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February 1965

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## INTELLIGENCE BRIEF

INFLATIONARY PRESSURES ADD TO INDONESIA'S WOES

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INFLATIONARY PRESSURES ADD TO INDONESIA'S WOES

Increasingly serious inflationary pressures are accentuating the decline in the Indonesian economy. The inflation has been marked by an upward spiral of budgetary deficits financed by new printings of rupiahs. In 1964 the deficit reached 45 percent of total budgeted expenditures. The cost-of-living index for the urban consumer went up about 90 percent, but increases in wages were minor.

In addition to difficulties of internal inflation, annual external payments obligations reaching about \$225 million have aggravated the problem of foreign exchange. Exports have not provided sufficient foreign exchange to permit imports of much-needed raw materials, capital equipment, and spare parts to maintain the economy. Proposed remedies have included the curtailment of annual imports of rice, which amount to more than \$100 million, and a moratorium on payment of foreign debt obligations. Such measures might alleviate the current drain on foreign exchange but would provide no lasting solution to the balance-of-payments problem. In fact, the adverse effect that this action would have on much-needed foreign loans and grants would add to the problem. These economic difficulties are reflected in internal political maneuvers, with the Indonesian Communist Party (PKI) seeking to focus blame on the anti-PKI elements in the Cabinet.

1. Inflation

Inflationary pressures in Indonesia have accelerated during recent months. Between September and December 1964 the free market rate for the rupiah declined from 3,100 to 8,000 rupiahs per US \$1, the lowest level in Indonesia's 14 years of independence.\* The cost-of-living index rose by about 90 percent during the past year. Although prices for rice were relatively steady for the first half of 1964, they rose by about two-thirds following Sukarno's announcement on 17 August that rice would no longer be imported and that substantial cuts in the government's program of rice distribution would be effected. In December, rice was selling at 320 rupiahs per liter in urban areas. During the past year the price of fuel more than doubled and that of textiles increased by about three times.

\* The official rate of exchange remains at 45 rupiahs to US \$1, and the rate for import-export "transactions" is 250 rupiahs to US \$1.

S-E-C-R-E-T

Salaried workers have had some wage increases, but these have been far from comparable to the increase in prices. Average wages range from 5,500 rupiahs a month for a hotel taxi driver to 14,000 rupiahs a month for a university professor. 1/

The decline in the value of the rupiah is the result of a continuing expansion of the domestic money supply to finance government budget deficits and a stagnation of industrial and agricultural production. In 1963 the budget deficit was about 61.6 billion rupiahs, with total expenditures of 155.6 billion rupiahs. 2/ For 1964 the deficit is expected to be about 250 billion rupiahs, with expenditures of 550 billion rupiahs. 3/ Proposed budget figures for 1965 show an even larger deficit, estimated at 300 billion rupiahs, because the domestic inflation necessitates even larger expenditures. Sukarno has not been willing to subordinate the Malaysian confrontation effort to the solution of economic problems, and thus there appears little prospect for a reduction in inflationary pressures. The government has begun to print 10,000-rupiah and 25,000-rupiah notes, indicating that no official devaluation is being planned. 4/

There has been no significant increase in the quantity of goods available for consumption to alleviate the inflationary pressures caused by the expansion of the money supply. Industrial output continues to decline because of shortages of raw materials and spare parts caused by stringent import restrictions. Industrial output is now estimated to be about 25 percent of capacity. There was some increase, however, in agricultural output during 1964 because of favorable weather conditions.

## 2. Foreign Exchange Problems

During the first 6 months of 1964, exports (excluding petroleum) increased to \$213 million, somewhat above the very low levels recorded in 1963. Earnings from sales of tin increased to \$12 million as a result of high world market prices and reasonably stable production. Although the total value of exports of rubber declined, the value of exports of estate rubber increased slightly. Exports of petroleum declined from \$115 million to \$97 million. Further increases in export earnings are likely to be hampered by the continuing harassment of private foreign firms in Indonesia. On 26 November all British investments other than those in the petroleum industry were placed under central government control, and US investments in the rubber industry have been subject to threats of impending takeover. 5/ Although the most important foreign investment is in the oil industry, agricultural estates operated by foreign interests make modest contributions to total agricultural exports.

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Indonesian import trade apparently has declined, but the resulting improvement in the balance of merchandise trade in 1964 cannot provide the necessary foreign exchange to cover expenditures for services and debt repayment obligations. Because Indonesia's foreign exchange reserves are already at a minimum level and further drawdowns can hardly be considered, efforts are being made to reduce external payments.

In an attempt to reduce the drain on foreign exchange reserves, President Sukarno announced on 17 August that Indonesia, having attained self-sufficiency in foodstuffs, would not sign any further contracts for the purchase of rice from abroad. Sukarno's announcement had and will have little immediate effect on imports, however, because existing contracts with major suppliers -- Burma and Thailand -- are valid through 1965. 6/ Imports of rice in recent years have been valued at about \$100 million annually and account for more than 10 percent of the Indonesian supply of rice. In conjunction with the announced program to curtail imports of rice, the government has reduced its commitment to supply rice to urban areas. Under the new plan, allocations of corn will be substituted for part of the rice rationed to government employees, and in areas with a surplus of rice cash allowances will be given for the purchase of rice on the free market. Because imports made up almost one-half of the government's annual goal for procuring 2.25 million tons of rice, 7/ the reduced ration commitments will reduce significantly the government's requirements for importing rice. Sukarno's announcement that self-sufficiency in foodstuffs has been attained, however, is far off the mark.

The rumored plan to declare a moratorium on repayment of foreign debts would be the first public admission of the severity of Indonesia's external payments difficulties. 8/ Current obligations on debt repayments amount to about \$225 million annually. Of this total, almost \$60 million is for payment on deliveries of military equipment from Communist countries. In addition, \$15 million must be paid annually to Communist countries for economic assistance credits. Payments to the US for economic assistance will amount to about \$20 million per year during 1964-70. The remaining \$130 million is owed to other countries of the Free World and to the International Monetary Fund. To date, Indonesia has not defaulted on any of its obligations to countries of the Free World. 9/ Obligations to Communist countries have not always been met fully, however, and rescheduling of payments has been agreed on by the USSR, Poland, Czechoslovakia, and Communist China in an apparent effort to assure some eventual return.

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By declaring a moratorium on debt payments, Indonesia can alleviate the current drain of foreign exchange, but this would provide no solution to the payments problem. In fact, by declaring a moratorium Indonesia would forestall prospective economic assistance, hastening the general economic decline. Because export receipts are not sufficient to meet both expenditures for imports and repayment obligations, foreign assistance is essential. Assistance from Western countries was reduced sharply following Indonesia's announced economic confrontation of Malaysia in September 1963. US aid proposals for fiscal year 1965 amount to only \$13 million, a sharp drop from the \$47 million extended in fiscal year 1964 and the \$136 million extended in fiscal year 1963. With Indonesia's withdrawal from the UN, aid contributions from UN special agencies probably will be stopped. Approximately \$44 million has been programmed for Indonesia by agencies of the UN. In addition, \$6 million has been planned but not approved for other UN-sponsored projects. <sup>10/</sup> Economic assistance from West Germany also is likely to be curtailed if Indonesia yields to East German pressures for full diplomatic recognition. In 1963, West German aid to Indonesia was \$17.5 million <sup>11/</sup> and for the first 9 months of 1964 amounted to \$7.5 million. <sup>12/</sup> Although the Communist countries are the most likely source for continued economic assistance in this time of crisis, Bloc grants of aid in past years have not noticeably eased domestic economic problems. Communist China extended a \$50 million line of credit in December. Of this loan, \$10 million was reported to be an immediate cash extension, but this amount is of only temporary significance to Indonesia's need.

Because Indonesia has essentially a peasant economy with about 80 percent of its population living in rural areas, the difficulties of the industrial and commercial sectors have not had as serious a political impact as they would in a more urbanized economy. Evidence of urban unrest is increasing, however, and the PKI and its front organizations have been attempting to focus blame for the economic problems on Third Deputy Prime Minister Chaerul Saleh and Minister of Trade Adam Malik. If these relatively moderate influences are removed from office through PKI pressure, it is probable that their portfolios would be taken over by persons who are either less responsible or who are under PKI influence or both. The result will be further Communist gains in the PKI's accelerating drive for increased political influence.

S-E-C-R-E-T

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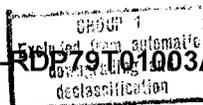
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