and multi-party cabinets became a norm in policy-making. This context is the *political* environment in which the Jokowi administration had to manoeuvre when elected in 2014 (Aspinall, Mietzner, and Tomsa 2015; MacIntyre 2006; Davidson 2018).

The politically chaotic period in the late 1990s and the early 2000s was characterised by a crisis-induced economic liberalisation. The government, under international financial organisations' auspices, removed trade and investment barriers and phased out direct involvement in economic activity. Moreover, a range of formal economic governance mechanisms and organisations, such as the fiscal rule and a competition watchdog, were established. These measures were necessary in persuading external lenders and investors whose money Indonesia desperately needed to recover the economy. Some of these policies were incomplete in their creation or disrupted during implementation as rent-seekers, in particular oligarchs, interfered to guard their interests. However, the changes in the economic architecture were notable. The plan to dramatically overhaul the economic system was eventually abandoned as the International Monetary Fund programme ended in 2003 and liberalisation and governance reform slowed notably. During the rest of the 2000s, the Indonesian government became less active in adjusting economic policies as the economy sustained moderate growth, which was aided by the robust global economy. The commodities boom was a boon for a country whose major exports included coal, palm oil, natural gas and copper ore. Therefore, modest economic performance was achieved even without significant public infrastructure investment and active policy adjustments. Nevertheless, the government had little interest in reversing the overall liberalising policy direction (Aswicahyono, Bird, and Hill 2009; Davidson 2016, 2018; Hill 2000; Pangestu, Rahardja, and Ing 2015; Robison and Hadiz 2004). However, as the commodity boom came to a close from the early 2010s, not only did resource nationalism intensify, but economic challenges such as weak manufacturing, which had been in the making for over a decade, also moved up the policy-makers' list of priorities. With the government beginning to respond to these challenges, Indonesia experienced 'creeping protectionism' in the first half of the 2010s (Garnaut 2015; Pangestu, Rahardja, and Ing 2015, 240; Tadjoeddin and Chowdhury 2019). This environment is the *economic* context in which Jokowi came into office.

In this political-economic environment, President Jokowi strengthened state activism with the aim of stimulating structural transformation. Compared to the past, the amount of government resources and the extent to which policies were adjusted were much larger and drew attention from various stakeholders with access to formal institutions. The rest of this section discusses how formal institutions linked to the three concepts introduced in the previous section, namely fiscal space, political consensus and societal demands, have shaped industrial policy-making under President Jokowi.

Firstly, we discuss the formal institutional mechanisms involved in shifting fiscal resources towards industrial policies. Expanding physical infrastructure to support economic upgrading and regionally balanced development has unambiguously been Jokowi's priority. Considering the slow pace of infrastructure expansion during the previous decade, the Jokowi administration has adopted a different tactic than the past government, which had focussed on private sector participation and produced disappointing results. It has taken a leading role in expanding roads, railways, ports and electricity generation (Davidson 2021; McCawley 2015).

This strategy required significant financial resources, but the Indonesian government had limited fiscal capacity. Indonesia's government revenue-to-GDP (Gross Domestic Product) ratio is one of the lowest among emerging economies; it is only half of the group's average and highly cyclical. These characteristics are largely due to inefficient tax code and collection and a heavy reliance of the tax system on the natural commodity sector (World Bank 2020). While the Jokowi government attempted to expand government revenues, such as by implementing the Tax Amnesty Programme, Indonesia continued to fall behind most large emerging economies (World Bank 2018). The government's investment capacity has been further constrained by the fiscal rule that caps annual fiscal deficits at 3% of the GDP (Law 33/2004 Article 83). The spending wiggle room is further limited as the government is legally mandated to devote at least 20% of the budget to education and 5% to health (Law 20/2003 Article 49; Law 36/2009 Article 171), as well as having to continue numerous social assistance programmes inherited from the previous government. Moreover, with the dramatic decentralisation following the Asian financial crisis, approximately one-third of government expenditure has been transferred to local governments.

In the democratic era, compliance with these formal institutional rules on government finances is monitored by oversight institutions such as the Parliament and the Audit Board (Blöndal, Hawkesworth, and Choi 2009). Key policy-makers may face considerable penalties if the rules related to fiscal spending are broken (Ikhsan 2014; Mihalyi and Fernández 2018). Moreover, policy-makers in the Finance Ministry, with their own mandate in a democratic administration, are sensitive to the fiscal situation and the international capital's perception of Indonesia's economic health in a liberalised financial system (Basri 2017a). Taking into account these factors, as well as regular personnel expenditures and interest payments, the World Bank (2020) estimates the share of discretionary spending in total government expenditure accounted for only 27.9% in 2016.

After using the room to increase fiscal deficits permitted by the fiscal rules (Figure 4(a)), government spending on economic projects could not be expanded significantly without

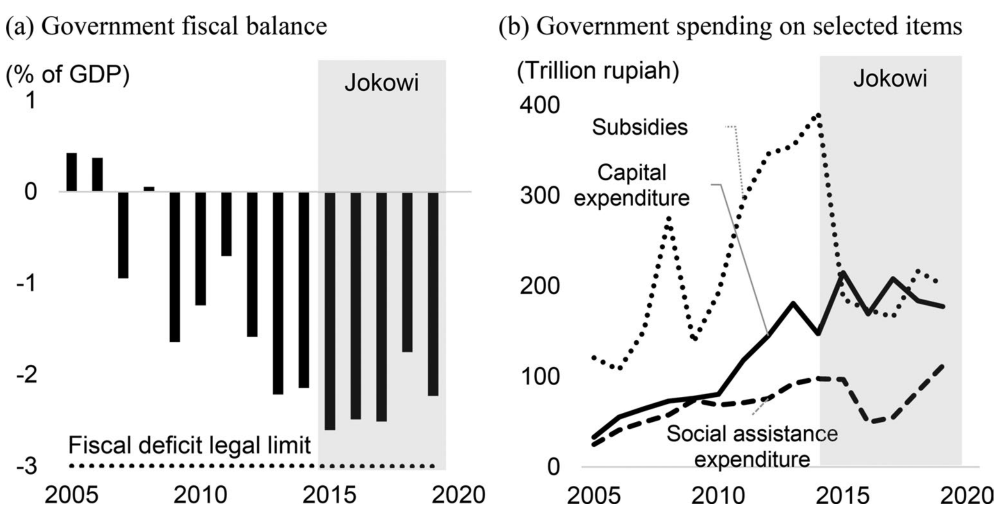

Figure 4. The Indonesian government's fiscal trends.
Source: Bank Indonesia; International Monetary Fund. GDP: gross domestic product.

reducing other discretionary spending components. For the Jokowi government, fuel subsidies were a major target to be curbed because of their substantial size and regressive characteristics (Chelminski 2018). Fuel subsidies accounted for 16% of government expenditure on average annually and were larger than capital spending every year during the previous administration. When Jokowi came into power, the global economic situation was conducive to reducing fuel subsidies because the international oil price was falling. By January 2015, the international crude oil price had halved from six months previously. By using the money saved from reduced fuel subsidies, the government significantly increased infrastructure investment. Between 2014 and 2017, infrastructure investment increased by 141%, whereas fuel subsidies shrunk by 80%. However, sustaining the rapid expansion of fiscal spending on economic projects was difficult in this fiscal environment, which was constrained by formal institutional rules on spending size and composition once the temporary factors such as low international oil prices diminished. Moreover, the political cycle has an important influence on the composition of discretionary spending. Figure 4(b) illustrates that subsidies and social assistance programmes expanded in 2018 and 2019 prior to the presidential election, with subsidies exceeding capital expenditure again.

Next, we discuss Parliament's influence on shaping the government's industrial policies through formal mechanisms. The strategy of accelerating infrastructure development also involved mobilising state-owned enterprises (SOEs) to co-finance and implement projects because of the private sector's continued limited interest. SOEs' involvement in long-term infrastructure projects was understood by the Jokowi government as a vital component of producing visible outcomes before the re-election bid. As well as fixing market failure problems, another major aim of mobilising SOEs was to strengthen the investment role of a fiscally constrained government. By leveraging SOEs' balance sheets, the government can increase investment beyond its fiscal capacity. When SOEs raise funds by issuing bonds and shares in the financial market and borrowing from financial institutions, the central government's fiscal balance is not affected, at least not immediately (Kim 2019, 2020). This SOE-driven approach was also understood as an internationally tried-and-tested strategy by countries such as China and one that was in line with the country's nationalist ideals (Davidson 2021).

Although some of Indonesia's SOEs were already sizeable, SOEs needed initial financial stimulus to seek further market funding and shift their focus to contributions to development. However, the government's plan to inject capital into SOEs faced a backlash. Opposition parties criticised that providing large capital for the second year running was a 'growth-first, redistribution-second' strategy that involved replacing subsidies for people with subsidies for SOEs. Many parties in Indonesia tend to support a more significant role of the state in the economy but also display strong pro-poor and poor-equality positions (Fossati et al. 2020). In such a situation, the Jokowi government's fiscal restructuring ignited a clash with several – particularly opposition – parties. Lawmakers also spoke out against diverse issues, including SOEs' corruption, inefficiency and partial foreign ownership. Opposition parties in a democratic environment demonstrated their power by freezing the disbursement of capital injections until budget revision in the following year (Gunawan and Afra 2015). In the subsequent years, capital injections into SOEs were moderate as criticisms of SOE-led strategy, more specifically capital recipients' financial position (Wirayani 2017), opacity of the capital injection process (Amindoni 2015) and unfair treatment of private companies (Dahrul and Ho 2017; Susanty 2017) strengthened inside and outside of the political arena. Criticisms were also made within the cabinet whose ministers had separate mandates, such as fiscal stability and infrastructure quality (Maulia 2016; Suzuki 2017). During the second half of the first administration, the spending focus shifted to social services and subsidies (World Bank 2019).

Although the state-centred infrastructure strategy has produced notable outcomes (McCawley 2019), the first Jokowi administration found the continuation of direct capital provision to SOEs, thereby displaying even stronger state activism, difficult as it faced challenges in readjusting spending. President Jokowi was surrounded by stakeholders with access to formal institutions who could constrain the government's plan. In Indonesia's multiparty system, Jokowi's parliamentary coalition initially represented just over a third of total seats and was composed of numerous parties, reflected in a low Herfindahl index of parties in the government (Figure 5). Under these circumstances, the government struggled to persuade opponents without providing sufficient benefits. The formal institutional mechanism of the budget process since democratisation began means that Parliament's involvement may be found on detailed items and at various stages of the budget approval process. Furthermore, influential formal parliamentary organisations, such as the budget committee and sectoral commissions, are led by representatives of various parties. At the final stage, the government budget is enacted by consensus rather than by majority voting. Therefore, all parties potentially have veto power, highlighting how broad the negotiation must be. Throughout this process, there has been continued tension between the Ministry of Finance and 'spending' ministries (Blöndal, Hawkesworth, and Choi 2009).

Responding to this challenge of directly funding SOEs, the government secured policy space by fostering the growth of development financing institutions (DFIs) under the Ministry of Finance. The Jokowi administration expanded and mobilised DFIs to finance SOEs' capital investment, land acquisition and exportation (Kim 2020). For governments facing political challenges in directly financing development projects, DFIs may 'empower competent technocrats' by allowing them to operate 'above the political fray' (Armijo 2017, 233). These organisations, as opposed to state budgetary processes, are often outside of tight parliamentary control, and funding decisions are usually made by the executive branch alone. Furthermore, these organisations' operations are less visible compared to many SOEs whose goods and services are consumed by the public on a daily basis.

Finally, we consider Parliament's role in the Jokowi government's implementation of business promotion policies aimed to stimulate structural transformation and the societal challenges that arose during their implementation. Under the first administration, pro-business

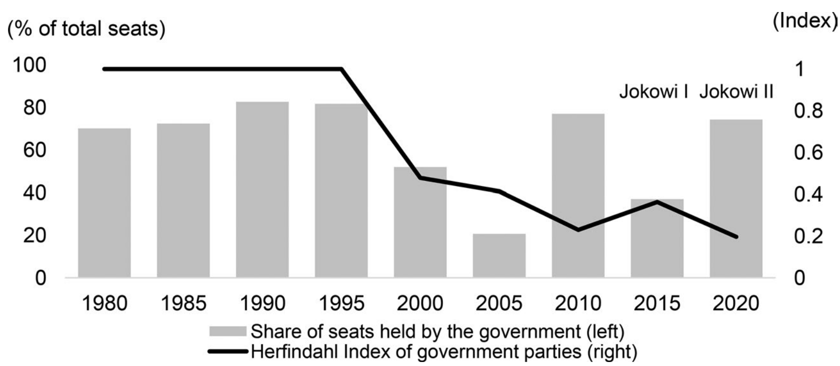

Figure 5. Government's coalitional Parliamentary seat shares and Herfindahl index in Indonesia. Source: Author's construction using data from Cruz, Keefer, and Scartascini (2021).

policies for stimulating structural transformation were rolled out between 2015 and 2018 in 16 small packages. Many 'broad' policies aimed to invigorate productive investment by harmonising regulations, simplifying bureaucratic processes and ensuring law enforceability. A number of 'narrow' policies provided financial incentives to specific sectors and firms, such as export-oriented, labour-intensive companies, industrial estates and aviation, pharmaceutical, e-commerce and logistics industries. One key measure involved extending the coverage and simplifying the process of the tax holiday facility aimed at large firms across 17 'pioneer' industries (ADB and Bappenas 2019; Investor Relations Unit 2020a).

Although many policies were aimed at larger firms, they did not face strong opposition because they also included notable measures for smaller firms. These measures included reducing the People's Business Credit interest rates by two-thirds and providing export incentives, such as cheaper loans and import tax waivers (ADB and Bappenas 2019). The major labour policy of centralising the minimum wage-setting process and strengthening predictability for businesses also faced limited opposition. The new formula for setting minimum wage levels ensured reasonable increases, and the government provided 'carrots' to unions, such as low-cost housing (Manning and Pratomo 2018).

In contrast to the gradualist approach chosen by the first administration, the second Jokowi administration took a leap in implementing a range of business promotion policies under the Job Creation Law. This law is over 1000 pages long, and its 15 chapters include 186 articles (Investor Relations Unit 2020b). The overall goal of this approach was similar to the previous administration's policy packages and involved stimulating structural transformation and job creation by enhancing the business environment. A large bulk of this law aims to simplify investment processes by amending 76 existing laws and eliminating over 20,000 central and regional regulations (PwC 2020). This law also includes measures to support research and development, strategic investment projects and economic zones. Through these measures, the government aimed to attract investment in diverse areas including five priority 'Industry 4.0' manufacturing sectors, mining, construction and services.

Compared to the gradual roll-out of policy packages, the Job Creation Law was similar to a shock therapy. The law was viewed as an aggressive tilt towards businesses and away from key areas of social development. The main areas of contention were labour and the environment. The law has been accused of allowing for the impediment of minimum wage increases, reducing severance pay, increasing allowable overtime and loosening outsourcing regulations (ITUC 2020). Unions were shocked by this law, especially because there was already heightened fear of automation weakening labour's position (Chang and Huynh 2016). The law has also been accused of including measures that weaken businesses' environmental protection requirements (ICEL 2020). Furthermore, the ambiguous procedure of designing and passing the bill has been criticised as being undemocratic (Argama 2020), and suspicions have been raised about the law providing lucrative business opportunities to oligarchs (FRI 2020). Sizable demonstrations against the Job Creation Law began in early 2020 and intensified in October 2020, when the bill was eventually passed in Parliament. Because labour unions had a limited influence in party politics, which some scholars have found roots in oppression under authoritarianism, and weak leverage in the tripartite negotiation structure, they were left with the option of street protests, which became increasingly challenging as the COVID-19 pandemic began to spread (Mietzner 2020; Robison and Hadiz 2004; Saifullah 2020).

Adoption of the Job Creation Law was possible because of the second Jokowi administration's broad political coalition. Jokowi began his first term with a minority coalition, comprising 37% of parliamentary seats. The president then used diverse strategies to gradually expand the coalition to 69% of seats by mid-2016 (Mietzner 2016), at which point the government pushed investment promotion policies in a number of moderate policy packages. Compared to the first administration, the second administration not only started on a stronger footing, with the coalition winning 61% of parliamentary seats in 2019, but also saw its coalition expand more dramatically, which aided the adoption of the Job Creation Law. The audacious appointment of the only rival presidential candidate as the Defence Minister in the new cabinet brought the third largest party (with 14% of seats) into the coalition, expanding Jokowi's share to 74%. This political strategy led to an increase in the coalitional share but a decline in the Herfindahl index (Figure 5). Coalitional relations were further cemented when the rival vice-presidential candidate was appointed as Tourism and Creative Economy Minister in the following year.[1]

Overall, the case of Indonesia highlights competition over government resources, rivalry in the parliament and societal pushback as three key political challenges in implementing industrial policies in a democratic developing country. This section has demonstrated that the Jokowi government has actively dealt with the first two challenges. In its early years, the first Jokowi administration struggled with readjusting the state budget, specifically with expanding direct funding to SOEs in order to accelerate infrastructure projects. Moreover, the multi-sectoral investment promotion policies were rolled out gradually in small packages as the government did not yet have strong coalitional support in Parliament. In contrast, in the later years of the first administration and during the second administration, the government found some means of expanding policy space by mobilising SOEs along with DFIs and securing parliamentary consensus by extending the political coalition. However, the Jokowi government has spent relatively limited energy on dealing with the third challenge, namely societal opposition. Implementing some of the measures for extending policy space sometimes entailed sacrificing societal legitimacy. DFIs may allow the executive branch to avoid political contestation and fiscal constraints, but, as a result, Indonesia now faces problems of delegative democracy, such as weak horizontal accountability, which has provoked criticism. The procedure of adopting the Job Creation Law was facilitated by an expansive political coalition but lacked negotiation and compromise with diverse societal stakeholders. Within a few weeks of the law's adoption, the constitutional court received no less than 10 judicial review petitions from opponents, including the two largest labour unions (Aqil 2020). More friction is expected in the process of adopting further regulations for implementation.

To sum up, compared to the authoritarian era, the government now has to engage in a continuous struggle with numerous political and societal actors who express different demands through formal democratic institutional mechanisms. When implementing industrial policies, the Jokowi government had to spend substantial political capital in finding fiscal resources, seeking parliamentary agreements and dealing with societal groups with various policy priorities. In Indonesia, and in many other democratic developing countries, the political environment in which technocrats could pursue industrial policies 'as long as the president was happy (*asal Bapak senang*)' has changed fundamentally (Dick 2019, 261). Today, industrial policy-making is viable only if a broad enough coalition of stakeholders is 'happy'. The episodes discussed in this section demonstrate the need to deepen our understanding of the domestic policy space for structural transformation strategies in a formal democratic institutional setting.

Conclusions

This paper offers an analysis of the new economic and political context in which developing countries are driving industrial strategy. Following a period of neoliberal 'hibernation', the revival of state-led industrial policies in many developing countries has been motivated by the aim of stimulating growth-enhancing structural transformation. Furthermore, the political environment in which this strategy is pursued has changed compared to the prime of developmentalism. Since the 1980s, many developing countries, including Indonesia from 1998, have democratised and embraced political pluralism and competitive electoral systems, however incomplete, illiberal and vulnerable these institutions may be. These characteristics are significant differences compared to the authoritarian developmental states. Therefore, democratic developing countries have different formal institutional mechanisms with which to implement industrial policy.

Considering these factors, this paper argues that the industrial policy literature should incorporate an analysis of the political process of implementing industrial policies in formal democratic institutional settings. Previously, the focus has been overwhelmingly on factors that shape inter-elite relations and technocratic capacity to implement industrial policies. In contrast, too little attention has been paid to the political challenges of finding fiscal space, reaching parliamentary consensus or gaining societal legitimacy in a formal democratic environment.

Democratic developing countries' fiscal situation, political contestation and societal demands are, of course, heterogeneous. Further research should discuss the specific parameters of this new, democratically constrained policy space for industrial policy-making and analyse how variation in these parameters leads to different designs and performance of industrial policies. Moreover, the case of Indonesia suggests that further research is required on instruments that support democratic governments of developing countries in expanding the relevant policy space in a way that is in tune with the checks and balances, and participatory and accountability mechanisms, of democratic politics.

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Notes on contributors

Lukas Schlogl is political scientist at the Department of Political Science. He studied International Development at the University of Vienna and the University of Vaasa and earned a doctorate in quantitative social science from the Department of International Development, King's College London. Previously, he was a Visiting Scholar at LSE's Saw Swee Hock Southeast Asia Center and a Research Associate at the ESRC Global Poverty and Inequality Research Network. His latest book is *Disrupted Development and the Future of Inequality in the Age of Automation* (Palgrave 2020).

Kyunghoon Kim has recently completed a PhD in the Department of International Development at King's College London. His research focuses on the role of state-owned entities in economic development. His recent publications include articles in *Competition & Change*, *Journal of Contemporary Asia*, the *Pacific Review*, *Asia Pacific Business Review* and *Asia & the Pacific Policy Studies*. He received an MSc from LSE and has worked as a Research Fellow at the Samsung Economic Research Institute, Korea.

Notes

1. Analyses of key policy decision makers and their politico-business networks are important in understanding the political economy of Indonesia's industrial policies. However, this paper leaves these issues for future studies as its focus is on formal institutions.

ORCID

Lukas Schlogl https://orcid.org/0000-0001-7335-4887
Kyunghoon Kim https://orcid.org/0000-0002-3460-4553

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