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Indonesia's

ECONOMIC STABILIZATION AND DEVELOPMENT

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Preface

THIS STUDY was first undertaken as a paper for the Kyoto Conference of the Institute of Pacific Relations in November 1954. As time went by and the paper remained unprinted, the Indonesian scene became increasingly complex; at the same time the Massachusetts Institute of Technology Indonesia Project added steadily to its store of knowledge about Indonesian economics and politics. The paper continued to grow in consequence, with this book as the result. The study may thus be regarded also as an interim report of the M.I.T. Indonesia Project, which is part of the Economic and Political Development Program of the M.I.T. Center for International Studies, launched in July 1955 with financing for five years from the Ford Foundation. Until recently the Project has concentrated mainly on the study of central government policy in relation to economic development, including financial and stabilization measures and the political background as they relate to economic development. At the same time, the Indonesia Field Team of the Center has conducted a series of studies of anthropological, sociological, and cultural aspects of Central Javanese society.

The present study presents in summary fashion some major findings of the Project with regard to central government policy between the transfer of sovereignty at the end of 1949 and the opening of the first elected parliament in May of 1956. One

aspect of this story has received more detailed analysis in the Project's paper, *Stanvac in Indonesia*, published by the National Planning Association (Washington, 1957). The Project also has in manuscript a study of financing economic development with special reference to Indonesia, and a survey of balance of payments aspects of development is nearing completion. These studies, together with the shorter monographs already published, mark the end of the first stage of our work and the transition to the next one. The final task will be to unite the economic and sociological approaches in a study of more deepseated factors in economic growth.

This book is in large measure a team product. Liberal use has been made of Dr. Douglas Paauw's work on finance, Dr. Guy Pauker's studies of politics, and Mr. John Rodrigues' and Dr. Clifford Geertz' surveys of sociological and cultural factors. Professor William Hollinger has helped with the fact-gathering and with the analysis of balance of payments problems. Other colleagues in the Center have also contributed assistance. Responsibility for any shortcomings, however, rests with the author. In particular, nothing said here should be regarded as representing official views of the Center for International Studies or of the Massachusetts Institute of Technology, or of the Institute of Pacific Relations.

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Introduction:

Indonesia in 1957

THE FATE OF INDONESIA is of obvious importance to the Western world. Indonesia is a large country: superimposed on a map of the United States, Indonesia's 3,000 islands stretch far into the oceans on either side, and from Canada to mid-Texas. Even when only land masses are included, the area of Indonesia is about equal to the United States east of the Mississippi. With some eighty-three million people, it is the sixth biggest country in the world in terms of population. Its position in Southeast Asia, stretching from a point opposite the northern tip of Malaya almost to the northern tip of Australia, makes it a bridge from continental Asia to Australia—a fact that was made abundantly clear in the course of World War II. It has a variety of strategic products: rubber, petroleum, tin, bauxite, copra, quinine and others. With its abundant water power, mineral resources and high level of native skills, Indonesia is potentially an important industrial nation.

Indonesia became a sovereign state in December 1949 after ten years of war and revolution. For three centuries before that it was a Dutch colony. This historical background plays a basic role in shaping current policies. Through its colonial

past and its neutralist present-day policies, Indonesia is linked to India, Egypt and Burma; but its predominant religion binds it to Pakistan, Turkey and the Arab world. In seven short years of independence Indonesia has already demonstrated that it is potentially an important political power. It has exercised leadership in the Asian-African bloc, serving as host to the first Asian-African Conference. Its record in the United Nations shows that its weight, thrown one way or another, can influence policies of the neutralist bloc, the Arab bloc, or the Asian-African group as a whole.

After the achievement of independence the first order of the day was reconstruction, unification, organization of basic government services, and political and economic stabilization. These tasks—and jockeying for political power—occupied most of the time and energy of Indonesia's leaders from the transfer of sovereignty to the elections at the end of 1955.

The degree of economic instability in the years following 1950 was so great that governments had no choice but to give priority to short-run stabilization measures. Indonesia's dependence for money income on a narrow range of raw materials exports made her economy unstable even before the war. The concentration on a few exports is even more marked today; and since the war the instability generated from the export side has been reinforced at times by inadequate fiscal and foreign exchange policies. At other times effective short-run measures have kept the external and internal deterioration of the currency temporarily in check.

Indeed, postwar Indonesia provides a classic example of what the International Monetary Fund calls "fundamental disequilibrium". From mid-1952 to mid-1954 Indonesia lost foreign exchange reserves at a faster rate than any other country in the world. In August 1954 the Indonesian government resorted to the escape clause in the statutes of the Bank Indonesia, permitting the Bank to suspend its 20 percent legal reserve requirements in "extraordinary circumstances". From then until 1956 the reserve position improved and the legal reserve ratio was restored; but the reserves were pro-

tected by import restrictions so severe that "bottleneck" unemployment appeared, some semi-luxuries were available only in the black market, and prices of others rose to levels several times as high as they were a few years earlier. The black market value of the rupiah in 1956 and early 1957 was about one-third of its official value—the biggest spread between black market and official rates among the currencies of members of the International Monetary Fund.

In July 1956, following another drop in export prices, the government was compelled to suspend reserve requirements once again. This time there was no saving recovery of export earnings. In April 1957 imports were suspended altogether, except for government orders, capital goods and certain special transactions. In May it was announced that imports would be gradually resumed, starting with industrial raw materials; but at the same time a bill was introduced permitting suspension of reserve requirements for another six months. Following the highly convenient Indonesian convention, this regulation is effective unless and until *rejected* by Parliament.

In presenting his economic program to Parliament in May 1957 Prime Minister Djuanda stated that there would be no official devaluation of the rupiah; but five weeks later still another modification of the foreign exchange regulations was announced which has some of the same effects as a devaluation. The new system is similar to the one suggested in Chapter 1 below. Exporters are to be granted Export Promotion Certificates equal to the full foreign exchange value of their exports, and representing claims on foreign exchange for imports. These Certificates may be sold in a free market. Eighty percent of the rupiah proceeds may be retained, the other twenty percent being turned over to the government as a kind of tax. The government itself will acquire its foreign exchange in the open market. At the same time the number of categories of import surcharge rates was reduced from nine to six—zero, 20, 50, 100, 140 and 175 percent respectively. These rates are applied, however, to the market price of imports, not to their price at the nominal official rate of ex-

change. Thus an item formerly on the 100 percent import surcharge list and costing \$10.00 would previously have cost the importer Rp. 228; if it remains on the 100 percent list but the Certificates are bought in the open market at Rp. 20.00 to the dollar, it will cost the importer Rp. 400.00. Rice and essential cotton textiles are on the free list; moreover, rice and possibly essential cotton textiles will be subsidized so as to avoid any serious rise in the worker-peasant cost of living. An interesting detail of the new regulations is that foreign investors and tourists will be treated as exporters and be granted Certificates in exchange for the foreign exchange they bring in.

In an effort to counteract the establishment of independent foreign exchange systems in the dissident outlying regions, the government has set up branch offices of the Foreign Exchange Institute in Surabaya, Makassar, Bandjarmasin, Medan, Palembang and Padang.

In announcing the new system the government spokesmen stated that they expected it to bring "a temporary rise in prices" but that it was necessary to eliminate black market trading in foreign exchange and smuggling, and to bring a balance between exports and imports. In short, by allowing the market a much bigger role in determining foreign exchange rates the government expects average prices of imports to rise. The government hopes, however, to stabilize the rupiah by monetary and fiscal policy. A new reserve requirement has been introduced for commercial banks; they must hold Treasury Bills equal in value to 10 percent of their demand deposits. Taxes on sugar and beer have been raised, and a head tax on foreigners imposed.

The Indonesian budget has been in chronic deficit since 1952, the deficit ranging from Rp. 2.0 billion in 1953 to Rp. 3.6 billion in 1954. The 1956 figure was Rp. 2.8 billion. Without the balance of payments deficits—which cannot continue any longer—even the worker-peasant cost of living would have been less stable than it has been. Sutikno Slamet, who became Minister of Finance in April 1957, said in an early state-

ment that, unless something drastic had been done, the deficit for 1957 would have reached Rp. 6.0 billion. Through the new taxes and a 20 percent cut in expenditure he hoped that the 1957 deficit can be held to Rp. 1.6 billion. He has also stated that he hopes to keep the 1958 deficit down to Rp. 800 million.

As this Introduction is being written (in July 1957, with the rest of the book already in press) Indonesian politics look at least as unstable as the Indonesian economy. As explained more fully below, economic and political instability interact upon and aggravate each other. The recent difficulties between the central government and the regions have contributed directly to the budget and balance of payments deficits. The pressure of immediate financial problems has prevented the central government from paying proper attention to economic development. Recovery since the war and revolution has been substantial, but output of several traditional exports is still a small fraction of prewar levels. Available data indicate that national income per capita is below the 1939 level, probably below the 1929 level, and may even be below the level of 1919. There is no clear evidence that per capita real income is currently rising, although living standards of the majority of Indonesians may be improving. The lack of economic progress heightens tensions between the center and the regions, strengthens extreme nationalist sentiments, and causes general dissatisfaction with whatever government happens to be in power.¹

¹ Nuradi, Indonesian delegate to the United Nations Commission on International Commodity Trade, told the Commission in May 1957: "Again, like many other underdeveloped countries, Indonesia has found that its efforts to undertake a steady and continuous program of economic development are persistently being hampered by volatile movements in the prices and volumes of its exports and by adverse developments of its terms of trade with reference to countries producing manufactured goods. It is imperative to recognize that inherent in this unfavorable situation are elements which make for serious political, economic and social upheavals. At this moment, profound and far-reaching political, economic and social convulsions are taking place in Indonesia and they are, to a large extent, the direct outgrowth of our inability to maintain economic and monetary stability under

To unravel the tangled skein of Indonesian politics during 1956 and 1957 is not an easy thing to do, and to explain these problems adequately in a few pages is impossible. Yet to leave the political story where it ends in the text, given the opportunity to bring it further, would be to fail my readers. Some of the background of the events of these years is presented below. Here I shall confine myself to a chronology of the more important of these events.²

In the spring of 1956 President Sukarno visited the United States. He returned to Indonesia a stronger admirer than ever of Western democracy. In the fall of the same year he visited Russia, Yugoslavia and China. Russia seems not to have impressed him very favorably, but as a result of his experiences in Yugoslavia and China he came back to Indonesia an advocate of "guidance". He began talking about the superiority of "guided democracy" over Western democracy for underdeveloped countries, and reiterated his wish to see the Communist Party (PKI) directly represented in the government.

Friction between the Army (or some of the Army leaders) on the one hand and the President, the extreme Nationalists (especially Ali Sastroamidjojo, Nationalist Prime Minister in 1953-1955 and again in 1956-1957) and the Communists on the other dates back at least to the "October 17th Affair" of 1952. This Affair might be briefly described as an effort of a few Cabinet ministers, backed by the Army, to seize power in a *coup d'état*, in order to overcome what they regarded as the extreme and irrational nationalism of other groups and embark on a systematic program of economic stabilization and development and elimination of continuing insecurity. This Affair contributed to the later fall of the Wilopo government, and its replacement by the first Ali Sastroamidjojo government, without resolving the basic conflicts. Ali's Cabinet was

conditions of recurrent and violent fluctuations in our export revenues over the years, as a consequence of erratic movements in the prices and volumes of exports of our primary commodities" (*Antara*, May 13, p. 6).

² For a more complete analysis of these events see Justus M. van der Kroef, "Instability in Indonesia", *Far Eastern Survey*, April 1957. See also James H. Mysbergh, "The Indonesian Elite", *ibid.*, March 1957.

ultimately brought down "because of the determined opposition of certain Army officers to the then Minister of Defense, to a newly appointed Army Chief of Staff and, in the last analysis, to a corruption-ridden government."³

Ali's return to power in the elections led to new outbreaks of conflict with the Army. In August the Minister of External Affairs (Ruslan Abdulgani) was arrested on orders of the territorial commander of West Java (Colonel Kawilarang) and released after personal intervention of the Chief of Staff (Nasution) and the Prime Minister. The Army was dissatisfied with the subsequent clearance of Abdulgani by a Cabinet commission, and in November the Assistant Chief of Staff Lubis (who seems to have been instrumental in Abdulgani's arrest) endeavoured to take matters into his own hands. With the assistance of an army unit from West Java he attempted a *coup d'état*. It failed; Lubis fled and twenty officers were arrested.

More serious challenges to the authority of the central government were to come. In December Colonel Simbolon, district commander of the North and Central Sumatra regions, who had for some time defied Djakarta to the extent of engaging in smuggling to obtain funds for the support of his units, announced that his district had "severed connections with the central government". He was immediately replaced by Colonel Gintings, who succeeded in establishing his authority in North Sumatra. Simbolon followed Lubis into hiding. In Central Sumatra, however, Colonel Husein was still leading an essentially independent government at the time of writing, and negotiating with Djakarta for a greater degree of regional autonomy.

In February Sukarno at last put his new political ideas (*konsepsi*) into a formal statement. Its main features were a "gotong-rojong cabinet", representing interests rather than parties, and a superior National Council selected and headed by himself, evidently with Communist representation in both.

³ van der Kroef, *op. cit.*, p. 49.

The basic ideas were stated more succinctly later in a Bali speech:

"On several occasions I have reiterated that I am a staunch believer in democracy and this reflection has been and always will be shared by the great majority of the Indonesian people, irrespective of their locality, religion or political belief. Nevertheless, the experience of new nations with their democratic experiments taught us that we must be careful indeed in the realization of democratic principles. This free and liberal enterprise of political activities should not give material gains for a few or certain groups alone at the expense of the nation as a whole. It will take time to achieve a mature democracy and stability as a way of life for the entire population. It is in this transitional period that we must look for ways and means to reach this ultimate goal.

I have said in my conception that I want to do away with Opposition which is merely conducted for the sake of opposition in order to replace one Government with another. Seventeen Cabinets within twelve years, almost half of them reflecting the political instability between 1945 and 1950, even in the period when we were at war with the Netherlands! You can imagine that if we go on like this, not merely the very existence of the Republic will be in jeopardy, but also the practice of democracy will not engender confidence among the people as the right course to serve spiritual and material desires of human beings. . . .

On the other hand, if opposition does not mean merely the persecution for the elimination of your political opponent, but the introduction of competition amongst all citizens, competition in honesty, competition in the creation of new ideas to solve our nation's problems, competition in hard work, then every result will always be a gain for the nation irrespective of the party which is victor.

These sentiments are not my personal invention. They are the reflection of the original way of life of the Indonesian people as a whole. *Gotong-Rojong*, *Musjawarah*—translated into English they might be *Mutual assistance and to settle problems by discussion*, not through imposing settlements—are the basic features of the Indonesian way of life, which we

cherish and which we want to preserve, even if super-imposed upon modern parliamentary democracy."

The announcement of the *konsepsi* was the signal for new protests from the Army and the Outer Islands, this time centered on South Sulawesi (Makassar). There, early in March, Lt. Col. Sumual declared martial law and rule by a junta under his direction. Kalimantan (Borneo) and even East Java also began showing signs of restiveness.

This series of events led at last to the dissolution of the second Ali government. First the representatives of some of the smaller parties, and then five members representing the big Moslem party (Masjumi) withdrew from the Cabinet. The Prime Minister and the President were apparently willing to fill the vacancies with Communists, but against strong opposition from both the Army and the Moslem parties they decided that there was no possible course but for Ali to resign. He did so on March 13. At the time Sukarno declared martial law throughout the nation and called in the dissident military leaders for consultation. When it became clear that the opposition to his *konsepsi* as presented was strong and widespread, and that no *formateur* representing a political party could form a government, "Sukarno as President" appointed "Sukarno as citizen" to act as *formateur* and selected a "special task Cabinet" of experts, with Djuanda as Prime Minister.

In assessing the significance of the friction between the central government and the Outer Islands (as represented by the military commanders of the regions) three points should be made clear. First, in contrast to issues in the American Civil War, or the strains between the Maritime Provinces and the central government in Canada, the challenges to authority from the Indonesian *daerahs* (outer provinces) are not secession movements. What the regions want is not independence but considerably increased local autonomy; more honest, more stable and efficient government at the center; and more rapid economic development. The Army itself is divided into factions, but is united in these broad demands. One Indonesian leader, recently returned from a tour of the Outer Islands,

described the regional governments' requests as "eminently reasonable".

Second, there is no argument in principle with regard to devolution of powers. Even before the transfer of sovereignty the revolutionary government in Djogjakarta passed a "Decentralization law". A bill on allocation of financial powers, involving many of the recommendations of the Nasrun Committee, is before Parliament. The only arguments about devolution of powers pertain to what and when. Mohammed Rohm, Deputy Prime Minister in the second Ali government, has put it this way to the author: "It is as though a mother baked a birthday cake and put it on the shelf for the birthday party; when she finds that the children have stolen pieces of the cake before the party, she says, 'You are naughty children; you should have waited for me to give you the cake; but since it was baked for you, go ahead and finish it.'"

Third, the defiance of central authority by regional military commanders has little to do with the armed violence under such rebels as Kartosuwirjo in West Java, Kahar Muzakar in South Sulawesi, Daud Buruh in Atjeh, and Ibnu Hadjar in South Kalimantan. The Army protests are an Indonesian version of "states' rights" campaigns and have involved no bloodshed. The armed insurrections of the above-named terrorist leaders involve mass murders, arson, and skirmishes with army and police; but such violence is confined to small pockets of relatively wild country, carried on by gangs which comprise at most a few tens of thousands, with a mixture of religious fanaticism, regionalism and sheer banditry as their main motivation (see below, Chapter 3).

The new government has insisted that it is still responsible to Parliament and has obtained a "green light" from Parliament to proceed with its efforts to solve Indonesia's mounting economic and political problems. The new Prime Minister has held a series of talks with regional leaders. Sukarno's *konsepsi* has shrunk to the appointment of a National Advisory Council with no very clear powers, and representing such diverse groups as workers, peasants, intellectuals, artists,