THE INDONESIAN ECONOMY

COLLECTED PAPERS

H. W. Arndt

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FOREWORD

IT is with great pleasure that I accede to Professor Arndt's request to write a foreword for his Collected Papers on the Indonesian economy. I regard it as an honour to be singled out from among his Indonesian colleagues.

Indonesian economists, both inside and outside the government, know Professor Arndt well and are greatly indebted to him for his constant interest in the Indonesian economy and the progress of Indonesian economic research. He has been both a good friend as well as a tutor for many of us. His *Bulletin of Indonesian Economic Studies* (BIES) is an authoritative source of information and analysis. Ever since 1965, the "Surveys of Recent Developments" in this journal have been his special responsibility. Professor Arndt himself, on many occasions, has gone into the field for several weeks at a time, to collect the data and to gain a personal feel for what is going on. Even now, in 1981, I find him still doing the same. But he has the best of access in terms of data sources and professional opinion, and shares these then with all students of the Indonesian economy.

Of course, that does not mean that he has a monopoly of the best perception, wisdom and judgement. Nobody has it and in political economy one's spectacles are always tinted. The course of evolution of the Indonesian economy has always had its own sympathisers as well as critics, and the lack of adequate statistics and social indicators has not facilitated proper assessments. During the 1970s the Indonesian economy did fairly well, with an average real growth rate of GDP of 7½ percent per annum, but there is controversy about the quality of the development. I presume that this debate will continue during the 1980s. As a member of the government during much of this time, and at the same time also still teaching at the university, I can remember vividly the uncomfortable times we had trying to explain things to gatherings of students.

Collected papers may have the drawback of looking like an old hat that in retrospect was not the right size to start with. A 1971 assessment of the "prospect for the eighties" draws a chuckle, because even the optimistic scenario envisaged a growth rate of only 5-6 percent per annum. On the other hand, such hindsight can yield additional understanding of the working and dynamics of an economy.

Not everyone will agree with Professor Arndt's reading of the progress of the Indonesian economy. But his long experience, the amount of empirical information he provides and the breadth of his analysis make this book a very valuable document on recent Indonesian economic development.

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Professor of Economics,
University of Indonesia.
Former Chairman of the Board of
Investments, Minister of Manpower,
and Minister of Mining.

Jakarta
17 October 1981

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CONTENTS

*With J. Panglaykim

**With R.M. Sundrum

TABLES

PART I

DEVELOPMENT

AND

EQUALITY

1 THE INDONESIAN ECONOMY: FACING A NEW ERA?

Introduction

THE past four months have been a time of awakening in Indonesia, to the country's economic condition, and perhaps the beginning of a new era – although as yet action has largely been confined to the political sphere.*

Beginning with two Statements in April by Sultan Hamengkubuwono IX, Deputy Premier in charge of Economic Affairs and one of the triumvirs of the new leadership (the other two being Lieutenant-General Soeharto and Mr Adam Malik), a picture of economic breakdown has been revealed to the Indonesian people and to the world which can have few parallels in a great nation in modern times except in the immediate aftermath of war or revolution.

It remains true that this breakdown does not greatly impinge on the majority of the people who live in the villages of Java and the Outer Islands. Nor is there as yet evidence of catastrophic or even serious food shortage.[1] Average standards of food consumption, and of living generally, are still, as far as it is possible to judge, substantially higher than, for example, in India. But economic breakdown in every other form is apparent in varying degrees.

The country is in default on a foreign debt officially estimated at $2,400 million. Current foreign exchange earnings in 1966 are unlikely to cover much more than one-half of foreign exchange requirements for imports and (unrevised) debt service. Tax collection has been falling ever further behind almost uncontrolled government expenditure. In consequence, inflation, as reflected both in rising money supply and rising prices, is continuing at a rate which is probably still rising. Shortage of imported raw materials and other factors have reduced industrial production to below 20 percent of capacity. While rice production is seemingly well maintained, production of estate and other rural products, with few exceptions, continues to stagnate or decline. Shipping, rail and road transport and all other public services are suffering from years of running-down of equipment and are operating with difficulty and intermittently. The whole elaborate system of government controls of the economy is rendered practically inoperative by evasion and corruption. The relevant laws and regulations are neither respected nor enforced.

All these features of the economic situation have been increasingly in evidence, and obvious to observers on the spot, for the past two years and more. It is only in the last few months that they have been officially acknowledged and squarely faced by the country's leaders. As the Sultan said in his Statement of 12 April:

**This survey was written in Jakarta in June 1966. For various reasons it has not been possible to give a published source for every fact or figure. The usual list of references is therefore omitted.*

With J. Panglaykim. First appeared as "Survey of Recent Developments", in *Bulletin of Indonesian Economic Studies,* No. 4, June 1966; reprinted as *The Indonesian Economy: Facing a New Era?,* Rotterdam University Press, 1966.

> "We decline to make promises which may arouse unrealistic hopes among the people. They may become disappointed if improvements fail to come up to their expectations. The only promise we give is that we will do our best honestly to meet the challenge."[2]

It is now clear that the first series of economic measures taken by the old leadership in the wake of the abortive coup in late November and December was not as constructive as appeared at the time of writing of the last survey. While the principles proclaimed were sound enough, the actions taken were partly – as in the case of the decision to make all foreign trade a government monopoly – merely further steps on the doctrinaire road followed in the preceding two years and partly emergency measures hastily conceived under extreme political pressures. The latter was true especially of the decisions to grant a large New Year bonus to government employees and of the December "currency reform" which was its direct outcome. It became apparent to the Central Bank that the amount of currency required for the bonus (75,000 rupiahs to each of about 4 million employees or 300 billion rupiahs), on top of rapidly rising routine expenditure and considerable withdrawals of cash from the banks, was altogether beyond the capacity of the government printing press. Hence the decision to introduce the new rupiah (equal to 1,000 old rupiahs) which made it possible to put into circulation large stocks of Rp 50 and 100 notes printed in 1960 that had been overtaken by the inflation and never used. Unaccompanied by any other stabilisation measures, it was an act of desperation, not a currency reform. The other major decision, to raise the official price of petrol and public utility charges to levels which would cover costs, though sound enough in principle, appears to have been disastrous in its timing – certainly for its authors. The 250-fold increase in the price of petrol was interpreted by the public as signalling final abandonment by the old leadership of efforts to hold the line against inflation. Together with the increases in public utility charges, it played an important part in arousing the students to political action which in March reached its climax in the overthrow of the old regime.

The months that have passed since then have been dominated by a continuing half-hidden struggle – "play" might be the better word if the stakes were not so high – for political power. At the end of June the feeling in Jakarta was that there was still much "unfinished political business", too much for decisive economic action. It seemed doubtful whether the new Triumvirate as yet commanded sufficient political power to take any, let alone all, of the highly unpalatable decisions that would be needed to tackle the economic situation. Confining action to areas in which it could count on a national consensus, such as the ending of "confrontation" against Malaysia and the "rescheduling" of foreign debts, it was seeking to consolidate its political position.

But if government attitudes and the climate of public opinion in Jakarta meant anything, a new era had certainly begun. There was a willingness to eschew slogans and ideology, to face economic facts, to be pragmatic, which had not been in fashion in Indonesia for many years. There was little optimism that the country would emerge quickly from the morass; but at least a measure of confidence that it would not be pushed further down by irresponsible leadership.

"Rescheduling" of Foreign Debt

THE Sultan's April Statement contained the following candid passage:

> "Any person who entertains the idea that Indonesian society is experiencing a favourable economic situation is guilty of lack of intensive study. For years to come Indonesia's economy is saddled with foreign debts totalling $2.4 billion. This year we have to begin to pay our long-term debts. If we fulfil all our obligations, we have no

foreign exchange left to spend for our routine needs. This is the reason why for years we have been importing our daily necessities through short-term loans (better known as deferred payments) on conditions detrimental to us."

As was pointed out in the last survey, in December 1965 Indonesia ceased to be able to meet her foreign exchange commitments. For sometime the Central Bank was unable to honour even cash letters of credit and had to suspend payment on a volume of foreign trade credit which, together with other short-term credit still outstanding at the end of the year, was estimated at $177 million.[3]

In April the Government compiled an account of Indonesia's total foreign debt (Table 1) and of repayments due over the years 1966-74 (Table 2). It showed that of the total medium and long term debt of $2,175 million, more than 60 percent was due to countries of the Communist bloc, mainly to the Soviet Union, and mostly on account of military aid. Among the other creditors, Japan was only slightly behind the USA, and much the largest if short-term debt is included.

With total foreign exchange earnings (including oil revenue) for 1966 estimated at only $430 million, it was obvious that Indonesia could not honour her commitments to repay $530 million in that year. By April, the need to seek a moratorium from Indonesia's creditors was publicly acknowledged, and efforts began to secure a "rescheduling" of her commitments. The Sultan himself led a delegation to Japan in the last week of May. A technical mission under a high official of the Department of External Affairs left about the same time for the Netherlands and other western Europe creditor countries to prepare the ground for the Sultan there. A similar mission to the Soviet Union and other Communist countries was to be led by Mr Adam Malik. The high priority given by the new leaders to ending "confrontation" against Malaysia was generally interpreted as not unconnected with the need to give proof to the world of Indonesia's intention to concentrate her efforts on the country's economic problems and thus to justify a sympathetic attitude among creditors and potential lenders.

Table 1 Indonesia's Foreign Debt (31 December 1965)

($ million)

Country	Medium/ Long Term	Short Term	Total
Communist Countries			
USSR	980	10	990
Yugoslavia	108	7	115
Poland	98	2	100
Czechoslovakia	58	19	77
East Germany	70	2	72
Hungary	17	2	19
Rumania	15	1	16
China	13	—	13
Other	2	—	2
Total	1,361	43	1,404

Western Countries			
USA	172	7	179
West Germany	112	10	122
France	113	2	115
Italy	84	7	91
UK (incl. Hong Kong)	40	2	42
Netherlands	12	16	28
Switzerland	–	3	3
Other	6	1	7
Total	539	48	587
Asian Countries			
Japan	168	63	231
Pakistan	–	20	20
India	8	2	10
Total	176	85	261
African Countries			
UAR	3	1	4
International Agencies			
IMF	102	–	102
Grand Total	2,181	177	2,358

Note: The totals do not include compensation to foreign owners of estates etc. now under negotiation, nor the $110 million due to the Shell Oil Company in payment for its assets.

Source: *Kompas*, 23 April 1966; private communication.

Intensive diplomatic activity persuaded an initially reluctant Indonesia to accept a consortium of all the creditor countries as the best instrument for negotiating an equitable rescheduling of Indonesia's existing commitments and exploring the possibilities of equally urgently needed new credits. It was also no accident that among the first of the international institutions Indonesia proposed to rejoin was the International Monetary Fund. An IMF mission arrived in Jakarta late in June, with an assessment of Indonesia's foreign exchange position as its first task.

Balance of Payments Position

TABLE 3 presents Indonesia's balance of payments for the five years 1960-64 and the first half of 1965 (no data for the second half are yet available), together with an estimate

Table 2 Foreign Debt Service: Payments Due, 1966-74

Year	$ million
1966	530
1967	270
1968	275
1969	198
1970	184
1971	145
1972	124
1973	107
1974	96

Sources: 1966: Sultan's Statement, 6 May 1966; 1967-74: Ministry of Finance, 2 April 1966.

Table 3 Balance of Payments, 1960-66

($ million)

	1960	1961	1962	1963	1964	1965[a] (to 30/6)	1966 (estimated)
Receipts							
1. Exports (f.o.b.)	601	527	470	412	426	173	360
2. Oil	280	239	241	244	206	25[d]	50[d]
3. Other	—	—	—	—	—	—	20
Total	881	766	711	656	632	198	430
Expenditure							
4. Imports	749	1,056	737	602	590	230	450
5. Invisibles (net)	316	231	222	282	272	125	170
6. Debt service	b	b	b	b	b	b	530[c]
Total	1,065	1,287	959	884	862	355	1,150
7. Capital inflow	180	353	80	86	142	21	?
8. Deficit/surplus	96	-168	-168	-142	-88	-136	-720

[a]No data for the second half of 1965 are as yet available.

[b]Included in row 5. [c]Before rescheduling.

[d]Net foreign exchange yield to government. The figures in row 2 refer to gross oil export earnings for the years 1960-64 but to the oil industry's net contribution to Indonesia's foreign exchange earnings for the years 1965 and 1966. The overall surplus in 1960 is therefore overstated, and the deficit in the years 1961-64 understated, by some $100 million.

Source: Private communication.

of the main items in 1966 as they appeared likely in the absence of action to increase exports, reduce imports and other expenditure abroad and reschedule debt payments. On these assumptions, earnings of foreign exchange would cover not much more than one-third of requirements. How is a balance likely to be struck?

Exports

THE Sultan's Statement pointed out that Indonesia's export income had dwindled from $750 million in 1961 to $450 million in 1965 and proclaimed the Government's intention to "give priority to every project which yields foreign exchange without bringing losses in other fields". This is indeed one economic field in which the new leadership has taken legislative action. A new regulation announced on 20 May 1966 widened the free market for foreign exchange by increasing the Export Bonus i.e. the proportion of their foreign exchange earnings which private exporters may legally sell to importers. For Group I products (traditional exports including rubber and other major commodities) the proportion was increased from 10 to 20 percent, in Group II (less well established primary products) from 15 to 60 percent, and in Group III (handicrafts etc.) to 100 percent. This was expected to yield an average rate of Export Bonus of 25 percent, with a total value of $(360 x 0.25 =) 90 million. The regulation also provided that one-half of the Export Bonus must be channelled back into the region in which the exports were produced.

The object of the new regulation was, first, to stimulate exports by a further partial exchange depreciation and, secondly, to assure to the export-producing regions, especially in Sumatra, a share in the proceeds in the form of imports. In both respects, the decisions were partly concessions to market or political pressures – difficulty in enforcing exchange control in the one case and acknowledgment of the power of regional commanders to take direct action in the other. In both respects, also, there was some doubt whether the regulation would achieve its purposes; whether the additional incentive provided by the relatively small increase in the Export Bonus on the main export commodities would make much impact on the volume of exports, particularly if the regulation relating to the Regional Export Bonus deprived exporters of much of this half of the increase.[4]

Immediately following the announcement of the new regulation in the third week of May, the free market rate for Export Bonus dropped from Rp 110 to Rp 90 for $1.00.[5] By 7 June it had fallen further to Rp 75 but it climbed back to Rp 90 later in the month.

Table 4 presents a commodity breakdown of the export target of $360 million (excluding oil), together with actual exports in 1965 where the figures are available. If any significance can be attached to the comparisons, they suggest that the authorities responsible for the targets were pessimistic about the prospects for exports of rubber, coffee and tea in 1966, but optimistic about the prospects for tobacco and copra. In view of the predominant role of rubber, the comparison suggests that the target for total exports may have erred on the side of caution.

On the trend of exports in the first months of 1966 it was impossible at the time of writing to obtain a clear picture. Applications for export licences, after running at a rate of about $30 million a month in the first quarter, fell off in April and May, presumably because exporters were holding back in anticipation of the increase in the Export Bonus. On the value of actual exports, different figures were being quoted by different government departments. But there seemed some ground for optimism that, if current rates were maintained for the rest of the year, exports (excluding oil) in 1966 would reach the current official target figure of $360 million and might even approach $400 million.[6]