

SPOTLIGHT ON INDONESIA'S ECONOMIC SITUATION

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1. One of the main features conditioning the economic situation in Indonesia today is the protracted inflation which has been going on for years. Many of the existing problems like corruption, inefficiency, low productivity level etc. etc. can be traced back to the distortions resulting from the ever increasing inflationary pressures. Inflation increased at a rate of $\pm 50\%$ from the end of 1959 till the end of 1961, after which the rate went up to $\pm 100\%$ till the end of 1963. The rate over 1964 was $\pm 140\%$ after which it jumped considerably to some 250% over the year of 1965. Details about the absolute figures in the money supply over this period will be found in the appendix. It can be seen that from the end of 1959 till the end of 1965 (a period of six years) the money supply went up some 70 times. New money was introduced Dec. 13, 1965 at the ratio of Rp 1 (new) against Rp 1,000 (old), partly to cope with the physical problem of printing and partly because the printing costs of the bills were higher than their value, especially for the smaller denominations. Due to neglect of some technical details and the psychological reaction of the public (people who have been thinking in terms of thousands of Rp will not object very much against price increases of one or two new Rp) prices went up even faster in the weeks after the introduction of new money, especially with the increase of salaries of government officials with 400%, increases in the price of gasoline and other controlled commodities and services, and the approaching Lebaran festivals at the end of the fasting month, Christmas, New Year etc. This accounts for an increase in the money supply of some Rp 600 billion (old) from Rp 2,200 billion on Dec. 13, 1965 to Rp 2,800 billion on Jan. 27, 1966 when Coordinating Minister

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of Finance, Dr. Simarno gave a press conference on the subject. The monthly increase in the money supply pending the introduction of new money was around Rp 200 billion "only".

2. The main source of the increase in money supply over the years has been the continuous budget deficits due to a wide gap between revenue and expenditures of the government. No figures are available on the realisation of the 1965 budget, but for the year 1964 an official report mentioned a deficit of Rp 340 billion (or 117% of the revenue of Rp 290 billion over that year) as against an increase of some Rp 360 billion in the money supply. This means that the non-government sector was responsible only for Rp 20 billion of the total increase in the money supply.
3. To correct the imbalance in the budget, efforts were made to increase the inflow of government revenue by adjustments in the tax rates to the prevailing prices, introduction of new taxes and "special compulsory contributions", intensification of tax collection etc. In a survey I made some time in the middle of last year I came to fifteen of these contributions, big and small. The number has increased ever since. But with the familiar tendency towards tax evasion in severe inflationary conditions these new taxes and contributions could hardly cope with the average monthly incremental money supply of Rp 200 billion. Also, appeals for austerity etc. remain futile and lack economic sense as long as there is an ever present and ever increasing demand as a result of the increasing money in circulation.
4. There is no uniformity in the price increases from commodity to commodity and from sector to sector. Generally speaking

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increases in the price of imported commodities have been steepest although rice prices have also shown sharp increases due to the seasonal scarcity or "patjeklik", transportation bottlenecks etc. The latter factor is also responsible for rises in the price of export commodities and other locally produced goods on top of a general increase in production costs. Lagging behind these increases are the salaries of the fixed income groups especially of the government officials. The rise of 400% in their salaries after the introduction of new money has been more than neutralised by the rise in the general price level.

Price instability and the distortions in price relations resulting from the inflation were a serious handicap for production of export commodities and manufactures as well. Several branches of industry are estimated to work at levels as low as 20-30% of their normal capacity. Capital was withdrawn from manufacturing and other productive sectors to embark in speculative trade. Interest rates ranging from 10 to 15% or even 20% monthly in some cases are indeed much more attractive for the owner of capital as compared to the meagre and unsecure returns from industry, not to mention the headaches connected with the maintenance of a healthy production unit, labor problems etc. In relation to the overall picture of the economy however this logical reaction and response of the business to the general economic trend can only increase the strength of the inflationary forces. Efforts have been made by the authorities to channelize the use of private capital into productive sectors by the BAMUNAS (Consultative Body for Private Capital), but no concrete results have been booked. Main reason for this failure is that BAMUNAS which in the old set-up of the cabinet was headed by a minister, is considered to work too much as just another ministry, drawing plans to collect money from private business without giving them

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any say in the spending. As things stand at present a so-called Private Development Bank has been set up to which all private business has been set up to which all private business has to subscribe at the risk of withdrawal of their license; this bank is meant to be the sole development bank for private business and is subordinated to the Minister for the Generation of Funds and Forces in the old setup. It remains to be seen what modifications will be made in this system with the recent changes in the cabinet (among others the ministerial post for BAMBUNAS Chief has been abolished) and the obvious difference in the general atmosphere in dealing with economic problems. In this relation I would like to refer to Foreign Minister Adam Malik's statement on Monday April 4 that the foreign policy he wants to pursue is guided by the domestic needs of the nation.

6. Although relatively small (11%) in its share in the national income as compared to agriculture (55%) the export sector is considered -- and rightly so --- to have a key position in relation to the problem of economic development in Indonesia. The performance in this sector over 1965 however was not encouraging due partly to increasing discrepancies between local and world market prices as a result of the inflation, and partly also to developments in the political field. As a result of the abortive coup on Oct. 1 1965 and the changes in the monetary field for instance, there was a virtual standstill in exports by the private sector leaving export activities only to some state-owned estates and State Trading Corporations. Figures covering the first six months of 1965 mention a total of Rp 9,700 million (or US\$ 217 million at the official rate of Rp 45 per US\$), giving rise to expect a total of some US\$ 400 million at the most for the whole year as compared to the targeted US\$600 million. For the year of 1966 the government

has set a target of only US\$ 400 million. The difficulties faced by the exporter in coping with price discrepancies can best be illustrated by the prices of RSS I rubber, which cost only Rp 890 per kg by end 1964 in the local Djakarta market, dropped to Rp 655 by the end of March due to favorable expectations with the introduction of the new foreign exchange law, but after these expectations were frustrated rose again to unprecedented heights to Rp 1,525 by the end of June, Rp 1,925 by the end of September, some Rp 4,000 with the issuance of new money medio December 1965, Rp 6000 with the issuance of the new effective export rate of Rp 10,000 per US\$ and some Rp 8,250 (old) or Rp 8.25 (new) last week. In order to give an incentive for exporters to export, an export-bonus system was introduced as from February 11 1966; allowing a bonus of 10% for such products as rubber, copra, tobacco, tea, coffee, pepper, palm oil and palm kernels, sisal and tin (Group I), 15% for the export of animals/cattle, herbs and spices, cattle and animal fodder, kernels containing oils and fibres (Group II) and 50% for the export of forest products, mining products except petroleum and tin, vegetable and animal oils and fats, handicraft products, plants and flowers etc. In terms of magnitudes, Group I comprises some 90% of the total export value, Group II 8% and Group III 2%. These export bonuses cannot be sold but can be used to import a specified number of commodities for the use of production of export products and for general use on order from third parties. The effectiveness and the sense of bonuses and other inducements for exports however is conditioned by the elasticity of supply production of these commodities since otherwise they will only lead to more price increases. With the existence of transport and communications difficulties as a serious impediment to the elasticity of production and supply of export commodities it is a good sign that the policy statement by Minister Coordinator

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for Economics, Finance and Development, Sultan Hamengkubuwono IX on April 4 1966 mentioned the removal of bottlenecks in transportation as one of the first priorities in his policy.

7. Mention has been made in this survey of the policy statements on April 4 by Mr. Adam Malik on foreign policy and Sultan Hamengkubuwono of Jogjakarta on economic policy. No obvious response on these statements has been recorded in terms of changes in the rising price trend. There has been however a noticeable "wait and see" attitude among business circles, making for a halt in the earlier buying rush in the efforts to hedge against further price increases. Once the projected imports of rice and other stabilisation measures become effective however, there will be more reason for optimism in the general economic picture, granting of course that other developments in the economic field as well as outside will be conducive to further stabilisation.

APPENDIX

MONEY SUPPLY IN INDONESIA

End, of	Billion Rp	
1959	34.9	
1960	47.8	
1961	67.6	
1962	135.9	
1963	263.4	
1964	676.1	
Dec. 13, 1965	2,200	(est.)
Jan. 27, 1966	2,800	(est.)

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