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# CREDIT AND DEBT IN INDONESIA, 860-1930



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# CREDIT AND DEBT IN INDONESIA, 860-1930

From Peonage to Pawnshop,  
from Kongsì to Cooperative

**EDITED BY DAVID HENLEY & PETER BOOMGAARD**



**KITLV • PRESS**  
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Cover illustration: Government pawnshop, Garut, West Java, 1903 (from a contemporary postcard in the private collection of Peter Boomgaard)

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# Preface

This book has its origins in a KITLV (Royal Netherlands Institute of Southeast Asian and Caribbean Studies) research project entitled “Credit, Risk, and the Economy of Debt: Indonesian Trajectories” (CREDIT), in which we have been the principal participants, and in a discussion panel on “Credit and Debt in Southeast Asia, Past and Present”, which we organized at the Fourth Conference of the European Association of Southeast Asian Studies (EUROSEAS) in Paris in September 2004. Besides six pieces which — in most cases after much revision — became chapters included here, the Paris panel also included papers by Andi Faisal Bakti, Greg Bankoff, Pramuan Bunkanwanicha, Caleb Kwong, Martin Ramstedt, and Willem Wolters. We remain grateful to these scholars for their input and insights, some of which are indirectly reflected in the present volume. Our thanks go also to Anne Booth, Thomas Lindblad, and other members of the panel audience for their critical and constructive comments. Two of our eight chapters, those by Jan Wisseman Christie and Heather Sutherland, did not originate in Paris, but were written after the conference at our request. We are particularly grateful to these contributors, without whom the range of topics and periods covered would have been much less adequate. In addition we would like to thank Rosemary Robson, for improving the English in some of the pieces; the staff of the KITLV, for their always cheerful assistance when we were in search of publications and illustrations; and Triena Ong of ISEAS Publishing, for her help, and forbearance, during the reviewing and editing process.

David Henley and Peter Boomgaard

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A Comparison Between Java and the Netherlands at the Beginning of the 19th Century”, *Explorations in Economic History* 40 (2003): 1–23; and “On the Efficiency of Markets for Agricultural Products: Rice Prices and Capital Markets in Java, 1823–1853”, *Journal of Economic History* 64 (2004): 1028–55.

# 1

## Credit and Debt in Indonesian History: An Introduction

*David Henley*

Credit and debt are increasingly important themes in social history. Concerns of all times and places, they begin with the most traditional and universal of all economic institutions, the gift. A gift, as Marcel Mauss (1954, pp. 35–36) pointed out in his famous essay on the subject, necessarily implies credit because it creates an obligation to repay while at the same time making it socially unacceptable to repay immediately. The interest-bearing loan, too, is a very ancient institution. The Mesopotamian legal code of Hammurabi, inscribed in a stone stele thirty-eight centuries old, already specifies maximum permissible interest rates for loans in grain and silver, and comes to the aid of peasant debtors by exempting them from the obligation to repay their creditors in years of drought or flooding (Homer 1963, pp. 26–27). The potential for accident and abuse that is inherent in credit, and especially the scope it may offer for profiting from the misfortunes of debtors, means that it has always drawn the attention of moralists and theologians as well as legislators. Even in secular and scientific contexts, discussions of credit and debt today continue to be informed by concepts of usury and prodigality rooted in religious and ethical teachings.

Another perennial source of interest in the topic of debt is the dramatic ambivalence of the phenomenon itself, as symbolized by its eerily antithetical synonyms: *credit*, indicating trust, approval, and empowerment, and *debt*, indicating obligation, constraint, and danger. Debt is, as Charles Malamoud (1988) evocatively puts it, *lien de vie, noeud mortel* — at once a lifeline and a hanging noose. Throughout history it has been both a valued resource and a feared encumbrance, not only for the poor in times of absolute need, but also for the rich and powerful in times when preserving their privileges

demanded a financial gamble. In the Middle Ages, kings of England pawned their own crowns for ready cash when funds were low (Barty-King 1997, p. 11). Credit, in history perhaps even more than in the present, was also the life blood of trade, allowing commerce at crucial junctures to grow beyond the availability of coinage and precious metals. Money itself, according to one influential theory, actually has its origins in trade credit, which it evolved to embody in an impersonal, transferable form (Gardiner 2004).

The reverse side of this coin, if the pun can be excused, is the periodic contraction or collapse of commerce when too much credit has been extended and too many debts created. While over-optimistic borrowing is obviously not the only cause of economic crises, the Wall Street Crash of 1929, the Asian financial crisis of 1997, and the recent mortgage crisis in the United States are all illustrations of the principle that debt can be as dangerous for businesses and nations as it is for individuals. So too, in a different way, is the chronic debt crisis into which many African countries descended in the 1970s (Nafziger 1993). A specifically contemporary reason for academic interest in credit and debt lies in current popular concern with the growing scale of (private and public) indebtedness in the United States and other Western countries, as dramatized in books with titles such as *Credit Card Nation* (Manning 2000) and *Running On Empty* (Peterson 2004). Some of the recent historiography of consumer debt in the West is inspired explicitly by this sort of concern, which it concludes either by reinforcing (Barty-King 1997; Williams 2004) or by rejecting as exaggerated (Gelpi and Julien-Labruyère 2000).

Perhaps not coincidentally, the last few years have also seen a spate of more purely academic studies on the social history of credit and debt in European contexts, from the Middle Ages (Schofield and Meyhew 2002) through the early modern period (Muldrew 1998; Smail 2003, 2005) to more recent times (Finn 2003). The emphasis in these studies is on changing cultural and ethical attitudes to borrowing and lending, and on how such attitudes affected the availability and uses of credit. In relation to the world outside Europe, by comparison, there is little comparable literature. The latest edition (Homer and Sylla 2005) of Sidney Homer's classic *History of Interest Rates* (1963), still a key compendium of sociological as well as statistical data on credit in history, includes scarcely more information than the first edition regarding the developing countries. Falola and Lovejoy (1994) have edited a collection on debt bondage in Africa, and two available books on women and credit in history also have a partly African focus (Jordan 1993; Lemire, Pearson, and Campbell 2001). For

China and Japan there is the collection edited by Malamoud (1988) on cultural representations of debt, and for India, that edited by Bagchi (2002) on money and credit in Indian history. For Southeast Asia, the present volume is the first of its kind. This is surprising given that in that part of the world, even more than elsewhere, credit and debt are topics of particular historical importance.

## **Debt, Dependency, and Power**

In Indonesia, and elsewhere in Southeast Asia, debt long played a central role in the maintenance of social and political order. Although the societies of precolonial Southeast Asia were complex, hierarchical, and in many cases encompassed large areas and populations, they featured neither the elaborate system of hereditary castes which underpinned Indian civilization, nor the strong bureaucratic state, cohesive patrilineal clans, and ethic of filial piety which gave China its unity and stability. Instead, social integration and political legitimation in Southeast Asia rested to a large extent on obligations and dependencies created by various kinds of debt: debt to kinsmen, debt to neighbours, and above all, debt to superiors.

The importance of debt to the traditional social order in this region is illustrated by the fact that surviving precolonial legal codes and documents from diverse parts of Southeast Asia are rich in stipulations relating to credit, interest, and debt bondage. Some of the earliest Javanese inscriptions, for example, record debts and debt settlements, and the oldest surviving written document from the Philippines, a copper plate inscription from the year 900, is a certificate of debt cancellation (Christie, this volume, Chapter 2). When Southeast Asian societies begin to come into clearer view in the historical sources as a result of the arrival of Europeans six centuries later, the same emphasis on debt is immediately evident. W.H. Scott (1994, p. 135), in his synthesis of the best early European descriptions — Catholic missionary accounts of the sixteenth-century Philippines — describes the fabric of precolonial Filipino society as one “woven of debt and dependence”.

In the twentieth century, anthropologists studying tribal societies in the more remote parts of Southeast Asia continued to observe the same pattern. Edmund Leach (1954, p. 141), on the basis of fieldwork in the 1930s and 1940s among the Kachin of highland Burma, put it strikingly: “When a Kachin talks about the ‘debts’ which he owes and which are due to himself, he is talking about what an anthropologist means by ‘social structure’.”

A more recent anthropological study from Nias agrees that “Niasans, like Leach’s Kachin, tend to characterize social relations in terms of debt” and that even “relationships which are basic to human life, such as that of an infant and its mother, are conceived in some contexts as incurring debt” (Beatty 1992, p. 183). In urban contexts too, it has sometimes been argued, economic relations between children and parents in Malay and Indonesian families differ from their counterparts among the ethnic Chinese population group in that these relationships in the Malay case tend to be mediated by, and conceived in terms of, gifts and debts rather than obedience and solidarity (Li 1989, pp. 41–74, 156–62). The affective importance of debt in Indonesian cultures is reflected in the emotional resonance of the term *hutang budi* and its even more evocative Tagalog equivalent *utang na loob*, a “deep” or “inner” debt of gratitude (Kaut 1961).

In the past, one particularly important manifestation of the social importance of debt was debt bondage or debt slavery. In most precolonial Southeast Asian societies, at least outside the domains of the major states, a considerable proportion of the population was in some form of slavery — in Sulawesi, for instance, typically around one third (Henley 2005, pp. 107–10). Anthony Reid (1983, p. 8) describes traditional slavery in Southeast Asia as a system based on obligation rather than compulsion, and comments: “If we seek a single origin for this system of obligation, it appears to be debt.” Even the enslavement of criminals and prisoners of war was apparently conceived in terms of debt (Reid 1988–93, vol. 2, p. 131). The most common words for “slave” in the Philippines, *alipin* and *oripun*, literally mean “one who has been given life”, and can be interpreted as indicating the debt owed by slaves to those who spared them after they had forfeited their right to live (W.H. Scott 1994, p. 133).

More often, the enslaving debt arose from direct economic “assistance” provided by a prosperous individual to a needy borrower who, if his debt exceeded the value of his life, became the property of his creditor. Such debts, if not redeemed, were passed on from parents to their children, who then became hereditary slaves (Kruyt 1911, p. 69). The directness of this link between economic debt and slavery appears to be specific to Southeast Asia. In other parts of the world where debt has been a common route into servitude, such as Sub-Saharan Africa, there usually seems to have been a clearer distinction between slavery on the one hand, and debt bondage or “pawnship” on the other (Falola and Lovejoy 1994, pp. 13–15).

In Indonesia, slavery was not the only type of hierarchical relationship to be generated or underpinned by debt. The same was often true in some degree of political leadership in general. Power holders of diverse descriptions used monopoly trade goods or stockpiled food reserves to put others in their debt, and thereby to accumulate further wealth and power. In Manado (Sulawesi) at the beginning of the nineteenth century, according to a contemporary Dutch account, “at least nine tenths of the natives” were “in debt to one or another of their chiefs” (Henley 2005, p. 34).

There is another respect, too, in which credit and debt were involved in the process of state formation. Among the economic benefits of centralized government, other things being equal, are reduced interest rates. In the seventeenth century the lowest recorded commercial interest rates in Southeast Asia were found in the areas under direct Dutch control (Boomgaard 1996, p. 501), and John Crawford (1820, vol. 3, p. 143) observed at the beginning of the nineteenth century that interest rates were “greatly reduced from the confidence and security which any form of European government, however imperfect, naturally confers”. In part this was simply a matter of security of persons and property: war, political instability, and unpredictable fiscal demands had been major sources of economic risk in Southeast Asia under precolonial conditions (Reid 1988–93, vol. 2, p. 109). Legal enforcement of credit contracts, however, was also significant. In the eighteenth century, Indonesian and Chinese traders were already making use of Dutch (VOC) courts and law for resolving trade disputes and recovering debts (Anderson Wellen and Sutherland, this volume, Chapters 4 and 5).

Indigenous polities, too, were involved in the enforcement of commercial contracts. According to one nineteenth-century source, the “gifts” which the captains of visiting trading vessels presented to the highest royal official in a Sulawesi harbour settlement were given “less as anchorage fees than with the purpose of securing his assistance later with the collection of outstanding debts” (De Clercq 1883, p. 118). Political leaders, in other words, justified the costs which they imposed on foreign traders partly by using their power and influence to help guarantee (unwritten) contracts with local trading partners — an important service given that most commerce, as in other underdeveloped economies, was based on advance payments on goods to be delivered at a later date (Reid 1988–93, vol. 2, p. 108). Small indigenous states like those of precolonial Sulawesi, ruled by chiefly oligarchies devoid of bureaucratic specialization, were already “market-

supporting institutions”, serving to reduce the risks involved in extending credit (Greif 2000, 2005).

The well known association between commerce and state formation in Southeast Asian history (Christie 1995; Hall 1985) is often interpreted primarily in terms of the opportunities for (more or less parasitic) taxation which concentrations of trade create. But there is some anthropological evidence, notably from upland Luzon in the Philippines (Barton 1949, pp. 174–208), to support a converse (but complementary) interpretation: that the demand from traders and their customers for institutions to reduce the risks of economic exchange, both in general terms by guaranteeing peace and order, and in specific terms by facilitating the collection of debts, was itself one of the reasons why incipient political centralization took place.

## **Debt, Culture, and Poverty**

One reason why it was easy to fall into debt bondage in the past, and difficult to escape from it, was that interest rates on loans — whether in cash or in kind — were often high. Another is that much of the population was poor, and very vulnerable to both natural and man-made calamities. From earliest contacts up to recent times, Western observers, noting the prevalence of debt bondage, the high cost of credit, the crisis-ridden character of economic life, and what appeared to be a general scarcity of savings, portrayed Indonesian societies as being caught up in self-reproducing vicious circles of debt and poverty (Boomgaard 2003, pp. 90–1; Reid 1988–93, vol. 1, pp. 129–36; vol. 2, pp. 107–11). Many also put part of the blame for this situation on cultural attitudes favouring profligacy, fatalism, and dependency, or on traditional practices involving the destruction of capital, such as potlatch-like “feasts of merit”, or the burial of gold and silver coinage with the dead. In a less moralistic way, modern anthropologists sometimes present similar arguments. Spyer (1997), for instance, argues that pearl divers in Aru are seduced by their supernatural “sea wives”, spirit-women who embody both the rewards and the dangers of commerce, into becoming permanently indebted to pearl traders.

Some reservations, and qualifications, are immediately in order here. The great variety of cultural meanings accorded to debt in essentially similar situations, first of all, suggests that the *explanatory* value (as opposed to their ethnographic value) of those meanings may be limited. Second, judging by modern evidence from economically backward areas, any idea that interest rates were *uniformly* high in the past, even for poor farmers, is misleading.

A rare quantitative survey from the upland Philippines reveals that eighty per cent of all loans carry no interest charge at all, being obtained from friends and relatives for emergency or “consumption smoothing” purposes as part of an informal system of reciprocal insurance (Fafchamps and Lund 2003, p. 285). The rotating savings and credit association (Javanese/Indonesian: *arisan*), an institutionally simple means of pooling the capital of a small group, is another way of providing a certain amount of interest-free credit, and has a long history in Indonesia (Geertz 1962). Thirdly, similar doubts must apply to the common claim in historical sources, often based on superficial observation, that rural people were unable to accumulate savings. In fact, savings were usually present even in the most traditional settings, not only in relatively opaque forms such as livestock, slaves, and “social capital” of various kinds, but also more transparently as gold jewellery, a concentrated, portable form of accumulated wealth which was carefully valued according to its weight and could readily be exchanged for other commodities (Beatty 1992, pp. 192–94).

Savings in the form of jewellery, on the other hand, did not produce interest for the saver. And if the interest rates paid by borrowers were not universally high, they were certainly not uniformly low either. Rather, the informal credit market was characterized by enormous diversity and fragmentation. To judge, again, from recent evidence, the interest-free loans offered by relatives in emergencies coexisted with interest rates equivalent to hundreds or even thousands of per cent per year for loans from commercial sources (moneylenders, traders, landlords) in the informal sector. In the 1970s and 1980s, anthropologists observed that small commercial loans to low-income Indonesians were typically supplied at monthly (not annual) interest rates ranging from ten per cent to over sixty per cent, while effective monthly rates on very short-term (daily or weekly) credit were sometimes far higher again (Robinson 2002, p. 101; Strijbosch 1986, p. 291).

One reason for the extreme spread of informal sector interest rates is that the social networks within which low- or zero-interest credit is available are small, usually encompassing only relatives and close neighbours of similar economic status (Fafchamps and Lund 2003, p. 285). This means that the amount of capital available within them is limited. “On the whole”, as Raymond Firth (1964, p. 20) straightforwardly put it, “peasants are poor, and their low income level, their poverty, is one of the prime factors in creating [...] unfavourable conditions for saving and capital formation.” The limited geographical scope of the low-cost credit networks also means that as insurance systems, they tend to fail in the

rather common event that economic adversity — for instance, crop failure — affects many individuals in a given locality simultaneously (Platteau and Abraham 1987, p. 471). Demand for commercial credit therefore persists alongside the “moral economy” of reciprocal lending. And the costs of loans from informal commercial providers, as noted, are high — certainly higher than those charged by the formal microfinance institutions (of which more below) that are now partly replacing them. Regarding the reasons for the high cost of informal commercial credit there are two rival schools of thought, both of which find some support in the empirical evidence from Indonesia.

The first view, taking its cue from agricultural economists who in the 1980s argued that informal moneylenders actually provide efficient services and represent “value for the people” (Von Pischke, Adams, and Donald 1983), is that high interest rates accurately reflect the high risks and transaction costs involved in making small loans to poor borrowers, and that informal commercial lenders are also constrained by their own limited access to capital. The success of modern microbanking, in this view, reflects its greater ability to pool capital, and its concentration on making slightly larger and more secure loans to a slightly more prosperous section of the rural population (Steinwand 2001, pp. 310–15). The second school of thought, by contrast, holds that informal commercial lenders are not usually constrained by any shortage of loanable funds, and that their risks and transaction costs, at least when dealing with established clients, are moderate. In this view their high interest rates reflect the fact that they operate under conditions of “monopolistic competition” (Robinson 2001, pp. 170–222). Their low risks in relation to trusted borrowers reflect histories of repeated, personal, well-informed, and usually exclusive (monopolistic) transactions with those individuals. Most lenders can build up only a few relationships of this type, while most borrowers have only one informal commercial lender, and know it might not be easy to find another quickly. In these circumstances lenders charge high interest both to exploit their effective monopoly, and to cover the costs of building up their client relationships and knowledge (Van Zanden 2004, pp. 1041–42, 1044).

Besides giving rise directly to debt, the crisis-ridden nature of economic life also inclined people to enter into debt for insurance purposes. The pre-sale of standing crops to traders at low prices well before the harvest, a practice known in Java as *ijon*, gave farmers the certainty of money in the hand while shifting subsequent risks to the buyers (creditors) — who, of course, incorporated a corresponding risk premium (Bottomley 1975, p. 282)

into their interest charges. Relationships of more permanent indebtedness between peasant farmers on the one hand, and shopkeepers, moneylenders, or traders in agricultural products on the other, often involved an effective commitment by the creditor to provide further credit or other commercial favours if these were necessary to protect the borrower from insolvency. Such relationships, in other words, contributed to the social security of the peasant, who might even seek loans with the specific intention of binding a trader to him as a guarantee of future favours (Burger 1975, vol. 2, p. 72). A permanent credit line also provided, again at a price in (explicit and implicit) interest charges, a buffer against the volatility of prices (Elson 1997, p. 198). More generally, it can be said that any kind of indebtedness, including that of the debt slave, gave the creditor a vested interest in the survival of the debtor. In an insecure world this interest, however limited and however expensively purchased, was a valuable asset and an important source of solidarity in a society otherwise poor in bonds transcending the boundaries of kinship.

The “debt trap” portrayed by early European and colonial writers, although oversimplified, was not imaginary. In this volume, Van Zanden (Chapter 8) reiterates that by comparison with Europe, Java seems for a long time to have been long “caught in a trap characterized by thin and fragmented capital markets, with high interest rates”. When moneylenders hold a large share of the microcredit market, as Robinson (2001, p. 185) observes “the high costs their borrowers pay for loans can have a substantial negative effect on development”. What limited savings Javanese peasants managed to accumulate, meanwhile, were not recycled into the credit market to take advantage of the high interest rates on loans, but rather remained in inert forms such as gold, incurring further interest charges if they were temporarily exchanged for cash at the pawnshop. Only in the late twentieth century did this begin to change with the emergence of formal microbanking — of which more below — to mediate directly between rural savings and rural credit.

## **Credit, Trade, and Ethnicity**

The fragmentation of historical credit markets in Indonesia was not only evident in the dramatic variety of interest rates on rural loans, from zero among risk-sharing networks of farmers to hundreds of per cent per month in many cases of moneylender loans. It was also evident in the contrast between the high cost of commercial loans to peasants, and the often rather

free flow of credit between members of groups professionally specialized in commerce. If trust, in relations between commercial lenders and peasant borrowers, was a scarce asset built up through sustained investment in individual relationships, the systematically high levels of trust prevailing in credit transactions within Indonesia's Chinese business community have long been something of a cliché. Anthropologist Alice Dewey, in her still classic *Peasant Marketing in Java* (1962), declared that among themselves, Chinese traders, in contrast to their Javanese counterparts, appeared to proceed from an assumption of creditworthiness: "A man who asks for credit normally gets it, and a man who gives it knows he will be repaid" (Dewey 1962, p. 47).

Similar statements, anticipating later theory on the role of trust and low transaction costs in Chinese commercial networks more generally (Landa 1983, 1994) are found in other anthropological studies from Indonesia in the same period (Castles 1967, p. 88; Ryan 1961, p. 31). In some such accounts, the differences between indigenous and Chinese credit practices may well have been exaggerated for contrastive clarity, or in accordance with stereotypes prevalent among informants. Subsequent research has certainly cast some doubt on the idea that Overseas Chinese traders in Southeast Asia enjoy systematically low risks or costs specifically in dealings with members of their own ethnic group or subgroup, as opposed to dealings with close business associates in general (Hodder 1996; Menkhoff 1993). There is, it must also be said, a dearth of quantitative historical data on interest rates in the Indonesian Chinese business world, and some qualitative sources mention high rates even on loans between family members (Vleming 1926, p. 139). What is nevertheless clear is that in late colonial times, the wealthiest and most creditworthy Chinese merchants borrowed at *annual* interest rates of just six to nine per cent from the Dutch-owned banks established in Indonesia from 1827 onward (Van Zanden 2004, p. 1046).

One of the reasons why statistics on interest rates in Chinese commerce are scarce, moreover, is that Chinese entrepreneurs sometimes worked not by borrowing on an individual basis, but by forming a joint venture or *kongsi*, pooling their capital in a common fund, and sharing the profits (Dobbin 1996, pp. 58–59, 176). This efficient procedure, which demanded a high degree of mutual trust among the participants (shareholders), was very rare in *pribumi* (indigenous Indonesian) economic life, where by and large, profit-sharing was known only as a basis for dividing the proceeds of a business loan from one individual to another. Although *arisan* or

rotating savings and credit associations did involve multiple participants, in an *arisan* the whole kitty brought together at each periodic meeting is immediately disbursed to the member whose turn it is to receive it, so that “no one has to be trusted to hold cash belonging to anyone else for any length of time” (Geertz 1962, p. 262). Carl-Bernd Kaehlig (1986), building on earlier work by Castles (1967) and Siegel (1969), has argued that historically speaking the inability to form a genuine corporate capital (*Gesellschaftsvermögen*) has been an important restriction on the ability of Indonesian entrepreneurs to compete with the Chinese commercial minority. A further sophistication of the Chinese diaspora in terms of financial organization was its use in certain business sectors, at least by the early eighteenth century, of “bills of exchange” enabling a debt owed to one person by another to be collected instead from a third party (Brown 1994, p. 20; Nagtegaal 1988, pp. 125–26).

Cultural interpretations of Chinese commercial success (Hofstede and Bond 1988; Redding 1990) notwithstanding, the business ethics and social control mechanisms associated with such institutions are not intrinsically restricted to particular ethnic groups. Rather, they tend to be found in any group, ethnic or otherwise, which exhibits a strong and established professional specialization in commerce. Dewey (1962, p. 43) notes that among those few Javanese who have succeeded in establishing themselves in wholesale trading, “the level of adherence to business ethics seems high”, partly because of “the intimate knowledge the members of the groups have of each other”. A key variable here seems to be the extent to which borrowers are constrained in their behaviour by the potential costs of losing their creditworthiness — costs which are determined by the scale of their existing success and by the range of alternative opportunities available to them outside the existing commercial specialization. Whereas a failed Javanese trader can often fall back on other economic options, and on social networks located outside the commercial sphere, the future of a Sino-Indonesian businessman tends to be more exclusively dependent, in social as well as economic terms, on commercial success, financial probity, and adherence to contract (Dewey 1962, pp. 47–48).

Perhaps the most common explanation for the (in this respect, though not in others) auspicious concentration of the ethnic Chinese in the commercial professions is a political one: that from the seventeenth century onward, the Dutch deliberately confined the Chinese community, with its small size and low political aspirations, to that role and supported it in its business activities as an “unthreatening alternative” (Reid 1993) to indigenous

Indonesian commercial power. The same tendency to favour vulnerable, politically isolated foreigners in commercial roles was also shown by indigenous Southeast Asian rulers in precolonial times (Kathirithamby-Wells 1993, pp. 133, 135). There is a direct parallel here, it has often been argued, with the way in which rulers in Europe once preferred the fruits of commerce to be enjoyed by unpopular and compliant Jewish minorities, rather than have them fall into the hands of potential rivals for political power (Chirot and Reid 1997; Hamilton 1978).

Other complementary explanations for the coincidence of ethnic identity with commercial specialization include the relative freedom of foreigners or “outsiders” from the constraints of the moral economy that requires peasants to provide their neighbours with economic favours such as interest-free loans (Foster 1974). Meanwhile the latent (and sometimes overt) hostility of the host society forces the foreign group ever more exclusively into its marginal, if lucrative, commercial niche, at the same time enhancing its internal solidarity, and hence its comparative advantage in terms of credit and transaction costs (Bonacich 1973). The Southeast Asian Chinese and the Jews of Europe are particularly prominent examples of a worldwide category of trade-specialized ethnic minorities. Other, more modest examples in the Indonesian context include “indigenous foreigners” such as the Kalang and Bawean traders of Java (Dobbin 1991; Guillot 1988). Before the Overseas Chinese rose to prominence in maritime Southeast Asia, another commercial minority, the (originally) South Indian “Chettians”, already occupied a comparable position in the region and had already developed the same sophisticated financial instruments, including corporate funds and letters of credit (Brown 1994, p. 12; Reid 1988–93, vol. 2, pp. 111–12).

The observation that credit flows more freely within trade-specialized communities than among the population at large has sometimes led the challenge of improving popular access to credit to be portrayed as one of providing more widely applicable substitutes for the informal, but compelling, social constraints that help to enhance trust and reduce interest rates among trading professionals. For Janet Tai Landa (1983, p. 102), for instance, a “policy implication” of the effectiveness of the Chinese code of business ethics is the need for the state to provide a functional alternative to that code for aspiring *pribumi* (indigenous Indonesian) entrepreneurs, in the form of “a well-functioning legal infrastructure for the protection of contracts”. On a different tack, Christine Dobbin (1980; 1983, pp. 125–26) has argued that the historical association between commercialization and

Islamization in Indonesia can be explained partly by the way in which Islam, on a decentralized basis largely independent of the state, provides an impersonal legal and moral framework for market exchange — a framework that has the potential to encompass, through conversion, the whole population. Similar arguments have been made by a number of writers in African contexts (Ensminger 1992, pp. 59–62).

## **Credit, Ideology, and Nationalism**

A further reason to regard credit and debt as central issues in Indonesian history is that in the early twentieth century, attempts to combat indebtedness and “usury” were closely associated with the rise of Indonesian nationalism, and with the ways in which politically conscious Indonesians came to understand their own society and history. The popular credit movement also informed a theory of underdevelopment, that of the “dual economy”, which became influential far beyond the borders of Indonesia.

From the seventeenth century onward, as noted, the role of indigenous political leaders as suppliers of credit was increasingly usurped by ethnic Chinese traders. One reason for this was the Chinese minority’s superior access to capital. Another was the rise of European power in the archipelago: the Dutch East India Company and the colonial state which superseded it regarded the Chinese as unthreatening economic partners at the level of intermediate or distributive commerce, and encouraged them to operate under European protection and in cooperation with European commercial interests. As foreigners they were mostly unable or unwilling to translate their creditor role into the customary forms of political power and patronage, and colonial protection meant that unlike their indigenous predecessors, they were not obliged to do so in order to keep their wealth secure from jealous enemies. Instead they generated economic dependency without political loyalty, and became a class of “pariah capitalists” (Hamilton 1978) with a stereotypical reputation for avarice and ethnic exclusivity.

At the end of the nineteenth century the issue of indigenous indebtedness in relation to Chinese “usury” began to attract the attention of social reformers within the colonial state. On home leave in the Netherlands in 1897, colonial civil servant W.P.D. de Wolff van Westerrode attended an agricultural congress at which there was much enthusiasm for cooperative farmers’ credit associations of the Raiffeisen type developed in Germany since 1849. If such cooperatives had succeeded in helping Prussian peasants

raised in a tradition of “every man for himself and God for us all”, reasoned De Wolff (1898, pp. 35, 106), how much more successful might they not be in Java, where the various customs of mutual help — which would later be referred to as *gotong royong* — suggested a cultural aptitude for cooperation and solidarity?

Two years earlier a small savings and loans bank had been established in his regency of Purwokerto in Central Java, apparently on the joint initiative of the local aristocrat and the previous Dutch administrator, with the aim of protecting Javanese civil servants from the usurious interest rates charged by Chinese moneylenders (Djojohadikoesoemo 1941, p. 11). Loosely following the Raiffeisen model, the function of this bank was now extended under De Wolff’s direction to include the provision of credit, in cash or in unhusked rice, to farmers. An explicit principle of the new “Purwokerto Savings, Mutual Assistance and Agricultural Credit Bank” was that it “would have nothing to do with Foreign Orientals” — that is, with Chinese, Indian, or Arab traders and moneylenders (De Wolff van Westerrode 1898, p. 40). In the long run, De Wolff (1898, p. 105) envisaged that the *desa* or village community itself would become “a cooperative society which manages its own finances and assists its members with loans, at first in paddy, later perhaps also in cash”. In an attempt to initiate this development, he and his colleagues also supervised the creation of a network of more than 200 *lumbung desa* or “village rice barns” linked with the credit bank.

Both the problem and the solution identified by De Wolff — respectively Chinese economic exploitation, and *pribumi* credit cooperatives — would resonate continuously down the next century of Indonesia’s political history in the form of distaste for “alien” capitalism and enthusiasm for cooperative institutions drawing on an indigenous tradition of collectivism. Indeed no idea has ever united political elites in Indonesia, whether colonial or anticolonial, like that of the cooperative society. Not for nothing did J.H. Boeke, advisor to or coordinator of the colonial Popular Credit Service from 1914 to 1929, describe the cooperative movement as “the area in which the government in its highest aspirations can work together with the nationalist movement in its most constructive activity” (Boeke 1929, p. 167). Neither is it coincidental that the director of the credit service’s Central Fund from 1924 onward, T.A. Fruin, was also president of a “Council of Anti-Usury Societies” and expressed understanding for (although not actual sympathy with) Nazi anti-Semitism in Germany (Fruin 1933, p. 145).

Today the name most closely associated with cooperatives in Indonesia is, of course, that of *Bapak Koperasi* (“Father of Cooperatives”) Mohammad Hatta (1902–80), principal author of Article 33 of the 1945 constitution, according to which “the economy shall be organised as a cooperative endeavour based on the principle of family life”. Often portrayed as a voice of realism and moderation among the early nationalist leaders, in this respect Hatta was, in fact, a utopian idealist who envisaged that one day the whole nation would become a “commonwealth of cooperatives” working together to “eliminate all competition” (Hatta 1963, p. 22). Soeharto too had a strong and apparently sincere attachment to cooperatives (Elson 2001, pp. 55, 64, 210–11), and after his fall, attempts to amend Article 33 were strenuously and successfully resisted in parliament (Mubyarto 2001). All this despite the fact that in practice, few Indonesian cooperatives have ever been very successful in achieving their economic objectives: the colonial credit service, indeed, quickly abandoned them in favour of direct state control, although it continued to pay lip service to the ideal of cooperative management and finance (Henley 2007, p. 96).

Despite all evidence to the contrary, Boeke and his colleagues held that mass indebtedness in Indonesia was a relatively recent development. They argued that it was contact with the ruthless agents and seductive products of an unfamiliar capitalist economy, based on money and profit, which had given the Indonesian peasantry a pathological thirst for credit (Boeke 1953, pp. 108, 206, 308; Fruin 1931, pp. 56–57). Originally, Indonesians had been innocent of both savings and debts, creatures of “limited needs” which they had satisfied by means of collective, rather than individual, ownership and enterprise. This characterization of pre-capitalist society was to find its way not only into Indonesian nationalist ideology, but also into academic theories of underdevelopment that became popular well beyond Indonesia.

J.H. Boeke was not just the leading figure in the colonial credit service in Indonesia. He was also the most internationally influential, for better or for worse, of all Dutch academic writers on Indonesia. His pessimistic theory of social and economic “dualism” (Boeke 1930), which has been described as “a sort of dependency theory *avant la lettre*” (Schmit 1991, p. 64), proposed that for cultural reasons as well as because of the pernicious ways in which the West had interacted with them in the past, non-Western societies were more or less impervious to economic development. Worse, such societies were said to respond to any economic growth which did occur by increasing in numbers rather than in living standards, so that

development efforts only served to fuel the global “population bomb”. Boeke’s ideas influenced many key non-Dutch academic works on Southeast Asia in the 1960s and 1970s, notably Geertz’s *Agricultural Involution* (1963) and J.C. Scott’s *The Moral Economy of the Peasant* (1976), and provided indirect support to efforts in Indonesia and elsewhere to pursue non-capitalist development strategies. Partly as a consequence of these strategies, ironically, developments in Indonesia in the 1950s and 1960s seemed to vindicate Boeke’s pessimism: the country grew in population but not in prosperity. But that was soon to change.

### **Insights from Hindsight: Microfinance Revolution, Macrofinance Crisis**

The chronological scope of this book extends from 860 A.D. — the date of the earliest known Javanese inscription relating explicitly to debt — to 1930, which marks the beginning of the greatest economic depression of modern times and the end of the “Ethical Policy” which inspired colonial-era interventions in Indonesian rural credit markets. Nevertheless it is also worth briefly considering two more recent events that serve to put the earlier history of credit and debt in Indonesia in a new perspective: the “microfinance revolution” of the late twentieth century, and the dramatic financial crisis which hit Indonesia and its neighbours in 1997 and 1998.

In the last two decades Indonesia has, unexpectedly for many, become famous for success in microfinance — the provision by formal institutions (banks) of financial services to the poor (Robinson 2002). By the beginning of the present century, the Village Unit (Unit Desa) system of the Bank Rakyat Indonesia (Indonesian People’s Bank, BRI) was the largest financially self-sufficient microbanking system in the world, reaching about a quarter of all households in the country (Robinson 2001, p. 47). Beginning in 1984, BRI had succeeded within a few short years in transforming a government-subsidized rural credit programme, with high arrears and substantial losses, into a profitable banking business. The reformed operation featured a bonus system rewarding timely repayment, a graduated loan ladder (in which initial loans are very small and repayment secures access to progressively larger ones), commercial interest rates, and performance-based remuneration for branch managers. In 1996, with support from United States Agency for International Development (USAID), BRI set up an International Visitor Programme to instruct delegates from overseas on how

successful microfinance is done. When the Indonesian government sold off a forty per cent stake in BRI in October 2003, the shares were fifteen times oversubscribed. BRI, moreover, is not Indonesia's only successful microfinance provider: others include the locally based, community-owned Lembaga Perkreditan Desa (LPD) of Bali, and an increasing number of private commercial banks.

One of the surprising things about Indonesia's microfinance revolution is that it has taken place in an institutional environment which hardly permits any legal enforcement of credit contracts. The Peruvian economist Hernando de Soto, in his influential book *The Mystery of Capital* (2000), argues that what is needed to bring credit to the world's poor is solid legal institutions which can transform the "dead" capital of land and property into collateral for guaranteeing loans. But Indonesia's dysfunctional legal system, which still cannot guarantee anything much even in the world of big business and foreign investment, let alone tiny loans to peasant farmers and microentrepreneurs, has little to do with the success or failure of microfinance. Borrower selection procedures in the BRI rural credit programme do include requirements for collateral in land, houses, and moveable goods. But in practice the bank seldom tries to seize these in the event of default: collateral assessment is viewed primarily as psychological incentive to repay (Robinson 2002, p. 244).

How, then, has Indonesia's recent success in microfinance been possible? One factor may be the institutional legacy of the colonial period. In the 1920s and 1930s the rural credit system in the Netherlands Indies was already more highly developed than any similar scheme elsewhere in Southeast Asia (Booth 1998, pp. 304, 323). Despite continuing ideological emphasis on cooperatives, in practice the Popular Credit Service came to be based on an extensive network of state-supervised village credit banks, financed initially by government loans, and subsequently by operating profits made possible by commercial interest rates. Repayment rates were high, and strict regulation kept administrative corruption under control. The postcolonial collapse of this system, according to one view, was a temporary consequence of political turmoil and uncontrolled inflation, leading to negative real interest rates on monetary loans. As soon as macroeconomic stability was restored at the end of the 1960s, the old institutions and practices were rediscovered and adapted to modern conditions (Kuiper 2004).

While there is undoubtedly some truth in this, it is also important to note that the first two successful microfinance providers of the New Order

period had no direct colonial antecedents. These were the BKK (Badan Kredit Kecamatan) system of Central Java, established and owned by local government, and the private Balinese bank BDB (Bank Dagang Bali), both founded in 1970 and both, to some extent, models for the later reform of the BRI system (Patten and Rosengard 1991, pp. 17–53; Robinson 2002, pp. 144–64). Moreover, the colonial microfinance institutions differed radically from their modern counterparts in that they failed to mobilize savings. Today savings, more than loans, are the mainstay of the industry: total savings deposits in BRI village unit banks far surpass total credit outstanding, and the number of individual savers exceeds that of borrowers by almost ten to one. In the colonial period, by contrast, the government village banks were pure credit providers offering almost no savings facilities (Steinwand 2001, pp. 95–96).

One reason for this former neglect of the microsavings option was the fact that Dutch colonial microfinance, as noted, had its origins in initiatives designed specifically to free Indonesians from the grip of ethnic Chinese moneylenders. This priority ironically led the state to concentrate on lending money itself, in an attempt to displace the Chinese “usurers”, rather than on reducing the need for Indonesians to borrow by helping them to save. Another reason why savings received no emphasis was the ideological conviction, inspired by Boeke, that the Indonesian rural population simply “does not know how to build up capital or how to save” (Fruin 1938, p. 106). Ironically this assumption was already contradicted to some extent by the success of the Credit Service’s own pawnshops, which in most years accounted for fully sixty per cent of all credit dispensed (Van Laanen 1980, p. 40), but which were seldom perceived by the Dutch in terms of the rural savings which the pawned gold and other valuables represented.

Whatever the institutional limitations on microfinance in the early twentieth century, there is also a clear structural reason why it should have become more successful in the late twentieth century: the economic rise of Indonesia in that period to the status of an Asian Tiger. Whereas per capita national income grew only slowly before 1930 and may actually have declined between 1930 and 1967, from 1967 to 1997 it grew at an average of almost four per cent per year (Van der Eng 2002, p. 155). The benefits of this growth were not confined to a small elite: the proportion of the population living in income poverty, at least according to the official statistics, declined from sixty per cent in 1970 to eleven per cent in 1997 (BPS, Bappenas, and UNDP 2004, p. 13). One result was that the economic environment became intrinsically more conducive to successful

microbanking. Surveys carried out for the BRI in the period 1979–84 concluded that recent growth had “created a large, unmet demand for savings services” in rural areas (Robinson 2002, p. 268). At the same time, Indonesians now had more opportunities to make productive use of credit than at any earlier period (Chaves and Gonzales-Vega 1996, p. 69). Cross-country statistical analysis confirms that worldwide, macroeconomic growth has a significant positive effect on the performance of microfinance institutions (Ahlin and Lin 2006).

The success of microfinance in Indonesia is often characterized as the vindication of a brave strategy of “banking on the poor” (Fox 1999), and there is no doubt that the microfinance revolution has helped many low-income households improve their situations. Nevertheless even its greatest admirers acknowledge that among the “enabling conditions” for that revolution was economic growth, which made the poor relatively less poor, and therefore more able to take advantage of the opportunities it offered them for self-help (Robinson 2002, p. 219). In a way this bodes well for other countries where microfinance is still weakly developed. But at the same time it also suggests that microfinance is not in itself the key to fighting poverty, and that Indonesian models of microfinance may not work in the absence of economic growth.

For scholars of Indonesia itself the most important lesson of the microfinance revolution, with its dramatic reversal of long-standing historical patterns, may be that history, especially when interpreted in terms of cultural rather than economic forces, is an unreliable guide to what is possible in the future. This is underscored by the ironic fact that just as Indonesian rural microfinance was confounding sceptics and making history with its success, that part of the banking sector serving big business, long regarded as a domain of much lower credit risk, was experiencing an unprecedented crisis caused partly by borrowing behaviour reminiscent of that deplored by earlier writers in relation to the rural economy. The East Asian financial crisis of 1997 and 1998 was precipitated by excessive borrowing, often for the sake of unproductive spending (Noble and Ravenhill 2000, p. 5; Matsumoto 2007, pp. 192–93). In contrast to the old rural pattern, however, here the borrowing was fuelled partly by excessive supplies of cheap capital. Sustained growth over the previous three decades had made the increasing number of foreign investors active in Southeast Asia overconfident, leading to “a rapid accumulation of international debt in the corporate sector fuelled by excess international liquidity” (Pincus and Ramli 2004, p. 116).

Then in mid-1997, ominous developments in Thailand “triggered a panicky reassessment of risks that fed into a contagious epidemic of negative expectations, collapsing asset prices and exchange rates across East and Southeast Asia” (Cole and Slade 1999, p. 107). By the end of 1998, more than half of all loans from Indonesian banks were “non-performing”; ultimately sixty-eight banks were closed and twelve nationalized. The collapse of the banking system and the associated government bailout of depositors imposed a loss on the public equivalent to at least forty per cent of GDP (McLeod 2004, p. 95). It would be five years before the per capita national income returned to its pre-crisis level. Yet at the height of the crisis in 1998, when other Indonesian banks were folding by the dozen, BRI microcredit customers continued to pay back ninety-seven per cent of everything they owed, and savings deposits in the Bank Unit Desa more than doubled (Patten, Rosengard, and Johnston 2001).

## **Credit and Debt in Early Inscriptions and Law Codes**

Following the present introduction, this book begins with two chapters based on the earliest available historical sources: precolonial inscriptions and legal codes. Jan Wisseman Christie (Chapter 2) deals with the period from the ninth century to the twelfth, a period of commerce, monetization and state formation, as well as cultural innovation and temple building, in Island Southeast Asia (Christie 1996, 1998). It was in this period that Java and Bali produced their own indigenous silver and gold coinage, replaced in the thirteenth century by Chinese copper cash and later by other types of foreign money (Wicks 1992, pp. 243–300). It is from this period, too, that Indonesia’s corpus of inscriptions largely dates. Most of the inscriptions are fiscal documents, typically *sima* or “benefice grants” in which a ruler transfers the tax obligations of a specific community from the state to a religious institution for the support of that institution. Some of these tax charters, especially in Bali, contain incidental but nevertheless detailed information on the regulation of debt repayment and debt bondage.

Christie’s evidence confirms that debt was a “major route to servitude” in early Bali and Java. Periodic interest rates are not specified, but there is frequent reference to the “doubling” of debts. Creditors had “the automatic right of mastery over defaulting debtors”. Two categories of debt-bonded people were distinguished, according to whether they lived with their masters or maintained their own households. These correspond

unmistakably to the “house slaves” and “out-door slaves” (or “serfs”) distinguished at later times in the outer islands of Indonesia (Ruibing 1937, pp. 30–38), and to the “hearth slaves” and “house-owning slaves” of the Philippines at the time of the Spanish conquest (W.H. Scott 1994, pp. 224–29). Debt-bonded individuals could be pawned by their masters, and under certain conditions also sold outright, although they retained in principle the right to “redeem their bodies” by buying themselves out of bondage. It is conventional wisdom that forms of bondage were less severe, and slavery as such less common, in the major states of Southeast Asia than in its stateless peripheries (Boomgaard 2003, pp. 87–88; Turton 1998, p. 448). Christie’s observations, however, show that in medieval times, at least, this contrast was not marked, slavery and debt bondage being in both settings nearly indistinguishable.

The epigraphic evidence from Java and Bali is rather at odds with the “anthropological” view of debt-slavery as a consensual institution based on custom and culture rather than on force and law. Many of the references to debtors in Christie’s sources involve individuals fleeing servitude by seeking sanctuary in the tax-grant communities. Here they were protected from seizure by their masters, and in Bali also exempted from further payment of interest on their debts, on condition that they worked to pay off the principal within a fixed period (in Bali, four years), and at the same time provided services or fees to the religious foundation supported by the community. Sanctuary-seekers whose debts had resulted from misfortune enjoyed more lenient repayment terms under the protection of the temple foundations than did those who had contracted their debts voluntarily. Not all of those falling into debt bondage, evidently, were content with their fate. Apparently too the state, albeit acting indirectly through the medium of religious institutions, was in some degree concerned to limit the degradation of its free subjects, via debt, to private chattels.

Written loan contracts, although none seems to have survived, are mentioned in two Balinese inscriptions, and in a Javanese law code passed down from this period via Bali. Several surviving original texts do record the clearance of existing debts. In these cases the people concerned are of high social status, and the sums of money considerable. The debts in question, moreover, are long-standing and often inherited, suggesting that indebtedness was a common condition even for the elite. Another subset of inscriptions considered by Christie records the pawning of land as a form of security for money loans. The creditor was entitled to interest on the loan, as well as to the use of the pawned land until the debt was

repaid. Formal ownership, however, remained in principle with the borrower (the original owner) even if the debt was never repaid. Christie concludes by noting that in early Java and Bali “there were many opportunities for falling into debt”, that much of that debt was debt in money, and that a surprisingly sophisticated legal framework existed to regulate its consequences.

In Chapter 3, Peter Boomgaard uses information from surviving indigenous legal codes to pick up the story in the fifteenth century, after the inscriptions of Java peter out. Drawing on legal sources from Burma, Thailand, and Vietnam as well as the Indonesian world, he begins by echoing that “debt was the main road to slavery”, and that the wide prevalence of slavery suggests that it was “rather easy to get into debt in early modern Southeast Asia”. Heavily indebted individuals were obliged to work directly for their creditor-masters as peons or slaves, and destitute people deliberately sold themselves and their families into slavery in order to survive. The temple or pagoda slaves to whom Boomgaard refers here probably correspond to the sanctuary-seekers described by Christie as preferring to serve religious foundations rather than accept debt bondage to private creditors. Although debt slaves usually retained, in principle, the right to buy their freedom, the legal codes do not indicate to what extent the conditions of their servitude were such as to permit, in practice, the accumulation of capital with which to pay for their manumission.

If slavery was a function of indebtedness, debt, in Boomgaard’s view, was primarily a function of poverty. “In all these cases”, he states, “indebtedness, or, more in general, poverty, was the root of slavery.” Among peasant farmers, harvest failures were a common cause of indebtedness. But the fact that urban artisans typically required advance payment (credit) for their services, just as farmers often took payment for their crop before it was ripe, suggests that even the relatively well-to-do “had very few reserves, and could easily become indebted”. Another source of debt and bondage was legal punishment, in the form of fines for infringements of state law and compensation payments for personal loss or injury. In the absence of prisons, traditional law relied heavily on economic sanctions, and as in the case of ordinary debts, inability to pay legally required compensation resulted in enslavement of the offender.

Interpretation of the interest rates mentioned in legal sources is problematic due to the normative character of legislation and the possibility that in rural areas at least, the specified maximum rates reflect moral ideals rather than practical guidelines or limitations. On the other hand the

Islamic proscription of interest (*riba*) in any form, as Boomgaard observes, appears to have had little or no influence on the law even in Muslim areas. The current interest among Indonesians and Malaysians in Islamic banking, with its elaborate circumventions of the interest prohibition, is of recent origin (Venardos 2005). In the past, religious doctrine on this point was seldom taken so seriously (Firth 1946, p. 169; Reid 1988–93, vol. 2, p. 111). Southeast Asian folk ethics, while sensitive to the level of interest rates, tended to take the legitimacy of interest as such for granted, often explaining it in terms of analogies with “the natural increase of crops and livestock” (W.H. Scott 1994, p. 135). In some periods and contexts, nevertheless, there was a preference, consistent with Islamic law, for profit-sharing arrangements rather than fixed interest rates; examples will be mentioned below in relation to Chapter 4.

The lowest of the legal maximum rates referred to in Boomgaard’s sources, at around thirty per cent per annum, accord with historically documented rates on loans made by European lenders to indigenous political leaders and Chinese traders during the seventeenth and eighteenth centuries. The most commonly cited figure is 100 per cent per year. The highest of the maximum rates for unsecured loans, as specified in the legal codes, is 150 per cent on an annual basis. Even this figure, it should be remembered, is still much lower than the real rates on short-term monetary loans observed in informal Indonesian credit markets in the twentieth century.

In accordance with earlier findings by the same author (Boomgaard 1996), the evidence presented in Chapter 3 reinforces Crawford’s observation that interest rates were lower in areas under European rule than elsewhere. Whatever the reasons for this difference, however, it evidently did not reflect any lack of indigenous interest in legal safeguards for credit providers. Like Christie’s epigraphic sources, the legal codes are rich in references to the registration of debts, typically involving witnesses and, despite the fact that literacy was far from universal, written contracts. Also frequently mentioned are collateral requirements, the laws in question often specifying lower interest rates for loans obtained on the additional security of land or livestock rather than just the standard collateral of the debtor’s own person. Boomgaard suggests that the need for formal credit contracts was greater in rural settings, where levels of trust in those outside the immediate circle of family and neighbours were low, than among traders, who belonged to networks integrated by frequent transactions, and for whom verbal agreements were as good as written ones.

## **Credit, Commerce, and Ethnicity in Early Modern Indonesia**

Chapter 4, by Kathryn Anderson Wellen, uses indigenous chronicles and Dutch records to examine credit practices within just such a commercial network: that of the Wajorese (To Wajoq), a Bugis people of South Sulawesi, in the eighteenth century. Anderson Wellen's emphasis is on institutions deliberately designed to promote trade by facilitating access to credit. Following a period of mass emigration stimulated initially by the military defeat of the Wajoq kingdom at the hands of Bugis and Dutch enemies in 1669, the To Wajoq came to form a commercial diaspora scattered throughout Indonesia from Aceh to Aru. The overseas settlements were linked to each other, and to Wajoq itself, by trade, family ties, and military alliances. Rulers in the homeland actively encouraged overseas commerce, and traders appointed their own representatives to court. One king, La Saléwangeng (ruled 1713–36), established a public fund, constituted by taxation, which was used partly for social security purposes and partly as a credit bank for entrepreneurs. Loans from this fund were made to traders on a profit-sharing basis: borrowers returned the principal together with one third of their profits, which were used by the state for military and other public spending purposes.

Another example of designed institutional support for trade and credit among the To Wajoq was their shared system of commercial and maritime law, usually referred to as the Amanna Gappa code after the man who sponsored its codification at a meeting of To Wajoq leaders from Makassar, East Kalimantan, and Sumbawa at the beginning of the eighteenth century. Anderson Wellen describes this code as “primarily concerned with fair business practices”. Eight of its twenty-five chapters relate to the lending of money and goods. The prescribed procedures involve various meticulously distinguished types of profit-sharing agreement, such as the one which applied to loans from La Saléwangeng's public credit fund. They do not include fixed-interest loans, which (although not forbidden) are explicitly discouraged. Also discouraged is the enslavement of defaulting debtors; if a creditor does resort to this extreme measure, he or she is obliged to forgive any debt that has accumulated beyond the value of the debtor's person. Other topics covered include the use of collateral or security deposits, and procedures for settling disputes over loans.

Compared with the (mainly) agrarian regulations described by Christie and Boomgaard, the commercial Amanna Gappa code, despite its detailed

character, is clearly more flexible and less punitive with respect to debtors. This is surprising given that it was designed to provide a secure legal foundation for business, whereas the Javanese and mainland Southeast Asian laws were intended at least partly to curtail rural usury. Nevertheless in its own context the mild Amanna Gappa system, often resembling more an ethical than a legal code, seems to have been effective. The commercial success of the To Wajoq, at any rate, was considerable enough to make them a threat to Dutch enterprise, notably in the textile trade. A VOC general described them as “skilled and trustworthy merchants”, praising in particular their honest handling of credit. Ready availability of credit made it possible for Wajorese people with few resources of their own to set themselves up in business. In Dutch Makassar, Anderson Wellen also notes, commercial disputes involving members of the Wajoq community were seldom brought before the VOC court, but rather dealt with internally. The exception described towards the end of the chapter involved a non-Wajoq (Dutch or Eurasian) creditor, to whom the outcome was more favourable than it would have been if the Wajoq laws had been applied.

In accordance with Boomgaard’s analysis, the commercially oriented Wajoq regulations seem to have presumed a high degree of trust between borrower and lender — high enough, at least, to make possible profit-sharing contracts, adherence to which by the borrower is intrinsically more difficult for the creditor to monitor than in the case of fixed-interest loans. The existence in eighteenth-century Wajoq of a collective insurance and credit fund, likewise, indicates unusually high levels of social trust and integration. Such collective funds, like corporate business capital, have been rare in Southeast Asian history, not least due to the difficulty of finding custodians who can be trusted not to abuse them for personal ends (Henley 2007, pp. 100–102; Popkin 1979, pp. 47). Anderson Wellen concludes with the observation that solidarity, ethics, and a spirit of cooperation, as well as organization and institutions, were central to Wajoq’s commercial and political success.

In Chapter 5, by Heather Sutherland, the setting remains eighteenth-century Sulawesi, and the theme remains the relationship between institutions and the supply of credit to traders. Here, however, the institutions in question are European, components of the VOC establishment in Makassar, the main Dutch settlement in Sulawesi. They comprise Makassar’s *Raad van Justitie* or Council of Justice, a civil law court acting in commercial and financial disputes, and two seemingly unlikely corporate credit providers: the town’s *diakonij* or college of deacons, which administered Protestant

church funds, and the *weeskamer* or “orphan chamber”, which managed the estates and finances of orphaned children.

Both the deaconry and the *weeskamer* were in principle charitable and religious institutions, the latter being linked to an orphanage supervised by the church. Both, however, invested a large part of their capital in, and derived much of their income from, commercial moneylending. There is an intriguing parallel here with the historical role of temple funds as sources of credit for the Chettiar moneylending diaspora (Evers 1988, p. 204; Schrader 1994, pp. 6–7), and for certain Chinese ethnic and clan groups (see below). As credit providers, religious institutions have the advantage of moral sanctions against defaulters. Moral pressure may also help protect the custodians of such funds from the temptation to abuse the trust placed in them — although in the case of the *weeskamer*, which Sutherland notes was “a focus of recurring financial scandals”, this was evidently an imperfect safeguard. Whatever their shortcomings, it and the *diakonij* succeeded in sustaining profitable credit businesses over many decades on the basis of annual interest rates of just twelve per cent, or in some cases even lower.

The ethnic composition of the borrowing clientele changed over time. In the first half of the eighteenth century it was overwhelmingly European, later substantially Chinese. Indigenous traders and nobles, a significant minority of clients at the beginning of the century, were gradually excluded after many defaulted and their debts proved unrecoverable. Sutherland explains this partly in terms of the fact that whereas the Chinese were economically tied to the city of Makassar and the Dutch, indigenous debtors could more easily evade Dutch creditors by taking refuge in the neighbouring, but substantially independent, Makassarese and Buginese kingdoms. In other words the dependent status of the Chinese, and their political isolation as “pariah capitalists”, improved their credit rating with the Dutch, just as it improved their credit ratings with each other. It also inclined them to make more use of the VOC judicial system for resolving trade and credit disputes than did trading groups with Indonesian roots, such as the To Wajoq. Nevertheless since the commercial networks of the Makassar Chinese extended to areas far beyond VOC jurisdiction, including China itself, there were limits to the effectiveness of Dutch judicial involvement.

Chapter 6, by Kwee Hui Kian, takes up the theme of ethnic Chinese commerce in the different setting of western Indonesia, particularly Java. She notes that by the eighteenth century at the latest, Chinese traders and

miners in Java, Kalimantan, and the Malacca Straits were routinely able to pool capital for joint business ventures by forming commercial associations or *kongsi*, thereby reducing their dependence on interest-bearing loans. When commercial credit was required, moreover, it was available not only from individuals, but also from institutions which, like the VOC's Makassar *weeskamer* and *diakonij*, combined commercial with charitable and religious functions.

Often these lending institutions were temple or cemetery associations linked with particular clans, surnames, dialect groups, or places of origin. As such they were able to rely for contract enforcement purposes partly on the various means of social control available to relatively intimate groups based on narrow, shared identities. The best documented examples from Indonesia, however, are two much more broadly based community associations: the Chinese Council (Kong Koan) of Batavia (Jakarta), founded in 1742, and the much later "House of Aid and Direction" (Tjie Lam Tjay) of Semarang. Both were philanthropic institutions that nevertheless accumulated capital, mainly from the sale of burial plots in Chinese cemeteries, and lent out part of their reserves at interest to businessmen. Like the VOC's own charitable institutions, these Chinese community associations were not always free from financial scandal. Nevertheless the fact that they came to play similar roles as commercial credit providers seems to confirm that historically speaking, the mechanisms of restraint and accountability which made possible the operation of corporate credit institutions tended to develop most readily in non-commercial or semi-commercial settings. These mechanisms were not products of deliberate institutional design in the pursuit of profit, but rather by-products, albeit perhaps not unanticipated by-products, of social and religious activities not explicitly focused on economic goals.

## **Credit and Colonialism in Java**

With Chapter 7 we arrive at the apogee of European economic as well as political power in Indonesia, the late nineteenth century, only to find European commercial creditors struggling in their relations with Chinese borrowers. In this chapter Alexander Claver describes a business crisis in Surabaya, then Indonesia's biggest city, caused by the overextension of credit, in the form of foreign manufactured goods, by European importers and wholesalers to ethnic Chinese intermediate and retail traders. When the

purchasing power of the Indonesian population declined in the 1890s as a result of falling prices for agricultural products on the world market, an established retailing system based on long-term credit abruptly collapsed.

The various European trading houses in Surabaya had long been locked in fierce competition with one another, and in order to maintain the trust of their overseas suppliers, they had expanded their operations during better years and cleared their shelves by the expedient of offering their Chinese distributors what Claver calls “fabulous credit on ever more generous terms”. In many cases, individual retailers had received goods on credit from more than one wholesaler. Once the credit chains started to unravel, the wholesalers, anticipating that full recovery of their debts would be impossible, and concerned to recover what there was to recover before their rivals beat them to it, settled quickly with their distributors on disadvantageous terms. Commercial law provisions were regarded as favouring the debtors, and since the assets of retail traders consisted mostly of the instalment payments owed to them in turn by their customers, nobody was anxious to see them declared bankrupt; the best chance of retrieving what they owed lay in keeping them in business. Retailers themselves were aware of this, and some of them had in the past been able to take advantage of the situation by defaulting repeatedly on wholesaler loans without ever doing so quite severely enough to have themselves cut off from further credit.

In 1896, however, the arrest of one heavily indebted Chinese trader triggered a dramatic wave of business failures which ended with the European import houses in Surabaya having to write off close to half of all their outstanding credit. Despite the severity of this crisis, the financial caution to which it gave rise was short-lived; within a few years, risky credit practices were once again the norm. The colonial establishment’s diagnosis of the problem was that it resulted from a regrettable inability on the part of the Dutch importing companies to cooperate by forming a *de facto* cartel, rather than allowing themselves to be drawn into self-destructive competition with one another. This interpretation no doubt partly reflected a concern with maintaining European authority and dignity. Nevertheless a problem of collective action was indeed involved here: for fear of losing market share, no single wholesaler was inclined to adopt a tighter credit policy unless its rivals did likewise; and since all these took a similar view, none acted until the debt crisis was already upon them.

In some ways the sequence of events described by Claver anticipated, on a miniature scale, the Asian financial crisis of a century later. In both cases

a period of superabundant credit, driven by inflated economic expectations and competitive overinvestment, cynically encouraged in some cases by credit recipients, ended suddenly when the financial bubble burst. Both crises underscore the fact that in commercial settings, excessive indebtedness is not necessarily a result of poverty or “capital scarcity”; on the contrary. Nevertheless in another respect, the credit-hunger of the Surabaya retailers did hark back to traditional, agrarian patterns: for the retailers, one of the attractions of credit was that money (or goods) in the hand were seen as a form of insurance against future adversity. The fact that this calculus was not disturbed, and the consequent boom-and-bust cycle not averted, by the relatively strong legal institutions of the late nineteenth century, when Chinese traders in Indonesia were subject to European commercial law, may be said to cast some doubt on the popular argument that weak regulatory institutions were a key cause of the financial instability at the end of the twentieth century (Cole and Slade 1998; Hamilton-Hart 2000).

The eighth and final chapter of the book, by Jan Luiten van Zanden, returns to the agrarian economy. It assesses the attempts made in the early twentieth century by the Dutch colonial state to reform rural credit markets as the spearhead of its new “Ethical Policy” for improving the welfare of the Indonesian masses. There were two major prongs to this reform. The first was the establishment of an extensive system of credit



Government Pawnshop, East Java, 1931  
 SOURCE: KITLV Image Collection, 25215

banks, at first along putatively cooperative lines, but ultimately as a centralized endeavour coordinated by the Popular Credit Service (Dienst van het Volkscredietwezen), established in 1912. The second was the “nationalization” (if that word can be applied in a colonial setting) of the pawnbroking industry in 1901.

In order to assess the impact of these reforms, van Zanden first compares the total amount of credit provided by the new banks and government pawnshops with the total value added of the agricultural sector (excluding export crops) in Java between 1905 and 1940. The ratio of credit to added value, he calculates, increased from about three per cent in 1910 to 8.5 per cent in 1929, before declining somewhat in the 1930s. If, however, the pawnshops and the urban *Volksbanken* or People’s Banks, which contributed only indirectly to rural credit, are excluded from the calculation, then the figures for the village banks alone are 1.7 and 2.3 per cent respectively in 1910 and 1929. Secondly, van Zanden looks at the development of interest rates. The rates charged by pawnshops on their smallest loans fell from 143 per cent before the introduction of the monopoly to 72 per cent in 1901 and 48 per cent in 1920. The village banks, by contrast, raised their interest rates after 1913, although at 40–60 per cent per year these remained substantially lower than what was customary in the private market. Finally van Zanden considers savings, which, he notes, never financed more than a small fraction of the loans made. The conclusion is that the reforms were “moderately successful” in the sense that in those parts of the capital market that were monitored by the state, interest rates fell and access to credit improved. This helps to explain why the output and productivity of Javanese agriculture, after remaining stagnant for much of the nineteenth century, grew strongly in the years 1900–20. The poorest strata of rural society, however, were not reached, savings were not generated or harnessed, and the new credit institutions remained heavily dependent on the colonial state for management and supervision.

## **Emergent Issues**

The essays in this book span more than a thousand years of history, and range in thematic coverage from debt slavery to corporate debt, from big business to religious charities, and from pawnshops to maritime law. Can any recurrent conclusions, or at least salient issues for further research, nevertheless, be extracted from them?

The spottiness of the evidence, not surprisingly, makes the identification and explanation of specific historical changes difficult. What is immediately apparent, however, is a considerable degree of historical continuity. This continuity is particularly striking with regard to the legal and political regulation of credit markets. A thousand years ago in Java, debts and debt repayments were already being registered in written, witnessed documents, endorsed by the law of the state. Legal provisions also existed to control interest rates, regulate the use of land as collateral, and provide avenues of escape from chronic indebtedness. Three hundred years ago in Sulawesi, a Bugis king established a public credit bank for traders, while his diasporic vassals spontaneously created, and enforced, a complex code of commercial and maritime law. A century ago the Dutch colonial state, as part of a concerted rural development strategy, attempted to transform capital markets in Indonesia by means of an extensive system of village credit banks.

An unavoidable corollary of these surprising parallels between past and present in the institutional and legal sphere, however, must be a certain amount of doubt regarding the importance of formal institutions to the actual development of credit markets, or to the practical consequences of indebtedness. Debt bondage, after all, remained common in pre-Islamic Java despite interest rate restrictions and the role of the temple foundations as debt sanctuaries, while state interventions were only “moderately” successful (to quote Van Zanden again) in reforming rural credit markets in colonial Java. And although the To Wajoq of eighteenth-century Sulawesi developed sophisticated institutions for the supply and management of credit, there are indications that these worked in the first place not because of the particular way they were designed, but rather thanks to the business ethics, defensive solidarity, and restrictive social norms of the trade-specialized ethnic minority which designed them. The recurrent historical role of religious institutions — Chettiar and Chinese temples, Dutch church charities — as corporate credit providers points likewise to a nexus of culture, trust, identity, and commercial professionalism, rather than to a nexus of power, policy, reason, and law, as the key to making credit cheap.

This is, of course, at odds with that important part of the institutional economics literature which focuses on the relationship between economic transactions and the state (Barzel 2002; North 1990). It is also at odds with the popular thesis of De Soto (2000), according to which the best way to reduce the risks, and thereby the costs, of lending capital is to provide a reliable legal means of expropriating collateral, for instance in

the form of land or real estate, in the event of default. In Indonesia, to reiterate, this is definitely not how successful microcredit has worked; the recent microfinance revolution has taken place in an environment of very weak legal institutions, and has relied on the incentive of repeated borrowing opportunities, rather than on the threat of collateral expropriation, to discourage default. Southeast Asian historical experience, moreover, indicates that the primary result of improved legal regulation of land tenure is often a negative one: the expropriation of peasant land on a large scale by creditors (Elson 1997, pp. 132–33, 198–99).

All this is not to deny that political power has sometimes played a key role in facilitating credit and commerce. The need for commercial contract enforcement, as noted earlier in this introduction, may lie at the very genesis of the Southeast Asian state, and Indonesia's recent advances in mass microfinance are largely the achievements of state-owned institutions such as the BRI. Nor does it make sense to deny the importance, in some circumstances, of deliberate institutional design; the systematic failure of Dutch colonial microfinance institutions to provide accessible facilities for saving as well as borrowing, for instance, was undoubtedly one reason for their modest impact in comparison with their modern counterparts. Nevertheless it is also true that in colonial times the rural population, being poorer, had less to save; that having fewer opportunities for productive investment, it was less creditworthy; and that living under less thoroughly commercialized economic conditions, it had not yet fully taken on board businesslike values such as a belief in the moral importance of fidelity to time-specific contracts (Andaya 2001, p. 30).

Under these conditions microfinancial development was intrinsically a tough challenge, and success effectively had to wait until the rural economy, for reasons connected with infrastructure investments and technological advances in agriculture, began to grow strongly in the 1970s. Probably there were marked threshold effects here. Robinson (2001, p. 187) observes that whereas the poor typically borrow for consumption and for emergencies, the better-off borrow more often for investment purposes. The spontaneous transition, with rising incomes, from credit as a form of insurance to credit as a source of investment funds no doubt helped, in itself, to set in motion a self-perpetuating virtuous circle of growth and saving. In an earlier era, a comparable transition was probably largely responsible for the disappearance of debt slavery from Indonesia. Here too the decisive factor seems not to have been institutional change (the legal abolition of slavery was seldom effectively enforced), but rather increasing

market integration, which reduced the incidence of poverty and subsistence crises, and at the same time provided a means of coping with such crises other than the traditional practice of placing oneself in the debt, and at the service, of others (Henley 2005, pp. 464–65). In the last analysis, economic development itself is probably the best way to ensure that credit becomes cheaper and more accessible. But it should not be forgotten that a more abundant supply of credit brings with it new risks of excessive borrowing, overindebtedness and, eventually, catastrophic correction. Here too, as noted, history offers instructive cautionary tales.

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