

## THE NEW ORDER AND THE ECONOMY

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It is rather ironic to recall President Sukarno's "banting stir" speech of April 11, 1965. Just one year and a day after that speech, the Sultan of Jogjakarta, Presidium member for economic and financial affairs outlined the economic policy of the "perfected" Dwikora cabinet, which was formed as a result of the first major cabinet reshuffle after the abortive coup. In it, the Sultan envisaged a substantial "turn of the wheel", but it was a "banting stir" in a direction not intended by the President the previous year when he had concentrated his attacks on foreign capital and private entrepreneurs. In the months that followed the Sultan's speech, there was a vigorous debate among the nation's intellectuals on the content of Indonesian socialism in the new era and the way in which the "just and prosperous society" so dear to the President<sup>1</sup> was to be attained.

Prominent in the debates were several groups of intellectuals scattered throughout the capital city: some affiliated to political parties, others in such organizations as the Intellectuals' Action Group (KASI). Membership in the various groups is not mutually exclusive. It is possible for a person to belong to a political party and also to be an active participant in several formal and informal groups interested in discussing economic problems and taking steps to influence the government. So a program issued under the name of a particular organization cannot be regarded as the brain-child of that group alone. Most of these groups included among their members academic economists, and for the first time in many years these groups were able to make their voices heard with effect in official circles.

Socialism remains the proclaimed goal of the Republic, but the methods of achieving this rather vague end are undergoing some important changes as the new government tackles the economic problems facing the country. To some extent, we are witnessing the return of the pragmatic outlook which was characteristic of the PSI-Masjumi coalition of the early fifties when Sumitro and Sjafruddin dominated the scene.<sup>2</sup> Although

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1. Many of the phrases of the old order have been retained, including this one. It may be given a new content, but it still remains to be seen whether the new formulation will be put into practice.
  2. For the use of this terminology see for example Bruce

these men are no longer members of the elite, there are others who have revived this approach to economic issues. In fact, some of them were close to the PSI and shared in the decision-making process of that earlier period.

However, the objective reality facing the present government and its advisers is vastly different from what it was when the earlier pragmatists were in control. The most important difference is the greater share of state ownership of the economy than was the case in the early fifties. The taking over and subsequent nationalization of Dutch companies in 1957 and 1958 placed most of the modern industrial-agricultural-commercial sector of the economy in the hands of the government. The state now has the commanding heights of the economy under its control. But the new government, having committed itself to some changes in the role of the state in economic affairs must still decide how to manage it.

In this article we intend to examine some of the ideas already expressed by the government and these groups on the type of economy appropriate for Indonesia, and also the debates on short run policies. While the debate on ultimate objectives continues, the government must act in the economic sphere out of necessity. In some ways, the short-run policies may conflict with the long-run objectives and we believe that it is worthwhile discussing the steps already taken and attempting to relate them to the objectives outlined by the government.

### The Political Background

The debate on both the nature of the economic system and the implementation of regulations designed to further the goals of the present government proceeds in an uneasy political atmosphere of turmoil and intrigue. As the civilians press their claims for recognition and for important positions in the major decision-making centers, there is an air of unreality about the current political constellation. The eclipse of the old order may give rise to a stable coalition between the civilians and the army or it may eventually turn towards a government much more strongly dominated by the military in spite of the protestations and hopes of General Suharto.

The first outward success of the alliance between the civilians and the army in the creation of the new order came with the installation of the "perfected" Dwikora cabinet on March 30, 1966. Headed by the triumvirate of General Suharto (chairman), the Sultan of Jogjakarta and Adam Malik, it was short-lived and on July 28 was succeeded by the Ampera cabinet,

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Glassburner, "Economic Policy Making in Indonesia", Economic Development and Cultural Change, Vol. X, January 1962, pp. 113-133.

presided over by the same triumvirate.

The composition of the Ampera cabinet represented a compromise between the varied competing forces which included: 1) the Armed Forces, 2) the political parties, 3) the younger generation, 4) the intellectuals (e.g., KASI, Universities), 5) Sukarno and his followers. The steps taken in the economic sphere in the second half of 1966 indicate that the Sukarno group had declined and that the intellectuals had gained ground in close co-operation with certain patrons in the Army.

The position of the intellectuals is not reflected in the cabinet itself, but rather at the levels of Director General and Secretary General. In the economic field, the ministries of Agriculture, Trade, Communications and Maritime Affairs are in the hands of members of the Armed Forces, while Finance and Estates are administered by Catholics, one of whom is chairman of the Catholic Party.<sup>3</sup>

The two main tasks of the cabinet are to prepare for general elections in 1968, and to solve the economic and financial problems of the nation.<sup>4</sup> Taken together, they constitute a program for both political and economic stability, but they can also be regarded as irreconcilable objectives. The likelihood that the process of the struggle for supremacy in the elections would induce a return to the practices of the period 1953-1955, is well realized by many Indonesians including General Suharto himself.<sup>5</sup> The intellectuals have pointed to the necessity of preventing a misuse of the country's resources in the scramble to build up party finances to contest the elections. They realize that the parties will attempt to weaken the role of the functional groups<sup>6</sup> and for this reason

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3. A list of cabinet members, Director Generals and Secretary Generals together with some background notes is found in Indonesia II.

4. For a statement on the cabinet's full program see General Suharto's speech to Parliament on August 16, 1966, discussed in Business News, August 24. Decision XI of the MPRS (Provisional People's Consultative Assembly), committed the Ampera cabinet to the holding of elections before July 5, 1968.

5. *Ibid.*

6. The functional groups include workers, peasants, national businessmen, intellectuals and educators, the Armed Forces, and so on. In the Parliament selected by the President in July 1960, the functional groups had 131 seats out of a total of 283, see H. Feith, "Dynamics of Guided Democracy", in R. McVey, (ed.), Indonesia, HRAF Press, New Haven, 1963, Table I, p. 345.

the Election Law is seen as the focal point in the coming struggle.<sup>7</sup>

For many years, intellectuals in general and economists in particular have been excluded from the centers of power and their influence has been restricted to the role of private citizens who give advice when called upon. In many cases, they were consulted unofficially at their homes which is not unusual when we recall that the Indonesian elite is small and there are always opportunities for informal contact in the capital. A significant example of the weakness of the economists as a "class" was the absence of economists on the National Planning Council, the body responsible for the formulation of the Eight Year Plan. The intellectuals are organized in organizations which at present are very influential, including ISEI (Association of Economists) and KASI (Intellectuals' Action Group). It is in the interests of the various discussion groups in Djakarta to ensure that the role of the functional groups in such government institutions as the Legislative Council and the MPRS is strengthened *vis-a-vis* the parties. And in the present power struggle, they tend to cluster around power centers.

Last August a symposium to discuss the general elections was organized by the National Research Council, KASI and the University of Indonesia. It was proposed that the PSI, Masjumi and Murba be rehabilitated, and that elections be organized in single-member constituencies at the kabupaten level. Economic stability as a prerequisite for the success of the elections was convincingly argued, while the dangers of a rise of militarism were recognized. It was felt that the latter could only be avoided if the various groups in society were represented properly. The symposium concluded that without democratic government some of the political parties would move towards radicalism as well as irresponsible actions. Such a trend could well lead to the replacement of moderate elements by extremists of which the final corollary could be militarism.

The intellectuals, especially those who are uncommitted to any party are in a weak and tenuous position. Their only hope of a voice in the future of Indonesia would appear to be in their ability to seek the patronage of the Army instead of the old political groups. The same applies to the smaller parties such as Parkindo and the Catholic party. Some of the larger parties, especially the PNI, would prefer to incorporate

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7. These views were presented in a study-paper prepared by a group of intellectuals in Djakarta. Throughout this paper the term intellectual is used rather loosely. Only when material has been published will we mention groups by name. Our main aim is to indicate that contributions to the current ferment are not the monopoly of one or two groups.

the newly emerging groups such as KASI, KAMI into their own camps but many feel that the old order minus the Communist Party (PKI) does not guarantee adequate representation of the modernizing elements aiming at economic development.

There is, however, an air of unreality in the approach of the intellectuals and smaller parties, best illustrated by the faith they seem to express in the elections: a faith somewhat reminiscent of the pre-election period of 1953-1955. Although they realize that preparations for elections may endanger attempts to ensure political stability, they appear to regard the elections as a necessary step in the direction of such stability.<sup>8</sup> It would appear that they hope for an Election Law which will minimize the role of the large parties, strengthen the position of the functional groups, and dissuade the army from extending its own influence. Even if the elections are postponed, the role of the army will still have to be determined. The intellectuals are aware of the dangers and some of them are moving individually into positions of influence, not only as Director Generals and Secretary Generals but more recently, on the personal staff of General Suharto.<sup>9</sup>

The basic assumption is that the government requires the services of the intellectuals; the question is how will they find positions of importance? In the early fifties, a prominent group of intellectuals were committed to the PSI-Masjumi coalition. Today, not all of the intellectuals are members of political parties or are committed to an ideology even though the non-party members may belong to such organizations as KASI and ISEI. It may well be that even the economists will be unable or unwilling to act together through the ISEI which, after all, is not fitted for this purpose. Some may prefer to act as individuals depending on patrons in the army. If we turn to a consideration of the economic scene, we will observe that through 1966 intellectuals made their influence felt both through their parties and groups and as individuals. Though it is too soon to be sure whether this tendency will continue, the intellectuals have so far played a decisive role in shaping economic policy.

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8. In July there were already rumors that both the PNI and the NU were making attempts to attract ex-PKI into their ranks with their eyes on the promised elections.
  9. Five economists became members of Suharto's personal staff as advisers to the general in his role as chairman of the Economic Stabilization Council. Their appointments were made on 12 September but were not reported in Business News until November 30, 1966.

The Future Economic System: Basic  
Principles and Objectives

The search for an economic system suited to Indonesian conditions has been a tortuous one. Socialism has been the accepted goal of all parties, but the content of their programs differed widely and their action more so.<sup>10</sup>

Ideas on the nature of the economic system suited to Indonesia were considered in the short life of the "perfected" Dwikora cabinet, although it was faced with a serious economic crisis when it took office. "Static expansion" characterized the development of the economy during the fifties but there were signs by the mid-sixties that unless there was an increase in investment in several sectors population growth would soon outstrip the economy's capacity to provide for its people without an increase in the death rate. The most pressing immediate problems were inflation and a heavy burden of repayment of foreign debts, part of which had not been used to expand productive capacity and were therefore not self-financing. The new government advanced on several fronts always with the short-term objective of debt rescheduling in mind.

The first major statement on domestic economic policy was made by the Sultan, the Vice-First Minister for Economics and Finance, in a report to ministers and the press on April 12, 1966. In this address, the Sultan mentioned most of the issues which were subsequently elaborated in policy speeches by other cabinet ministers, while some of them were contained in MPRS Decision XXIII. The points covered included:

1. The burdens of foreign debt and inflation were candidly assessed. He admitted the country was unable to repay its debts and at the same time finance essential imports from current foreign exchange earnings. He announced that the government would approach its creditors to discuss rescheduling.
2. Emphasis was placed on the necessity to rehabilitate the infra-structure especially through the import of spare parts for all types of vehicles.
3. Government policy was to be judged by economic considerations, not ideological and political ones.

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10. For a discussion of ideas on socialism see for example K. D. Thomas, Indonesia's Approach to Socialism, 1950-1960 - An Historical Analysis in Political Economy, unpublished M.A. thesis, University of California (Berkeley), 1962, and on trends during the period 1963-1965 see L. Castles, "Socialism and Private Business: The Latest Phase", Bulletin of Indonesian Economic Studies, Australian National University, Canberra, No. 11, June 1965.

4. The regions were to be allowed to play a more active and positive role in economic development. They will be permitted to use their own resources for their own needs without detracting from or hindering the economic policies of the central government.
5. State Enterprises are to be operated in accordance with economic norms. The functions of the General Management Councils will be reviewed.<sup>11</sup>
6. The taxation system would be reviewed.
7. Socialism was declared to be the main objective of the Revolution as it has been in the past. But it was pointed out that this was a long-term goal. The Sultan said that he was discussing short-term measures for rehabilitation and stabilization, so that it was necessary to take action on the basis of an assessment of current realities. Swasta (private enterprise) is at present a strong and important sector. "A pragmatic approach therefore justifies a policy of giving private enterprise an opportunity to develop and regulate itself in the attempt to rehabilitate and stabilize our economy according to the directions indicated by the government".<sup>12</sup>

Few of the issues raised by the Sultan were analysed in detail and during the months that followed they were the subject of intense debate in both government and intellectual circles. Even so, the policy decisions which resulted from these discussions were not the fruits of a mere two months. They were the outcome of many years of discussions among various groups in the capital during the period when free discussion was not encouraged. Groups from various parties, especially the smaller parties such as the PSI, and the Catholic party along with the well-known group from the Faculty of Economics, University of Indonesia, were preparing programs for economic development in the hopes that some day they would be heard and implemented.

The MPRS Decision XXIII of July 5, 1966, on the Reform of the Basic Economic, Financial and Developmental Policy was presented as a reversal of the Presidential policies of the

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11. On the General Management Councils see Dr. J. Panglaykim, "Worker-Management Councils", World Politics, January, 1965.
  12. For a full text of the Sultan's statement see Republic of Indonesia Radio Broadcast, Siaran Pemerintah, 12 April 1966, (our emphasis).

immediately preceding years. At the same time, the new policy was held to be consistent with the Constitution, the Economic Declaration of March 28, 1963 (Dekon) and other statements of principle made in the past. Before the decision intellectuals had met to consider the formulation of suggestions to the Assembly. In this instance, it was the Faculty of Economics group which came up with concrete proposals in the form of a detailed draft which in many respects was incorporated into the final MPRS statement.

The MPRS accepted the old principle of a guided economy based on the Pantja Sila, arguing that policies based upon this principle would ensure the realization of economic democracy. The Assembly was specific in stressing that economic democracy should exclude:

- a. "free fight liberalism" of the period 1950-1957;
- b. étatism--where the state and its economic apparatus fully dominate the economy and tend to push out and to stifle the potential and creative powers of those economic units which operate outside the government sector;
- c. monopolies which are harmful to the people.<sup>13</sup>

Short term problems were to be emphasized and after success in resuscitating the economy,<sup>14</sup> a rehabilitation and stabilization program should be formulated to control inflation and restore production levels. The following priorities were listed:

- a. control of inflation,
- b. provision of adequate foodstuffs,
- c. rehabilitation of the infra-structure,
- d. an increase in activity in the export sector,
- e. provision of adequate clothing (pangan--which includes shelter).

The Decision also made important statements on three

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13. Translated from the text of the Decision published in Business News, July 8, 1966. The notion of the class struggle was rejected because the economy was to be based on the principle of kekeluargaan--contrasting sharply with the idea of the President.
  14. Resuscitation (penjelematan) required overcoming stagnation in the production of sandang-pangan (literally food and clothing, but including the basic necessities of life), exports and bottlenecks in the infra-structure by making available raw materials, spare parts and the minimum of capital equipment for these sectors.



issues which have been the subject of much controversy since independence, namely the role of the regions and private enterprise in economic development and the role assigned to international economic relations. We shall discuss each of these in turn.

The Role of the Regions: After stressing how imperative it was to speed up implementation of land reform and land use programs,<sup>15</sup> the Assembly favored the granting of wide autonomy to the regions and the de-concentration of management under the co-ordination of regional governments.<sup>16</sup> Even so, article 33 of Decision XXIII provided that "in order to ensure consistency in the national plan, regional and community development must be co-ordinated by the central government" (our emphasis). Clearly, the old issue of the extent to which the regions are to be independent in economic matters is still unresolved. We must wait and see how the government tries to regulate center-regional relations in practice. The basic principle to be borne in mind when considering regional development is that the objective is an integrated national economy (Decision XXIII Article 34).

Role of Government and Private Enterprise: The state has little choice in playing the leading role in economic development in Indonesia; the question is "shall private enterprise be encouraged or gradually eliminated?" This issue has always been a favorite topic for debate although in practice, given the financial weakness of the private section,<sup>17</sup> the outcome has rarely been in doubt particularly since the expulsion of the

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15. This should be easier than in the past, since the class struggle no longer has a place in Indonesian society according to Decision XXIII!
  16. The concept of deconcentration was the subject of much discussion in 1963. Deconcentration was mentioned in the Dekon and a seminar was convened from July 12-18 by LEKNAS (National Research Institute) and the MIPI (Indonesian Science Council) to analyze it in connection with Article 24 of the Declaration. Their findings were published in the Reports of the Workshop on Deconcentration of Management in State Enterprises published under the auspices of the two institutions which had organized the seminar. Two types of deconcentration were mentioned: geographical (which is the type referred to in the text above) and deconcentration in the sense of a delegation of authority within state enterprises.
  17. This is a weakness which hampers the development of the indigenous private sector. Other groups, especially the Chinese (citizens and non-citizens) are in a much stronger position as we shall see later.

Dutch in 1957-58. Even so, when the Dutch companies were taken over by the government part of the indigenous private community hoped that the government would transfer at least some of them to private enterprise.<sup>18</sup> This would have been possible only if the government had been willing to provide substantial credits to the private sector (assuming of course that they had also had the necessary managerial skills). In fact, however, as far as the modern agricultural-trading-industrial sector of the economy was concerned, (i.e., that portion of it owned formerly by the Dutch), the government has shown no inclination to release its hold. During the period 1959-1965, the state continued to extend its influence and control over the economy, directly through the establishment of new industries and indirectly through regulations which often remained on paper only. It came to be said that instead of a "regulated economy," Indonesia was an "economy of regulations." Included in the trend towards greater state control (on paper) was the attempt to break the control of the alien traders in rural areas and the often-cited intention to reduce the role of private enterprise in the import sector.<sup>19</sup>

In Decision XXIII, the government is again assigned a positive role in overcoming economic stagnation and in economic development. Besides carrying out economic activities through its own departments and enterprises, the government is obligated to guide (*membimbing*) the non-government sector (Article 38). Article 40 then declares that "in performing its functions in the economic sector, the government must place more emphasis on controlling (*pengawasan*) the direction of economic activity rather than performing all activities itself."<sup>20</sup> To this end, it is felt necessary to de-bureaucratise the system of control and provide for the deconcentration of management in state enterprise."<sup>21</sup>

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18. For a discussion of this issue, see K. D. Thomas, *op. cit.*, pp. 116-128.

19. Sukarno referred to his intention of squeezing private importers out of business in his *Berdikari* speech of April 11, 1965 and in November the government announced that the policy would go into effect in the New Year.

20. The translation of the article presents some difficulties; the contrast is between *pengawasaan* and *penguasaan*. Even if this is not a literal translation, we think that we have indicated the spirit of the article.

21. In contrast to geographical deconcentration, see footnote 16.

Swasta (private enterprise) is to be encouraged within the limits provided for in the Constitution and private entrepreneurs are to be allowed to choose the economic sphere they wish to operate in provided that it does not affect the livelihood of the people, and is not a strategic sector. Here, the Assembly echoes the words of Djuanda at the National Conference of National Businessmen (KENSI) in September 1958.<sup>22</sup> To complete the similarity, a Law on the sectors which will be open to swasta is promised by the MPRS decision. In 1958, Djuanda had mentioned that the forthcoming Foreign Investment Bill would provide a guide to the areas in which swasta could operate, but that Law was quickly overtaken by political events. In the present situation, swasta is to be under the guidance of the government apparatus, which is open to a wide variety of meanings. The Assembly does hold out the promise of assistance of an unspecified type to private enterprise but the enterprises listed are small scale.<sup>23</sup>

International Economic Relations: According to Article 58 of Decision XXIII, import policy must ensure the importing goods which can increase production directly or increase the supply of commodities required by the people, in accordance with an import plan (our emphasis).

The Assembly makes it clear that it accepts the argument that the rehabilitation and stabilization program cannot be a success without more foreign credits. But such credits are considered justifiable only as an integral of a well-defined program, they should not be wasted. Besides foreign credits, the scarcity of local capital indicates the necessity to attract foreign capital for development. A foreign investment law was therefore thought to be essential as soon as possible.

A foreign investment law should, according to the MPRS decision, make provision for foreign domestic capital, basically Chinese, but also Indian, Arab and the capital of other foreign citizens resident in Indonesia. In particular, Regulation 10/1959 concerning the elimination of alien traders in rural areas was referred to with the comment that it should be brought up to date and made a law.

Finally, the MPRS recommended that Indonesia take immediate steps to return to the International Monetary Fund and the International Bank for Reconstruction and Development.

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22. Discussed in K. D. Thomas, op. cit., p. 121.

23. Cooperatives are mentioned briefly in Decision XXIII, but all governments have done that in the past but the performance and significance of this sector is negligible.

Decision XXIII is different in spirit from the trend of the previous two years, as in its acceptance of foreign investment and the decision to return to various international organizations for example. Private enterprise is also to be encouraged to play a more active role in the economy in contrast to the stated ideals in the period between September 1963 and February 1966.<sup>24</sup> But even so, since the phrasing of the sections in Decision XXIII on the role of private enterprise is very similar to earlier promises proffered to the private sector at least until September 1963, the real significance of the latest pronouncements will only be realized in implementation. And we must always bear in mind what we have already said about the financial position of the indigenous private entrepreneurs, which will obviously limit their role in practice. Similarly, the promise of more autonomy to the regions has been made before.

Comparisons between the principles embodied in the MPRS decision and those enunciated by various governments since independence would be instructive. Here we merely wish to concentrate our attention on one particular period for comparative purposes. The Dekon of March 1963 is very similar in many respects to Decision XXIII and the events leading up to the Dekon have important parallels to the sequence of events since March 1966. In the period from August 1962 to May 1963, the Djuanda cabinet, having settled the West Irian dispute, was able to make preparations for a serious approach to economic problems. Uppermost in the mind of the government at that time was the necessity for Western aid and the IMF sent advisers to Indonesia to assist in the drafting of an economic program. A Western consortium seemed likely to back the government's policies and an amount of \$250 million dollars was rumored as the first step. The Dekon was announced on March 28, 1963 as the basic strategy of the government. Like Decision XXIII it was a product of compromise between various pressure groups. When the government announced its "14 regulations in implementation of the Dekon" opposition from the Nationalist Party and the PKI was formulated in such a way that the government's policies were alleged to be a betrayal of the Dekon! This is why, in commenting on the Decision of the MPRS we have stressed that only concrete regulations on the various topics discussed will enable us to form a clear picture of the direction in which the new order tends to travel.

Decision XXIII and a short-term program: Besides enunciating broad principles, the MPRS also stressed that the

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24. The divergence between the stated policy and the actual reality concerning the scope for private enterprise has been ably presented by Castles, op. cit., pp. 32-38.

government should concentrate its attention on a short-term program of resuscitation, stabilization and rehabilitation. The Indonesian economists had presented the MPRS with a detailed draft of "Basic Objectives." In its turn, the MPRS requested the economists to outline a short-term program along the lines suggested in Decision XXIII. In their conference in Bandung in July, the economists' association (ISEI) proposed to the government the following program:

1. a six-month resuscitation program aimed at reducing inflationary pressures,
2. a two year stabilization program continuing the resuscitation program, but more intensively,
3. a one year program aimed at the rehabilitation of the industrial apparatus, including the repair of roads, factories and agricultural estates.<sup>25</sup>

Since the rehabilitation program was to be put into practice after the two year stabilization program, the time-span envisaged for the whole program was 3½ years.<sup>26</sup>

#### The Cabinet and Guide-lines of Policy

In the middle of August, the newly appointed Ampera cabinet announced its own program for realizing the twin objectives of stabilization and rehabilitation based on Decision XIII. Probably drawing upon the ideas of the economists, the government decided upon a four-phase program: 1) resuscitation, 2) rehabilitation, 3) consolidation, and 4) stabilization, each phase being of six months duration. This two-year program is equivalent to the period allowed the cabinet by the MPRS for holding elections, i.e., not later than July 5, 1968.<sup>27</sup> The government apparently considers the success of its program as vital to the creation of the economic stability which it regards as a prerequisite for political stability. A favorable climate for the elections is considered to be dependent on achievement

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25. Compare this program with the short-term program outlined in the Dekon. Again the similarities are striking.
  26. The complete text of the program is published in Business News, August 12 and 15, 1966. We will not discuss their proposals further, but suggest that as the government issues regulations on economic policy reference be made to the document to assess the impact of the ISEI ideas on policy makers.
  27. MPRS, Decision XI, July 11, 1966.

of stability in both spheres.

By stage (4), the period of stabilization begins and the way is open for a development program. But politically, fears have been expressed about the effects of the preparations and campaigning for the forthcoming elections. In a Business News editorial, for example, the program is regarded as modest and is said to convey the impression that the Ampera cabinet is merely taking responsibility for the holding of elections under tranquil conditions.<sup>28</sup> Only in stage (3), or eighteen months after the program has been in progress, will the nine essential commodities be available in what are considered to be reasonable quantities, and in phase (4) the attempt is to be made to cut the rate of inflation by 50 per cent. Given the present rate of inflation, that is hardly likely to engender political stability. Inflation will therefore continue to be a serious problem over the next two years, according to the government's own calculations, and it is unlikely that much will have been accomplished before the rush for electioneering funds gets underway. The implications of this situation for the success of the fourth phase of the program are clear.

A major statement of policy was presented to a group of Indonesia's creditors in Tokyo on September 17.<sup>29</sup> The new government indirectly criticized "strict" planning and declared itself in favor of the "removal of distortions caused by these controls, bothersome procedures and undue state interference (resulting from planning), and which are in a sense correlated features of inflation, (which) requires a drastic reversal of policies by letting a more normal operation of market forces. Decontrol of the economy and of the pricing system "will enable the government to base its revenue on more realistic prices and will certainly improve results." One of the most important single steps in facilitating decontrol was, according to the government, to be the introduction of a realistic exchange rate. State enterprises would be allowed to operate on a more realistic pricing system which would enable them to charge higher prices and reduce their inefficiency. This would make it possible for the government to reduce their subsidies and enable the companies to contribute more to the budget. If the enterprises lacked

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28. Business News, August 24, 1966. This section is based on the Business News report of General Suharto's comments on the government's program, and includes part of the penetrating analysis of the program in the Business News editorial.

29. An IMF team was already in Indonesia assisting the government in preparations of a short-term stabilization program, and Suharto acknowledged in Fund's assistance in drawing up the September 17 statement.

able managers, General Suharto said that they might be able to attract foreign personnel. He also said that prices should develop in line with production efficiencies within the limits of "socially permissible profit-making." To this end, the government will abolish preferential treatment to State enterprises covering a very wide variety of cases.

More concretely, the chairman of the Presidium said that the government would intensify its tax collecting efforts and would also introduce new taxes.<sup>30</sup> The objective was to increase government revenue to 10 per cent of the National Income compared with an estimated 1.5 per cent in 1965. "Strict planning," to use General Suharto's phrase, may be dispensed with but it is clear from Decision XXIII that planning as such is not condemned. If the government does succeed in increasing its revenue, it should be in a much better position to influence the direction of the economy than has been possible before. It may prefer, however, to rely on market forces rather than on the more direct methods employed with little success by previous governments.

### Economic Policy Measures

The most important steps taken by the Ampera Cabinet since it took office in July have been the introduction of new export and import regulations in October and the tabling of a draft budget for 1967 and of a foreign investment bill on November 17. Before we discuss these measures, we must first take a look at how the government prepared the way for these important measures, particularly in its search for foreign exchange and its taxation policy pronouncements.

### Preparations for the October Regulations

Foreign exchange position: In his first major economic speech, the Sultan had made it clear that the economic situation was serious. He emphasized then that export earnings had

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30. The land tax was cited as a major source of revenue in the future, although it is not mentioned in the 1967 budget as we shall see below. It is interesting to speculate on the effects of any attempt to collect the land tax on the outcome of the proposed elections. A tax on agricultural products (pajak hasil bumi) is still being collected but in the 1967 budget the revenue from this tax (now called the regional development collection--iuran pembangunan daerah) is only Rp.2 million or less than 3 per cent of total revenue (see Table 1).

fallen in recent years and that it was impossible for the government to finance the imports required for a rehabilitation program, and repay foreign debts as well.<sup>31</sup> The government therefore decided to attempt to persuade its creditors to agree to a moratorium and rescheduling of debt payment. Rapid moves were made to reassure its creditors of the seriousness of the government's intention to tackle economic matters. Statements were made to the effect that confrontation would soon be brought to an end, and on June 6, 1966 Indonesia affected a rapprochement with Singapore followed on August 11, 1966 by a similar agreement with Malaysia. Decision XXIII reversed the former hostile attitude towards foreign investment and the announcement that Indonesia would seek readmission to international monetary organizations was quickly acted upon with the dispatch of a delegation to the IMF and the IBRD in Washington.

The total amount of Indonesia's foreign debts has been estimated at around \$2.3 billion of which some 60 per cent is owing to Communist countries (42 per cent to the Soviet Union alone). By 1967, the amount of repayment including arrears is estimated at \$727.9 million. No data has been made available on the proportion owing to Communist countries, but if we take the percentage distribution of the total debt as a guide,<sup>32</sup> \$436 million would be outstanding to them. Missions were sent to both Western and Communist countries to explain the government's policies, and

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31. We have already indicated elsewhere that we concur in this analysis, but several statements made subsequently by various ministers seem to indicate a misunderstanding of the nature of the export problem. General Suharto, in his statement to the Tokyo meeting in September referred to an increase in export earnings between 1958 and 1960, and cites this increase as an indication of the efficacy of stricter monetary controls. Export earnings did increase in those years from \$476 million to \$620 million (excluding oil). Between the same period, the export value of rubber, the most important export product, rose from \$262 to \$377 million, an increase of 44 per cent. At the same time, export volume fell from a total of 685,198 tons to 610,452 tons. It was the increase in the price of rubber on the world market rather than any internal policy measures which was responsible for the increase in exports noted by General Suharto, see K. D. Thomas and J. Panglaykim, "Indonesian Exports: Performance and Prospects, 1950-1970, Part I," Bulletin of Indonesian Economic Studies, Australian National University, No. 5, October 1966; also will be published as booklet by the Rotterdam University Press, April 1967.
32. A list of Indonesia's total foreign debts can be found in J. Panglaykim, H. W. Arndt, The Indonesian Economy: Facing a New Era?, Rotterdam University Press, November 1966, Table I.



to seek new credits. The Sultan led a team to Japan at the end of May, then in September he went to Europe where he met, among others, representatives of the British and Dutch governments. His purpose in both cases was to discuss the settling of claims for compensation for firms taken over by the Indonesian government. An agreement was reached in Holland that Indonesia would pay compensation of approximately \$165 million (Fl. 600 million) commencing in 1971 at 1 per cent interest spread out over 30 years. In Britain the matter was left open, representatives of the British firms concerned being invited to Indonesia to discuss the matter further.

The meeting of creditors in Tokyo was regarded as the crucial test but the outcome was rather disappointing. In a statement in Parliament, the government had indicated that for its economic program imports to the value of \$590 million were required and given the expected level of exports for that year further credits of \$250 million would be sought as well as the moratorium and rescheduling.<sup>33</sup> No decision was reached concerning new credits but there was an agreement in principle on a moratorium and rescheduling. But the countries concerned<sup>34</sup> decided to postpone the formulation of a timetable on a moratorium and rescheduling until December when they agreed to meet again in Paris. The Sultan reported that the possibility of new credits would also be discussed at the Paris talks.<sup>35</sup>

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33. Monitored radio broadcast, September 17. In its statement presented in Tokyo on the same day, the government mentioned an amount of \$350 million extra credit. Both amounts seem excessive if imports are estimated at \$590 million and exports for 1967 at the \$450 million quoted in Business News, September 21, 1966.
34. Japan, the United States, Western Germany, France, Holland, Italy, the United Kingdom; Australia and New Zealand and Canada as observers-small creditors. Commenting on the absence of the Soviet Union and other Communist countries, the government stated in Parliament that efforts were still being made to come to an agreement with them concerning a rescheduling of debts, see Business News, September 19, 1966.
35. It is interesting to follow the timing of the meetings of the creditor countries in relation to Indonesia's approaches to the Soviet Union. Foreign Minister Malik was due to meet Soviet leaders in early September but at the last minute the talks were put off until some time in October, i.e., after and not before Tokyo as originally planned. It is therefore possible that the Tokyo club preferred to agree to a moratorium-rescheduling in principle in September promising more concrete proposals after the Russians had declared their policy on the issue of their much larger debts. Subsequently, the USSR also agreed to a moratorium in principle

In spite of the results of the Tokyo meeting, the missions of the Sultan and Foreign Minister in May and September 1966 did produce concrete offers of credits. However, we have been unable to ascertain the precise amount available, official figures varying within a range of \$174 million and \$286.8 million.<sup>36</sup> Taken together, the acceptance of a moratorium in principle, including the arrears up to the end of 1966, and the availability of some credits which would be used currently meant that the immediate pressures occasioned by the scarcity of foreign exchange were eased considerably. The effects of the reduced pressures were evident in the form which the October regulations took as we shall see below.

Taxation policy: General Suharto announced the government's intention of raising revenue by intensifying the collection of such direct taxes as income, property, sales, and company profit taxes on September 20.<sup>37</sup> General Suharto said that the government must try to increase revenue from direct taxes because expenditures were far in excess of receipts. In July 1966, he pointed out that the money supply was Rp.10 billion (new money) compared with Rp.2.8 billion (new money) seven months earlier. Reduction of the budget deficit was a way to prevent further increase of that magnitude he said.

Most of Indonesia's tax revenue has, in the past, come from indirect taxes levied on the foreign trade sector, whereas there had been little success in collecting scheduled taxes

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but again nothing more definite. This cat-and-mouse game between the creditor nations is partly responsible for the delay in the granting of sizeable rather than piece-meal credits to Indonesia, and may, in the not-too-long run, seriously affect the success of the government's economic program and exacerbate the internal political tensions.

36. The Minister of Finance gave a figure of \$174 million, of which \$100.8 million had already been allocated (Business News, October 19, 1966); (2) The Public Relations Section of the First Minister for Finance and Economics gave a figure of \$220 million of which \$180.35 million was available for 1966 (Business News, October 21, 1966); and (3) the Sultan, in a statement in Parliament on October 24, 1966 (monitored broadcast) mentioned \$286.8 million. He comments on several of the credits, some of which are earmarked for special projects including the \$30 million loan from Holland for West Irian, \$2 million from France for Djatiluhur and \$2.5 million from Japan for the flood victims of Solo.
37. For the text of this statement see Business News special news sheet, September 20, and Presidium Instruction No. 10/EK/IN/1966, Business News, September 23, 1966.

from incomes, property and profits. As the Presidium chairman pointed out, the government's tax drive would mainly affect businessmen, companies and high officials, groups which had consistently succeeded in their efforts at tax evasion. But in stressing the fact that the rakjat (the general public) would not be affected, he gave an impetus to the already low esteem in which the business community, including government enterprises, is held.

The main targets of the tax collectors would be the cities and those persons who paid their taxes would be given a tax certificate as proof of payment. General Suharto realized that tax officials might encounter difficulties in the performance of their duties because the groups affected had considerable influence in the community, but he warned that those who tried to evade paying their taxes would be dealt with firmly.<sup>38</sup> Difficulties other than those mentioned by General Suharto will have to be faced in the effort to increase taxation. More skilled and honest personnel may be required and it may be necessary to pay them an "adequate" salary, a rather complicated task if the rate of inflation is not reduced. Probably, an added incentive in the form of a bonus system would help.

We are now in a position to discuss the implications of the October 3 regulations (and the follow-up measures) and the Budget for 1967 both as component parts of the stabilization and rehabilitation program and as measures designed to further the government's policy objectives in such matters as regional and central government roles in development and the respective roles of private and state enterprises.

#### The October Regulations and the Budget

On February 11, 1966, the Dwikora cabinet had introduced the export certificate system (Bonus Ekspor--B.E.) which with modifications is still in operation. Under this system, the exporter receives an income from a combination of:

1. the rupiah he receives from the Foreign Exchange Fund for that portion of his exchange earnings which he is obliged to surrender to the government to be converted at the official rate (now Rp.10 = \$1);

2. the rupiah which he receives from the sale of that portion of this foreign exchange earnings which he receives in the form of an exchange certificate (BE);

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38. Tax officials could call upon the Armed Forces to assist them if necessary. See Presidium Instruction mentioned in note 37.

3. the foreign currency which he obtains as a result of the difference between the check price (as fixed by the Department of Trade, Export Division) for his product fixed in foreign currency by the government and surrendered to the Foreign Exchange Fund and the actual price he gets from the foreign buyer. This portion is known as the DP-A and the exporter can deposit it in an overseas bank or sell it or part of it to those who need foreign currency (it then becomes a DP-B and legally it cannot be traded again. The rate for the DP-A is usually very close to the black rate for the rupiah, sometimes higher sometimes lower).

The Ampera Cabinet announced on October 3, 1966 a series of Presidium Decisions affecting foreign trade sector. These new measures, issued at a time when the top ministers for economic affairs were overseas,<sup>39</sup> provided for changes in the spheres of both exports and imports.

Exports: The regulations on October 3 provided for an increase in the percentage of foreign exchange granted to the exporter in the form of BE as compared with the percentages fixed on May 20:

Group I (including rubber, copra, coffee)	from 20 to 50%
Group II	from 60 to 75%
Group III	100% as before. <sup>40</sup>

In total, the amount of foreign exchange available as exchange certificates to exporters (BE-E) has been estimated at 65%.<sup>41</sup> Of the rest, 10% is allocated to the First Level Autonomous Regions (Dati I) as an automatic foreign exchange allocation (ADO). The regions are obliged to purchase this foreign exchange from the Foreign Exchange Fund at a price of Rp.10 = \$1.

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39. Both the Sultan and Adam Malik, the Foreign Minister, were abroad discussing Indonesia's foreign exchange position with her creditors. At the moment, we are not sure whether the timing of the October regulations is significant, but a Business News editorial was also prompted to mention the absence of these ministers in its issue of October 5, 1966. The new regulations are published in the same edition.

40. For a complete list of the commodities in each group see Kompas, October 8, 1966.

41. Mentioned in Business News, October 5, 1966. We do not know the basis on which this estimate was calculated. We did however make a calculation of our own which gave a figure of 55%. In this latter case, commodities in group I accounted for 88% of total exports. We will use the B. N. estimates until we have more information.

The remaining 25% goes directly into the Foreign Exchange Fund.

As a result of these changes, the initial distribution of foreign exchange from exports is:

1. <u>Bonus Ekspor</u> to the exporter ( <u>BE-E</u> )	65%
2. <u>Automatic Foreign Exchange Allocation</u> to <u>Dati I</u> ( <u>ADO</u> )	10%
3. Foreign Exchange Fund	25%

The government also decided to sell its own foreign exchange from (3) as BE, and at the same time the regional governments were allowed to sell the foreign exchange certificates from their ADO to importers as Regional B.E. (BE-D).<sup>42</sup>

One other source of foreign exchange certificates was created by the government in the October regulations when it decided to sell foreign credits in the same way as foreign exchange from the government's Foreign Exchange Fund. These foreign credits will therefore become BE-K. So there are now four different types of exchange certificates: (1) B.E.-E., (2) B.E.-D., (3) BE-K, and (4) B.E. ex Foreign Exchange Fund.

The rates of the BE-E and BE-D are to be determined in the open market by the forces of supply and demand, whereas prior to the October regulations such certificates were sold through the Central Bank. Under the old system, the importers submitted their bids to the Central Bank and once a week foreign exchange was allocated by auction. With the October measures, importers can purchase whatever they require in the open market at any time.

Exchange certificates of types (3) and (4) are to be sold by the government through the Bank Negara Indonesia (Central Bank) at rates to be determined periodically by the government. In this way, the government expects to be able to influence the rate of the BE from all sources.

Imports: Import groupings and their respective customs duties remained as before but the rate at which the duties are to be levied is increased from a rate of Rp.10 = \$1, to Rp.75. This new rate could according to the regulation be revised quarterly.

As under the old system, certain restrictions were retained on the types of goods which could be imported with foreign exchange certificates:<sup>43</sup>

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42. We are following Business News terminology.

43. The lists of the goods in the various categories are as follows: (i) Presidential Instruction Aa/D/31/1966 of February 26, 1966 in Business News, March 24, 1966; (ii)

(1) BE-E, BE-D, BE-ex Foreign Exchange Fund can be used to import goods in categories I, II and III;

(2) ADO can be used by the regional governments only for imports which are required to rehabilitate and improve the infra-structure;

(3) BE-K can be used in theory to import the same goods as in category (1), but in practice will be subject to the availability of goods in the country providing the credit.

The 1967 Budget: Although the Budget was not tabled in Parliament until November 17, we will consider the revenues side of it here because in this respect the budget is based upon the changes instituted in the October 3 measures. Moreover, because the budget is dependent on the successful implementation of those regulations, when we consider their impact on the economy we can also assess the possible effects of current trends on budgeted revenues.

Government revenues for 1967 are presented in Table I. Prior to the introduction of the budget, various members of the government had made numerous statements concerning the necessity to increase revenues from direct taxes and a tax drive was begun to ensure that such taxes were collected. References were also made to the land tax as an important source of revenue in the future. A great deal of preparation will be required before a suitable land tax can be levied, in the meantime the 1967 budget clearly adheres to the old pattern of a dependence on indirect taxes.

A balanced budget was brought down with revenues and expenditures at Rp.81,300 million. The major sources of revenues are:

1. Customs Duties	Rp.	9,063 m.
2. Sale of foreign exchange from exports	Rp.	14,230 m.
3. Sale of credits from foreign countries	Rp.	29,500 m.
4. Company tax	Rp.	6,950 m.
5. Sales tax	Rp.	7,000 m.
6. Excise on tobacco	Rp.	<u>6,075 m.</u>
	Rp.	70,868 m.

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Instruction No. 105/M/SK/1964, of April 22, 1964 cited in October 3 regulations on "Changes in the Amount of Exchange Certificate". The list is in Business News, April 27, 1964. These restrictions on the types of goods which can be imported contrast with the statement by H.W.A. that "importers seemed in practice to be free to buy what they wished", "Survey of Recent Developments," Bulletin of Indonesian Economic Studies, No. 5, October 1966, p. 7.

Table I  
Indonesia's 1967 - Budget Revenues  
(in million rupiah)

<u>Revenue</u>			
<u>I. Tax and Duties</u>			
<u>Direct Tax:</u>			
Income		1,500	
Corporation		6,950	
Property		15	
Profit		<u>1</u>	8,466
<u>Indirect Taxes:</u>			
Sales		7,000	
Stamp		300	
Transfer motorized vehicles		240	
Foreign Exchange Traffic		30	
Luxury goods		150	
Dwikora		10	
Auction		<u>20</u>	7,750
<u>Excise + Duties</u>			
<u>Import:</u>			
Foreign Exch. realization	1967	6,075	
Foreign Exch. realization	1966	783	
Surtax on Import duties	1967	1,012	
Surtax on Import duties	1966	97	
Free Foreign Exch. realization		843	
Surtax		<u>253</u>	9,063
<u>Excise:</u>			
Tobacco	1967	6,480	
Tobacco	1966	1,080	
Sugar		600	
Beer		75	
Alcohol (Kersone P.M.)		<u>52</u>	8,287
			33,566
II. Regional Development Collection*			2,000
III. Sales of Foreign Exchange from export (Group I-13,770, II-460, III-nil)			14,230
IV. Foreign Credit: (Rescheduling repayment 13,800 and new credits 15,700)			29,500
V. Other Revenues			<u>2,004</u>
		Total	81,300

Source: BN No. 1427,1429, Monitoring 17-11-66,30-11-66 and  
FEER 1-12-66: compiled by Dahlan Talib.

\* Iuran Pembangunan Daerah, the previous tax on agricultural products, see above p 87. The revenue from this tax is to be transferred to the region in which it is collected.

Revenues from the foreign trade sector amount to Rp.57,793 million, of which only the custom duties are not directly dependent on the sale of foreign exchange certificates.<sup>44</sup> The sales of such certificates from items (2), (3) and (4)<sup>45</sup> amount to \$487 million and for budgetary purposes the certificates are valued at Rp.100 = \$1. The actual value of the exchange certificates is therefore the vital factor in the budgeted revenues; if the rate falls below Rp.100 a budget deficit is possible.

### The Impact of the Regulations

#### The Role of the Regions

The October measures provided the First Level Autonomous Regions (DATI I) with 10 percent of total foreign exchange earnings in the form of an "automatic foreign exchange allocation" (ADO), under conditions explained in the last section. The export target for 1967 was estimated at \$450 million,<sup>46</sup> so the regional governments would get \$45 million at a cost of Rp.450 million. Part of this amount could be used to cover the rupiah cost, i.e., \$4.50 million at a rate of Rp.100. If they kept \$24.3 million (60%) for their own import requirements, the sale of the remainder as B.E.-D would give them a revenue of Rp.1,620 million at the rate of Rp.100 = \$1.

If we take South Sumatra (excluding Dati I Lampung) as an example, we can assess the significance of the new regulation more easily. Confining ourselves to smallholder rubber exports from the region, which average 25% of smallholder rubber, the

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44. The indirect dependence of customs duties on the sale of BE should not be overlooked, however. At the same time, it is also important to note that revenue from the tobacco excise is also affected by developments in the foreign trade sector, to the extent that imported materials are required for the production of cigarettes.
45. Of the total companies tax of Rp.6,950 million, the oil companies are expected to contribute \$50 million which are to be sold as exchange certificates (presumably ex Foreign Exchange Fund) at a rate of Rp.100 (see Business News, December 21, 1966). Incidentally, it is worth noting how small the company tax on indigenous enterprises is.
46. See Business News, September 21, 1966 and statement by Minister of Trade in a monitored Radio Republic Indonesia broadcast January 17, 1967.



value of such exports for South Sumatra in 1964 was approximately \$34.3 million. After paying the Foreign Exchange Fund Rp.343 million and recovering the cost by the sale of BE-D, the regional authorities would have \$3.087 million at its disposal. Assuming as before that the region kept 60% for its own imports, it could sell the remaining \$1.235 million for Rp.123.5 million. Antara reports that the total budget for the province is Rp.46 million, so the income from rubber alone far exceeds the rupiah made available in the budget without taking into account the foreign exchange revenue.<sup>47</sup> Apparently, there is considerable debate in South Sumatra on how to use the foreign exchange from the ADO efficiently. It is unlikely that this region, or any other, has detailed plans to cope with the new foreign exchange allocation.<sup>48</sup> The MPRS made it clear that regional planning must not be in conflict with national development, but in the absence of a national plan a calculation on this basis is out of the question. In the past, foreign exchange was controlled by the central government but it would be impossible to assert that it was allocated in accordance with rational economic principles. But the decision to give the regions greater control over their own exchange earnings may not lead to a more rational allocation of resources if the regions in their turn have no planned set of priorities. Regional sentiments may be assuaged but rationality may not be served.

The increase in exchange allocation to the regional governments was accompanied by a Presidium decision concerning the appropriate authorities delegated to regulate the export sector. In particular, all regional authorities, both civil and military, were prohibited from issuing export regulations and instructions. Furthermore, they were also ordered to refrain from collecting taxes on enterprises and agricultural products in the export sector without the permission of the central government.

The levying of taxes without the consent of the central government has been increasing over the years and levies have been imposed not only by the Dati I governments but at lower levels of regional government (civil and military) as well.<sup>49</sup>

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47. Antara, December 4, 1966. The same source reported that in the first 40 days after the October regulation South Sumatra had already been allocated \$584,000.
48. We reserve judgement on the Mokoginta plan for Sumatra (North only?) because we have not yet seen it.
49. We are assuming that the levying of such taxes has always been illegal, the central government acquiescing only because it was unable to prevent such exactions. For the lower levels of government, the trading channels have been

Some indication of the extent of the extra taxes can be seen in the report of a team sent to North Sumatra to ascertain the effects of the new regulations. Two major Dati I taxes were being levied in connection with the Mokoginta plan: (1) Rp.10 in the \$ on exports payable to the Inter-Regional Command, and (2) Rp.1 per \$ on exports for regional welfare. It was estimated that for the whole of Sumatra, with exports at \$210 million, a total of Rp.462 million could be collected. Besides that, four other regional levies were mentioned, all of which could have to be abolished under the Presidium decision. In return, Sumatra would, on the basis of the \$210 million mentioned above, get \$21 million. If 40 percent were to be sold as BE-D at Rp.100 = \$, the amount available for regional development would be Rp.796 million, three times the current levies.<sup>50</sup>

The principles underlying the present kind of export incentive are by no means new in Indonesia, and it is interesting to remember the effects of a similar instruction applied to

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the most lucrative source of revenue, adding to the "hidden costs" of trade. The implication of this analysis is that the central government has, in the past, been unable to prevent such exactions in the regions. Our research into the remilling industry in South Sumatra in 1965 indicated that certain levies imposed by the regional government were declared illegal in mid-1964. A regulation issued by the central government in September 1965 included a clause stipulating that the levies prohibited in the previous regulation were not to be collected any more--evidence that the regions had ignored the earlier request. The problem of government control over the regions is one which the new order will have to face. The re-allocation of foreign exchange earnings in the manner provided for in the October regulations may contain some inconsistencies, but it may be a step in the direction of better relations between the center and regions. In the meantime, there have been rumors that some regions are not satisfied with the new arrangements, Atjeh, for example, requesting an allocation of foreign exchange from oil. And there are reports of an increase in smuggling to Singapore. Furthermore, the article on regional levies by Dr. Emil Salim (Antara 19.1.67) seems to indicate that the October 3 prohibition on regional taxes in the export sector is not being implemented. Such developments are not encouraging.

50. This report on the Sumatra survey was given by the Director General of Development and Marketing, Department of Trade, see Business News, October 26, 1966. We are inclined to believe that the amount mentioned for Sumatra as a whole is too low, but it could be the amount for North Sumatra. On taxes collected in other areas in Sumatra see Business News, December 16, 1966.

the regions in 1957 by Prime Minister Djuanda. The provisions of the current regulations are much more favorable than those of the Export Certificate system (Bukti Ekspor--also abbreviated to BE) introduced in June 1957. A regional revolt then seemed imminent and the government brought in the new system in an attempt to avert civil war. Even so, the government refused to surrender its control over foreign exchange, offering the exporters an exchange certificate which, because the rate was to be determined in the open market, guaranteed them a rupiah income in a period of severe inflation and low exchange reserves and imports.<sup>51</sup>

Under the new system, the regional authorities not only get a foreign exchange allocation, but indirectly receive a considerable amount of rupiah also. In effect, the October instruction satisfies the MPRS Decision which requested that special attention be directed towards the financial relations between the central government and the regions (Article 33 (c)). A separate law may be enacted eventually, but it is probable that it will be similar in principle to the provisions of the present regulations, because the foreign trade sector is the most important source of wealth in the regions outside Java. But in the absence of detailed national and regional plans, it could be argued that coordination between national and regional development is jeopardised. Restricting the regional authorities as to the way in which their foreign exchange is to be used is helpful, but it can only be regarded as a provisional measure until more concrete proposals are formulated by the central and regional governments.<sup>52</sup>

#### Economic Trends Since the October Regulations

Throughout September, the rate for exchange certificates (BE-E) had fluctuated considerably, and even as late as September 22 it was Rp.128. The decline in the latter part of the month was undoubtedly due to calculations made by importers on the likely effects of Indonesia's re-entry into the UN, and her coming membership of the I.M.F. and I.B.R.D. and the Asian Development Bank. Rumors of new credits from the United States also stimulated the pressures for a lower rate. If the importer bought BE-E at high prices in September and new credits were then made available from overseas, the certainty that imports

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51. At that time, however, exports were over \$900 m. for each of the three years 1955-1957 and imports were much higher than they have been over the last three years.
52. MPRS Decision XXI on the granting of "as much autonomy as possible" to the regions (seluas-luasnja) is no less vague than Decision XXIII on this issue.

would increase considerably could result in heavy losses for those who had purchased the high-priced BE-E. There were also signs, even at this early date, that cash was scarce<sup>53</sup> and the tax drive was beginning to take its effect on the market. Those in a position to buy BE-E were often unwilling to do so for fear of being asked questions about the source of their funds by the Taxation Department. Both speculators and bona-fide businessmen were affected in this way, and some believed that whereas speculators might escape the net, the legitimate businessmen might not.<sup>54</sup>

Exports and the BE: The increase in the percentage of total exports which was to be sold on the market as exchange certificates from export proceeds (B.E.-Eksport or BE-E) to importers re-enforced the factors which were pushing the BE-E down at the end of September. While it is true that the government also announced on October 3 that credits received from foreign countries would also be sold as BE (BE-Kredit or BE-K), this could hardly have affected the market immediately because no credits were made available at the time. It was not until October 25 that the Government declared that \$48 million of credits (from Holland, Pakistan, India and West Germany) were to be released as BE-K in the near future. The Indian credits were scheduled for release on November 15 but by that time the new system was faced with stagnation in the trading sector which may be partly the result of the effects of the implementation of the regulations themselves.<sup>55</sup>

During October, the BE-E rate fell dramatically dragging other foreign exchange rates down with it including the black market rates for foreign currencies. In the first week of October, the BE-E rate fell from Rp.119 to Rp.105 and on the 11th it was below Rp.100. By the end of the month it was down to Rp.82.50. According to reports in Business News, these low rates do not tell the whole story. As the rate fell, buyers did not react favorably and even at a rate of Rp.82.50 demand was apparently sluggish.

A fall in the BE-E rate was expected, given that the amount of certificates was to be increased. Even if exports remained at the same level a fall in the rate was still most probable because of the increases in the percentages in each export group which were convertible into BE-E, and also because the

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53. See Business News, October 3, 1966, pp. 13-14.

54. Ibid., p. 16.

55. One aspect was the tight money policy of the Central Bank which was discussed by Business News in its editorial "Limits of Tight Money Policy", 19-12-66.

government was going to sell exchange from its Foreign Exchange Fund. More than that, the government itself would be able to exercise a certain degree of control over the rate because it was also prepared to buy BE-E in the open market if necessary.<sup>56</sup> In this case, the Foreign Exchange Fund would be assuming a new role: that of exercising a controlling influence on the rate.

There was a considerable amount of conjecture as to the rate at which the certificates would stabilize. In the middle of November when the government presented its budget the rate was fluctuating between Rp.85-90. Yet the government itself seemed to be confident that it could conduct its open market operations in such a way that the rate would be at least Rp.100 throughout the coming year. All the items in the budget which are affected by the rate of exchange certificate are, as we have seen calculated at the rate of Rp.100; a point of no little significance considering that over 50 percent of government revenues depend on the sale of these certificates. Moreover, since the government has announced that there will be no supplementary budget<sup>57</sup> it is difficult to avoid the conclusion that the government has committed itself to the Rp. 100 rate. Even so, as late as December 20, the management of the Bank Negara Indonesia (the Bank which is temporarily assigned the task of handling the exchange certificates), said that the Bank's policy in determining the rate of certificates to be sold from the Foreign Exchange Fund or from foreign credits would be based on the three functions of the exchange certificates, which are:

- (1) to enable exporters to eliminate the price disparity and give them a profit;
- (2) to be attractive enough to importers so that they can make a profit;
- (3) to act as a source of revenue for the government.<sup>58</sup>

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56. This point was made by Drs. Kaptin Adisumarto in the second of three articles on the new regulations in Kompas, October 7-8-10, 1966. So far, we have been unable to find other references to the effect that the government was contemplating buying as well as selling exchange certificates but, as we shall see below, this is in fact what the government did in mid-November.

57. Statement by the Sultan before Parliament on November 17, see Business News, November 18, 1966.

58. This statement was made in reply to a series of questions put to the Bank by a Business News correspondent, see B.N., No. 143a, December, 1966.

The exporters will want as high a rate as possible, while the importers will want a low rate. If only these two factors were involved, the rate would be determined by the relative strengths of the two parties. But there is also the government to consider and, having fulfilled the task required of it by MPRS Decision XXIII in producing a balanced budget, it must *a priori* sell certificates at a rate of Rp.100. We are therefore unable to understand the assessment of the situation as presented by the Bank Negara Indonesia; the government has much less room to maneuver than it assumes. If the rate falls below Rp.100, the unfavorable effects on the budget could be offset if the government were able to obtain more foreign credits than have been budgeted for.<sup>59</sup>

Through the early weeks of November, the BE-E rate remained below Rp.100. By November 11, the free market rate was Rp.81, having recovered from a low of Rp.76 on November 2. The alternate governor of the Central Bank announced on November 9 that the following week the government would begin selling BE-ex Foreign Exchange Fund "effectively." The rates announced each week since early October had been for administrative purposes only or for old contracts.<sup>60</sup> Then on November 12 the government declared that commencing on November 14 it would begin to buy BE-E and BE-D at a price of Rp.84.50 and that future rates would be determined periodically. And on the same day, the governor of the Bank Negara Indonesia said that the Bank would begin to sell Indian credits at Rp.85.<sup>61</sup> Taken

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59. But even if more credits are forthcoming, there is no guarantee that the government will be able to sell them as we shall see later.

60. Business News, November 11, 1966.

61. As we have already mentioned, the government is going to sell two types of exchange certificates: a) those originating from the Foreign Exchange Fund, and b) those coming from foreign credits. In the budget, no attempt is made to distinguish between the two, both of them being valued at the rate of Rp.100. On closer examination, however, a case can be made for treating them separately when attempting to assess the prices at which they can be sold. In theory, both the BE-ex Exchange Fund and the BE-K can be used to import the same types of goods as the BE-E. But in practice, they will be restricted in their use to those goods which are available in the country from which the foreign exchange originates or which supplies the credit (we are assuming here that the government will differentiate between the various currencies in the Exchange Fund). In the case of Indian BE-K, for example, the market for Indian goods in Indonesia is not very attractive, with the

together, these statements appear to be contradictory. If the government felt obliged to enter the market to purchase exchange certificates, it could hardly expect to be able to sell certificates for the Indian credits, particularly since the latter are less attractive than the BE-E because they are tied to the import of goods from the country supplying the credit.

We must now consider the effects of the declining BE-rate in order to understand why the government decided to enter the market as a buyer. Then we must attempt to assess the reasons for the decline.

The government decided to increase the amount of BE as an incentive to the exporter.<sup>62</sup> Under the new system, the following calculation was made by the government on export earnings by the exporter:<sup>63</sup>

50% at a rate of Rp.10 = \$1 (Transaction rate + Export Premium)	= Rp. 5.-
50% at <u>BE-E</u> rate of Rp.100 (or prevailing rate)	= <u>Rp.50.-</u>
	Rp.55.-

When the BE in group I was 20%, the exporter received only Rp. 28. In contrast to this estimated increase in the rupiah earnings per dollar, there were also signs that the costs of the exporter were increasing as well. It has been claimed that new regulations have not eliminated the price disparity, though the government hoped that they would.<sup>64</sup>

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exception of gunny bags and hessian cloth. If BE-E and BE-K are for sale at the same time, the importer will undoubtedly prefer the BE-E. On the other hand, the BE-K from Japan will be very much in demand. The certificates are not homogeneous and it is unlikely that the importer will be prepared to pay the same price for them all. If there are variations in the prices of the certificates the government's ability to balance the budget will be affected.

62. Presidium Instruction No. 21/EK/IN/11/1966, appendix, quoted in Business News, November 7, 1966, p. 9A.
63. Business News, November 11, 1966. Note that the BE is quoted at Rp.100 although it was only Rp.81 on that day. It is surely more than a mere coincidence that all the examples given by government departments use the Rp.100 rate.
64. Calculation made in Business News, November 2, 1966, (which does not seem entirely accurate), and also by the Central

Domestic inflation has continued since the beginning of October and is reflected in the local price of rubber. Moreover, since October, the spread between the official rates of exchange (as expressed in the BE rates) and the free market rates of exchange has contracted sharply. This means that in his attempt to cover the loss on export transactions, the exporter has less room to maneuver in closing the disparity.

Previous changes in the exchange rate system have usually been accompanied by a sharp increase in the price of exchange certificates. Part of the reason for the reverse trend in late 1966 has been the increase in the amount of BE-E available. But even at the low rates for the BE-E there have been relatively few buyers. Some importers may not have the cash to buy, while others may be waiting for a further decline, although this is unlikely after the government announced its decision to buy BE-E. This action to support the rate may succeed, but there is no guarantee that importers will eventually purchase the exchange from the government at prices close to the rate at which the government bought the BE.

Between January and August, the value of export licenses issued each month was within the range of \$34.9-41.4 m. (excluding the \$70 m. of May), while in the latter two months it was \$40.4 and 41.4 m. respectively. In September, only \$24.4 m. licenses were issued, partly because exporters were holding off waiting for new regulations. There was a strong upsurge in October, to \$67.3 m. but in November and December provisional data give licenses of \$12.4 m. and \$3 m. respectively. If these latter estimates are correct the export sector was experiencing real difficulties.

The BE-E rate for December fluctuated around Rp.90 and most of the time supply exceeded demand. In the first week of the New Year, it was reported that demand exceeded supply but this was probably because of the decreasing amount of exports in the last two months with a consequent decline in supply of BE-E. The Exporters' Association (GPEI) calculated that exports in 1967 would be around \$450 million, or approximately \$120 million per quarter. To earn one dollar, they say that Rp.50 of finance is required, or for three months (the turn-over period) Rp.6 billion approximately half of which is for exports from State Enterprises. About 40% of this should be obtained from their own sources and 60% from the banks at a "reasonable" rate of interest. Part of this finance should be obtained through the banking system and the rest from

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Bank. For a brief explanation of the price disparity problem, see K. D. Thomas, "Price Disparity" in Export Trade, Bulletin of Indonesian Economic Studies, No. 4, June 1966, pp. 101-102.



the unorganized money market. The bank rate of interest is currently 14 percent per month, while in the unorganized money market it is about 20%. Assuming a three month turn-over, this means that the rate on each transaction is between 42-60%, or roughly 50%. Apparently it is now difficult for exporters to earn a 50% profit, partly because the difference between the free market rate of the rupiah and the official rate received by the exporter is only 20 percent. The tight money policy is already taking effect in the export sector but the situation is more critical in the import sector.

The export and import sectors are closely interrelated in several important respects. In our discussion of the effects of the October regulations on the import sector we have therefore considered it worthwhile to include a considerable amount of background on the structure of this sector.

Imports, the BE and Rupiah Financing: Prior to the introduction of the new regulations, the links between the import sector and other sectors can be summarized as follows:

Importers:

1. private, using BE certificates, about 25% of imports;
2. State Trading Corporations and State Enterprises which import on their own account using the Foreign Exchange Fund;
3. The government and its various departments (including the Army) using the Foreign Exchange Fund.

Users of Imports:

1. private manufacturers, especially textiles;
2. State enterprises, especially the agricultural estates;
3. Producers of smallholder exports requiring equipment, raw materials;
4. Consumers of essential commodities (including those in (3) above), such as rice, textiles;
5. Government department.

Both the government and private sectors obtained their finance from the State and private banks and from the unorganized money market.<sup>65</sup> The State banks have been a major source

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65. The unorganized money market consists of all economic units operating outside the banking system. These separate units are linked together informally by groups which function as financial agents. Usually the "brokers" try to bring together these units which need credit or cash, and those which are ready to supply it on terms acceptable to both

of funds for the State Enterprises (PN) in general, and the State Trading Corporations (PNN) in particular. In 1964 and 1965, the government tended to channel credits through the State enterprises as end-users rather than directly to the Trading Corporations as in previous years (see Table II). But the manufacturing and agricultural producing units often placed indent orders with the State Trading Corporations for imports, so that in effect the PNN's were able to avail themselves of government credits. The PNN's also drew part of their finances from the unorganized market.

Table II

Government Credits Advanced to State Enterprises 1960-1965  
(millions of old rupiah)

	State Trading Corpora- tions	% of Total	Other State Enter- prises	% of Total	Sub- total	Grand Total
1960	8.255	80.77	590	5.78	8.845	10.220
1961	11.408	66.45	3.728	21.71	15.136	17.169
1962	11.034	40.01	7.131	25.93	18.165	27.508
1963	3.537	9.26	19.330	50.63	22.867	38.197
1964	6.857	7.15	40.593	42.37	47.450	95.814
1965						
January	7.178	7.61	38.723	41.03	45.901	94.369
February	8.600	7.22	61.965	52.00	70.565	119.154

Grand Total includes credits to the Food Purchasing Organization (J.U.B.M.) and to the Food Foundation (B.P.U.P.). Because of the rapid inflation during the period 1960-1965, the allocations in percentages are probably more useful for comparative purposes than the rupiah totals.

Source: Bank Indonesia.

parties. The commercial sector is therefore able to draw upon the resources of these persons, who, over the years, have been able to accumulate considerable quantities of cash, e.g., lawyers, medical doctors, brokers, high ranking government officials, managers of state enterprises and so on. The resources available from this sector are probably greater than the resources in the banking system (i.e., of private banks and the State banks, excluding the Central Bank).

Private importers financed their imports with assistance from manufacturers (on indent orders) and from the unorganized money market. Of the manufacturers, the most important are in the textile industry where the Chinese, both citizens (WNI) and non-citizens, are the most powerful. In the supply of goods to the consumer, the distribution units, especially the wholesalers, supplied part of the credit to the licensed importers in addition to the amount supplied by the unorganized money market. Although the Chinese are not eligible (legally) for import licenses, they occupy a strong position in the wholesale trade and in the unorganized money market as brokers, and as an actual source of the investable funds.

Before the war, the Dutch "Big Ten", companies which beside their interests in the import trade also owned banks, agricultural estates, manufacturing establishments and so on, occupied a key position in the internal distribution trade and in the collecting trade which handled the export products of the Indonesian smallholder. The "Big Ten" financed a large proportion of this trade and were able to draw upon the financial resources of the banks to assist them, and when they were nationalized at the end of 1958, their role was theoretically to be taken over by the newly created State Trading Corporations and the private wholesalers. Both groups helped to finance imports, and they also provided credits to the distribution and collecting trades--in the latter trades, the wholesalers and the unorganized money market were far more important than the PNN's because the State enterprises were not permitted to operate as "freely" as private traders.<sup>66</sup> The supply of local and imported goods to the smallholders, through the distribution channels, was a vital link in the chain which began with the importer and continued down into the village and the farmer as consumer, and then started with the farmer as producer of smallholder crops and ended with the exporter in the city.

The intricate network of relationships between the various units in the import and export sectors, between the import sector and end-users of imported goods (including the manufacturer, the smallholder producing export crops and the final consumer), between the import sector and the wholesale-retail trade, was and still is held together by the special financial arrangements which have evolved over the years.

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66. The risks involved in the collecting trade are considerable. The smallholders often require credit in the form of goods and the PNN's are usually not allowed to offer credit without collateral, for more details see J. Panglaykim, An Indonesian Experience: Its State Trading Corporation, Jajasan Badan Penerbit Universitas Indonesia, Djakarta 1965, Chapter III, especially pp. 53-54. These conditions have not changed since 1961.

Both the unorganized and the organized money markets are vital to the smooth flow of goods. The State Trading Corporations were able to get funds from the banking system, dominated as it was by government banks, directly or indirectly, whereas the private import sector and the wholesale trade has been successful in tapping the unorganized money market. Often, the State Trading Corporations and the private business community co-operated in various informal ways so that each could draw on the financial resources of the other. The Chinese business group has not been permitted to import on its own account but national importers have been heavily dependent on the financial resources of Chinese wholesalers and manufacturers and these latter have been well-placed to obtain finance from the unorganized money market.<sup>67</sup>

The October regulations increased the amount of imports which could be handled by the private sector through the sale of foreign exchange from exports. The amount of rupiahs required by private entrepreneurs to finance imports therefore increased considerably. A fall in the BE-E rate reduces costs but it should not be forgotten that the rate on custom duties was raised by 650%. Moreover, the government itself is going to sell its own foreign exchange as BE and also the foreign exchange from foreign credits. We must now consider whether the organized and unorganized money markets can finance such trade.

Assuming that exports for 1967 are around \$450 million, the amount of foreign currency available to the importers will be:

1. <u>BE</u> from the Exchange Fund	\$ 142.30 m.
2. <u>ADO</u> for regions \$450 m. x 10%, of which we assume the regions will sell 40% to importers	18.00 m.
3. <u>BE-E</u> of \$450 m. x 65%	292.50 m.
4. Overseas credits ( <u>BE-K</u> )	<u>295.00 m.</u>
	\$ 747.80 m.

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67. It should not be forgotten that Chinese businessmen in both Singapore and Hongkong were an important element in Indonesian trade. These outside groups not only exported goods to Indonesia and purchased Indonesian commodities, they were also an important source of credit for the Chinese merchants in Indonesia. The elimination of Singapore as a trading partner during confrontation meant that an important financial link was cut. With the ending of confrontation, Singapore as a source of finance for internal trade may be restored.

If we accept the government's figure of Rp.100 for the BE in all cases, this amounts to Rp.74.780 million. To this we must add customs duties of Rp.9,063 m., to get a total of Rp.83.843 million. With a turnover of between 2½ to 3 times per annum, the importers would have to find at least Rp.27,948 million.<sup>68</sup>

Included as importers are the State Enterprises, especially the agricultural estates. Presumably, they will use some of their BE's for their own enterprise, i.e., from the BE-E of \$292.50 million. To that extent private importers will have less rupiah to find. But compared to the finance required previously, the burden on the private sector is considerable, especially if we take into account that the private sector must also find rupiah for the export sector as well. In the export sector, finance is available in part from the banks, but for imports practically no credit is to be made available. Prior to the new regulations, the amount of rupiah required from the private importers was much less:

1. the amount of BE-E was only 25 percent of total imports;
2. the Exchange Fund rate for its exchange was much lower than the rate for the BE, whereas now it is to be close to the prevailing BE-E rate;
3. there were few foreign credits, and they were not put on the market as BE-K;
4. the customs duty was calculated at the rate of Rp.10 = \$1.

So the total amount of rupiah finance which must be provided by the private sector is much greater than before at a time when the government is also pursuing a tight money policy.<sup>69</sup>

Precise data are unavailable on the resources in the hands of the private sector, especially the unorganized money market. But even under the most favorable circumstances, it

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68. It would also be interesting to consider the relationship between turn-over, money supply, the budget and foreign trade. If the government intends to raise a revenue of Rp.81 billion, how much business should there be in the foreign trade sector to realize this amount? The total money supply at present (end December) is Rp.15 billion, and the government appears to be acting on the assumption that this Rp.15 billion (only a portion of which is available in the foreign trade sector) can generate Rp.81 billion in taxes, an average velocity of 5.3. This does not seem to be realistic under present circumstances.

69. This tight money policy seems in principle to be changed into more "selective credits" (more directed).

is doubtful whether it could generate the amount of rupiah required. The obstacles now hindering the operations of the private sector are numerous and make the task even more difficult. The indigenous importers lack organization, skills and finance apart from such enterprises as the Indonesian Service Company with its affiliates, Dasaad Concern, N. V. Rahman Tamin, P. T. Piola, Bakri Brothers, P. T. Masayu, P. T. Teknik Umum and probably some others in the regions. The Chinese group, both WNI and non-citizen, represents as we have seen the most important group in the private sector, in manufacturing and in the unorganized money market. It also has an important role in the distribution and collecting trades. The campaign against the Chinese, supposedly those with Chinese citizenship (RRT), is affecting all members of the trading community and although the government has tried to prevent the spread of anti-Chinese feelings, success has eluded it.

The Indonesian economists at their conference in Bandung recommended the implementation of Regulation 10/1959 which provided for the banning of alien traders in the rural areas. MPRS Decision XXIII called for a Law on Domestic Foreign Capital and the Sultan said that although the Foreign Investment Bill was put first because it was the more pressing issue, the cabinet was preparing a bill to deal with domestic foreign capital. Given that the government has declared that it will pursue a pragmatic approach it is expected that it will do all it can to prevent further disruption of the trading channels at this juncture.

The tax intensification drive is forcing those with cash to refrain from channeling it into the various business sectors, including imports.

It would appear from the discussion so far that the role of the State Trading Corporations could be expected to expand. But they are facing similar problems to the private groups in the importing trade. General Suharto told officials of the Bank Negara Indonesia that the State Enterprises would no longer be given special assistance by the government.<sup>70</sup> The government agricultural enterprises are fortunate in that they can profit from the sale of BE-E, but the State Trading Corporations have no such source of finance available to them. Moreover, the government's new credit policy allows 90% of credits to the productive sector, including food, clothing, transportation, exports.<sup>71</sup> The PNs are again in a more favored position than the PNNs because the government expressly prohibits credit allocations to the import sector. In particular, credits are not

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70. Business News, November 4, 1966.

71. Business News, October 28, 1966.

available for the purchase of BE.

Nor are the State Enterprises exempt from the tax intensification drive. Lists of those which had not filed their books appeared in the press in October and those which had not paid their taxes were to be given a surat paksa and instructed to pay within 48 hours.<sup>72</sup> After that time, their goods were liable to seizure and auction. Also in October, there were already reports of congestion at Tandjung Priok, imported goods piling up in the warehouses awaiting clearance. A Presidium Instruction of October 25 laid down the procedure for clearing the goods from the harbor and those which had been brought in for the PNNs and for private importers were to be sold quickly, if not they could be auctioned. Apparently the importers were not able to obtain finance to pay the customs duties at the newly imposed rate.<sup>73</sup>

In recent years, the State Trading Corporations have been obtaining credit indirectly through State Enterprises. If they are to survive this practice would have to be continued on a much larger scale because of the increased amount of foreign exchange available for imports and the increased charges. Several of the PNNs are in danger of closing down for lack of finance,<sup>74</sup> but so far the government has shown no signs of lifting the pressures on them.

State Trading Corporations have been the target for a great deal of criticism for several years. They have been charged with inefficiency and corruption, often not without reason. But they have been operating under difficult conditions. Control over the import and distribution of nine essential commodities is always open to abuse, but the temptations for corrupt practices during a period of rapid inflation and widespread shortage of goods are overwhelming. Some managers earned the opprobrium in which they were held by the public and were an easy target for criticism from political groups.

On the other hand, the corporations are executors of government policies and are part of a bureaucratic apparatus which is generally regarded as inefficient. Often the PNNs became the scapegoat for the mistakes of others. Import policy, for example, was the responsibility of other governmental agencies,

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72. Business News, October 21, 1966, pp. 5-6 and 11-12. The taxes were paid in December.

73. Business News, October 28, 1966. It was also reported that some were leaving their goods in the warehouses deliberately because trade was slack.

74. Antara, December 24, 1966.

but the Trading Corporations were often blamed for the inadequacies of supplies.<sup>75</sup> The frequent organizational changes in the companies between 1961-1965, were not conducive to efficient operations either and the existence of competing groups within the management of the corporations was always a source of conflict.

The present government has tended to down-grade the commanding role reserved at least in principle for the State Trading Corporations, and in concrete terms has placed a ban on direct credits to the import sector. In part, this is a reflection of the traditionally hostile attitude towards trade prevalent in many circles but it is also due to the past conduct of the PNNs themselves. But it is not only the PNNs which are cut off from substantial official sources of credit, the entire trading sector seems in the same position. The government may be acting on the assumption that the private sector, the PNNs and the unorganized money market has sufficient resources to finance imports at the new high level, in part a reflection of the old idea that a large part of the greatly increased money supply has found its way into the trading sector. It also seems to assume that the PNNs, if permitted to increase their prices, will be able to finance themselves without substantial credit facilities.

An attempt was made in 1963 to increase government revenues from the import sector by increasing the import rate. Foreign credits were also expected to flow in and the 1964 budget was centered around greatly increased revenues from the import sector. But stagnation was the result. The State Trading Corporations could not finance their share of imports with the result that goods began to pile up in Tandjung Priok because the companies could not pay the extra duties. Eventually the government was obliged to waive the extra charges on condition that they be paid later. This sequence of events may well occur again.

The PNNs came into existence partly because the private national sector was financially too weak to replace the Dutch in 1958. Some of the companies are efficient and all of them have gained in experience since 1958. They have become an integral part of the trading structure, having links with both the organized and unorganized money markets and operating in importing, exporting and the internal distribution and collecting trades. But their ability to tap the resources of the

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75. For a detailed analysis of the strengths and weaknesses of the PNNs see J. Panglaykim, An Indonesian Experience, Its State Trading Corporations. Our description of the role of the PNNs leans heavily on this work.



private sector is greatly reduced by the Instruction that they must advise the taxation department, if requested, from whom they receive their indent orders. The PNNs were able to resist such pressures in the past, based on an understanding reached between the respective Ministries. So they were able to continue to attract money from the public and the unorganized money market, giving them a certain degree of control over their sources of supply.

Weakening the PNNs does not necessarily open the door to the indigenous private trading group because it is still not strong financially and organizationally. And the Chinese business community is still regarded with suspicion. The government is beginning to channel goods through such new government owned companies as P.T. Berdikari, but the amount of government imports is likely to be far less than previously, given the policy of selling exchange from the Foreign Exchange Fund and from foreign credits.<sup>76</sup> The government may have to revise its attitude towards the PNNs, including its credit restrictions on trade. The Catholic Party, in a memorandum to the MPRS, recommended that the PNNs be given special facilities on condition that they improve their efficiency and give effective economic leadership.<sup>77</sup> In trade, state corporations should act to facilitate and extend overseas and domestic trade. To this end, the party advocated that State Trading Corporations, along with all State Enterprises should be guided carefully by the government.

Reports at the beginning of 1967 that both exports and imports were stagnating may induce the government to accept the type of proposals presented by the Catholic Party. It should be easier for the present leaders to change course because they have already emphasized that they will not be doctrinaire in their policies. The Indian credits which were available for purchase in November were slow to be sold, a clear indication of the seriousness of the situation in the import sector where finance is in short supply. The rate of the BE-E is now steady and there are signs that demand now exceeds supply, but this is only because the amount available of BE-E is low as a result of the low level of exports in November and December (assuming that the provisional data are correct). The partial failure of the Paris meeting of creditors was therefore not so harmful at this stage.

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76. At the present time, P.T. Berdikari works in close cooperation with the government agency Komando Logistik Nasional (Kolognas). In December both of them were coming under attack in Parliament. General Suharto denied the charges and a correspondent of Angkatan Bersendjata recommended "open management" in both institutions to satisfy the critics, see A.B., December 17, 1966.

77. "Keadaan Finek Kita Sangat Parah," June 23, 1966.

### The Road to Paris

The government was experiencing some difficulty in implementing its policy measures of October 3, but it did not lose sight of the importance of continuing its search for more foreign aid. From this standpoint, both the foreign investment bill and the decision on foreign companies "taken over" during the "physical" phase of confrontation (i.e., after September, 1963), can be seen as gestures of goodwill and proof of a rational attitude to the creditor nations, preparing to meet in Paris in December. On the other hand, from a long-term point of view both are important in their own right, especially the foreign investment bill.

The Foreign Investment Bill: MPRS Decision XXIII had requested that a foreign investment law be enacted quickly because of the scarcity of domestic capital compared with the needs of national development. This attitude, as much as any other statement on economic matters made by representatives of the new order, symbolizes the spirit of the post-coup period. The desire to attract foreign capital reverses a trend which has been a dominant theme in Indonesia's approach to economic development since President Sukarno virtually scuttled the Foreign Investment Law of the Djuanda cabinet in 1958. Although Djuanda remained an advocate of foreign investment until his death, the old government's attitude was always ambivalent.

The Petroleum and National Gas Mining Law of 1960 led to meetings in Tokyo in mid-1963 and to Government Regulation No. 18 of June 1, 1963. The new agreement with the oil companies appeared to prepare the way for new explorations,<sup>78</sup> but the severance of diplomatic relations with the new state of Malaysia in September, 1963, shattered those hopes and the relations between the government and the oil companies steadily worsened. Established British, American, Belgian and other foreign companies were "taken over" in 1964, and in 1965, while the oil companies themselves, the last bastions of foreign investment, also came under severe pressure.<sup>79</sup> On March 20, 1965 all foreign oil companies were placed under the control/supervision of the government.<sup>80</sup> Sukarno's attack on foreign capital in his "Berdikari" (self-reliance) speech of April 11, 1965, merely set the seal on what seemed to be an accomplished fact,

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78. See A. Hunter, "The Oil Industry: The 1963 Agreement and After," Bulletin of Indonesian Economic Studies, No. 2, September 1965.

79. Shell oil installations in South Sumatra were almost "taken over" in September, 1963, along with other Shell property elsewhere in Indonesia. See Hunter, Ibid., p. 31.

80. See Hunter, op.cit.

putting an end to "the problem of foreign capital in Indonesia, so that we can achieve full freedom in the economic sphere." In this same speech, the Eight Year Plan was said to be no longer appropriate to present conditions because it was too dependent on the B-Projects, the foreign exchange earners which were largely dominated by foreign capital.

Production sharing agreements kept the door ajar for foreign investment and were probably in the "non-conventional" class of investments as contrasted with the "conventional" type which were no longer regarded as suited to the new spirit of self-reliance. The general attitude towards foreign capital, however, was not conducive for the full development of production sharing projects either.

The new order adopted a much more favorable attitude towards the outside world in general, and towards the West in particular. This new approach could only partly be attributed to the government's conviction that a moratorium on foreign debts was an absolute necessity for its economic program because more than fifty percent of its debts are owed to the Soviet Union, and also more new credits are needed to enable it to tackle the short term problems.<sup>81</sup>

The government was aware that Indonesia would be competing with other countries for investment funds and there are the usual favorable conditions for repatriation of capital, a tax holiday, and so on.<sup>82</sup> Provisions are also made for joint consultation on compensation in the event of nationalization but, unlike the investment law of 1958, there is no mention of a time-limit on investment.<sup>83</sup> The sectors in which foreign investment will be permitted to operate are not stated with clarity in the bill. The government is to decide which fields are open to foreign capital and after listing the sectors which are closed to the foreigner (article 5), a clause is included which allows the government to add to that list. Detailed priorities are to be formulated by the government "each time (it) draws up its short, medium and long terms plans . . ." Moreover, in mining ventures foreign capital participation is to be based on co-operation with the Central Mining Authority

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81. The Sultan hinted at this in his statement to Parliament on presenting the Foreign Investment bill, Monitored 18-11-66.

82. For a complete text of the bill, see Business News, November 25, 1966.

83. For example, the 1958 law offered titles to agricultural estates for a maximum of 30 years (article 7). On the other hand, there was no mention of nationalization in the old law.

and will take the form of working contracts and the like.<sup>84</sup>

There is no possibility at this stage of predicting exactly in which fields foreign capital will be welcomed. It is for this reason that we emphasize that the timing of the bill is as important as its actual content. In relation to the rehabilitation and stabilization program, it is most unlikely that any new investment will be able to contribute anything substantial in the next two years. But the Indonesian delegation to Paris was able to take with it a concrete expression of the new order's good and serious intentions.

The Decision on the Return of "Taken Over" Companies: A number of foreign companies were "taken over" and placed under the control/supervision of the Indonesian government during the period of "physical" confrontation. No definite decision was made concerning their status, although it was generally believed that they would eventually be nationalized.<sup>85</sup> On December 12, a Presidium Instruction provided for the restoration of the companies "taken over" to their former owners, on condition that it would not give rise to social tensions in the firms concerned and so long as production is guaranteed.<sup>86</sup>

The foreign companies affected include manufacturing establishments such as Unilever, Naspro<sup>87</sup> and Goodyear Tire, remilling factories owned by Malaysian residents, and agricultural estates. Until they were "taken over" in 1964 and 1965, foreign estates accounted for about one half of the estate area in Indonesia and could therefore be regarded as the most important type of investment apart from the oil companies. Although the data are not available to us, it is likely that the leases on most of these estates were nearing the expiration date. If we take rubber as an example, any estate which is contemplating investment in a replanting program to ensure future production levels would require guarantees of tenure for at least 30 years. In part, the foreign investment bill<sup>88</sup>

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84. In the Tokyo Oil Agreement of 1963, the foreign oil companies became contractors to the State Oil Enterprises.

85. Almost a year elapsed between the time when the Dutch companies were "taken over" and the enactment of the nationalization law.

86. Instruksi Presidium Kabinet No. 28/U/IN/12/1966, December 12, 1966, cited in Business News, December 14, 1966.

87. Naspro was given back to the former owners during the visit of the Australian Minister of External Affairs to Djakarta, January 25-27, 1967.

88. It became law on December 24, 1966.

before Parliament fulfilled this function with its offer of compensation in the event of nationalization. Nevertheless, the reaction of each company may differ considerably, so that it is impossible to judge the impact of the government's decision on the foreign investor.

The decision came only three days before the Paris meeting began. It is therefore likely that in spite of the uncertainties surrounding its implementation, the government must have been hoping that it would create a favorable impression on the creditor nations. On December 28, when the meeting was over, the cabinet announced specific conditions pertaining to the transfer of the companies to their original owners. Most important was the requirement that restoration will only be effected where "new investment, expansion or modernization is carried out."<sup>89</sup> Then in January the government declared that the agricultural estates would not be given back. Instead, they would be purchased by the government on terms agreeable to both sides. In this, the cabinet is probably acting on the assumption that if the foreign owners returned they would be more concerned with maximizing profits from existing investments than in investing in an adequate replanting program. But it is interesting to observe the timing of the announcement on the conditions of returning the properties. The Paris meeting had come and gone, the gesture had been made, and the time was ripe for a touch of realism.

Paris and the Decision on the Foreign Debt: The creditor countries meeting in Tokyo in September had agreed "in principle" to a moratorium and rescheduling of Indonesian debts but had decided to consider the matter in detail in Paris in December. In general, however, there was an understanding that the creditors were only in a position to permit a postponement of payments for two years and that Indonesia should commence repayment installments again in 1969.<sup>90</sup> Prior to the talks in Paris, the Soviet Union had already agreed to a moratorium of Indonesia's debts but no details of the terms are available to us. But the Paris group followed the Soviet example by agreeing to a moratorium on \$357 million of the debt with a period ranging from 1971 to 1979,<sup>91</sup> a considerable improvement on the Tokyo position. On the other hand, it is believed that the Indonesian delegation went to the conference hoping for a postponement of all repayments, principal as well

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89. See The Economist, December 24-30, 1966.

90. Business News, December 12, 1966.

91. Our information on the Paris meeting is taken from The Economist, December 24-30, 1966.

as interest, until 1973.<sup>92</sup>

The results achieved at Paris therefore fell short of Indonesian expectations. No action was taken on \$600 million of the debt<sup>93</sup> and repayment on that part of the debt on which a moratorium has been declared must begin in 1971. At the same time, an interest rate of 7 percent is to be charged on the overdue payment. Another conference has been scheduled for February in Holland to discuss unsettled issues.

Indonesia's position is summed up in the statement made by Foreign Minister Adam Malik when he commented that if debt repayment must begin in 1969, the government is only able to set aside 15 percent of export earnings annually for this purpose.<sup>94</sup> Even at a rate of \$100 million a year, it would take 23 years to repay all debts incurred before the "perfected" Dwikora cabinet took office in March 1966, and new debts have been incurred since then including the \$165 million (Fl.600 million) to Holland as compensation. But if we use the Foreign Minister's calculation, annual payments of \$100 million a year would be equivalent to total export earnings of \$660 million. In 1964, the latest figure we have, exports without oil totalled \$456.8 million. If we include oil we could expect a figure of approximately \$520 million.

An austerity program formulated in 1963 by a group of foreign advisors to the Indonesian government included import requirements of around \$610 million a year.<sup>95</sup> This program made no provision for new investment projects. But if the government's rehabilitation and stabilization program is successful, it is probable that the government will want to begin new projects in a development plan. Import requirements would then be in excess of \$610 million.

Indonesia's export earning capacity is unlikely to increase sufficiently to support either the austerity program (exclusive of debt repayment) or a more ambitious development program in

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92. Business News, December 12, 1966.

93. We are using the total debt figure cited by J. Panglaykim and H. W. Arndt "Survey of Recent Developments," Bulletin of Indonesian Economic Studies, No. 4, June 1966, Table 1, p. 5 rather than the figure of \$750 million mentioned in The Economist, December 24-30, 1966.

94. Business News, December 12, 1966.

95. For a discussion of this program, see K. D. Thomas and J. Panglaykim, op.cit. This paragraph is based upon this article, including Part II, which is to be published in Bulletin No. 6 and as a booklet, Rotterdam University Press, April 1967.

the years up to 1970 at least.<sup>96</sup> The government is partially aware of its dilemma, although sometimes its officials tend to overestimate the country's export capacity over the next few years. We have already mentioned that even if the foreign investment law attracts new capital, especially in the export sector, it is unlikely to be very productive in the next four to five years. A moratorium on all debts is therefore essential and the terms of the Paris meeting fall short of what is required even for the Western portion of the debt. Moreover, if we assume that Indonesian export earnings are unlikely to exceed 600 million in the near future, more credits will be necessary for the success of any rehabilitation and stabilization program without even considering a development program.

### Conclusion

In this article, we have attempted to show that many of the principles which have been espoused in the post coup period are not new. Foreign investment is to be welcomed, private enterprise is to be permitted to operate in all fields which "do not affect the livelihood of the people," and regional governments are to be given greater opportunities to assist in the development of their respective areas. But in each case there are certain qualifications, and until the government begins to legislate in these matters we cannot be sure how the principles will be implemented.

The series of regulations issued on October 3, 1966 were the first concrete steps taken by the government in the economic sphere, apart from the institution of a tax drive and statements on a tight money policy. By the end of the year there was a general malaise in the foreign trade sector as a result of the changes brought about by the regulations. There are indications that the government expects too much from the private sector, overestimating its financial resources, while the tendency to down-grade the role of the State Trading Corporations may be premature and ill-conceived. Added to this are the problems arising from the campaign against the alien Chinese who are strong in the trading channels. Fortunately, the government has declared that it is not going to be doctrinaire in its attitude so that modifications in its policies can be expected if it is clear that the economy is not functioning properly.

Every effort is being made to persuade creditor countries

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96. The assumptions on which this statement rest are the theme of the article/booklet cited in footnote 2 above.

to offer a moratorium and re-scheduling of debts. In spite of the low earning capacity of the export sector in relation to the requirements of a rehabilitation and stabilization program, the creditor nations have adopted a very cautious approach. A careful assessment of Indonesia's position indicates that more credits are necessary if the Ampera cabinet is to succeed in its economic policies.

The Government has only been in office for six months but time is pressing if it wishes to create the stable conditions it thinks are necessary for holding elections. Much needs to be done to restore the country's economy and to provide the basis from which a development program can be launched. Political instability is still affecting the economic situation and is not conducive to efforts to improve the economic situation but a serious attempt is being made. The transition period will be difficult and we should not expect too much in the initial stages.

Canberra

January 1967