

August 13, 1964

CONFIDENTIAL

I N D O N E S I A

Briefing Paper

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WBG ARCHIVES

I. MEETING WITH DELEGATION

No meeting scheduled.

II. MEMBERS OF DELEGATION

Mr. Harsono, Ambassador to Japan (Governor)

Mr. Soerjono, Secretary of the Ministry of Finance (Alternate Governor)

Mr. Soerjadi, Deputy Governor, Bank Indonesia

Mr. Bambang Sentanu, Secretary to the Minister, Coordinator for
Financial Affairs

Mr. Abdullah Habir, Economic Counsellor, Indonesian Embassy, Tokyo

Mr. Moh. Barmawde Alwie, President-Director of Indonesian Development
Bank

Mr. Sumanang, Adviser, Executive Director, International Monetary Fund

III. STATE OF RELATIONS AND TOPICS FOR DISCUSSION

- (a) State of relations, including Bank/IDA lending prospects.

For some years now the Bank has had practically no contact with Indonesia because the deteriorating economic situation, highly unstable financial conditions, and default on debt owed to the Dutch Government as well as refusal to consider claims of compensation for expropriated private Dutch property left no scope for Bank/IDA operations. A year ago, it appeared that this situation might change, but these hopes have not materialized. With the exception of the question of Indonesia's financial obligations to the Netherlands on which negotiations are continuing, the situation has rapidly reverted to the previous, highly unsatisfactory position. The lack of financial stability and the almost complete absence of consistent and sound economic policies continue to bar Bank/IDA operations. Besides, there are further obstacles posed by Indonesia's policy of confrontation against Malaysia and the harassment of British properties in Indonesia.

- (b) Topics to be raised by Bank:

None: no meeting proposed.

- (c) Topics likely to be raised by delegation:

None: no meeting requested.

IV. BACKGROUND INFORMATION

- (a) Bank Loans as of July 31, 1964

None.

- (b) IDA Credits as of July 31, 1964

None.

- (c) Disbursement Problems

Not applicable.

- (d) Technical Assistance Activities

None.

- (e) 9% Capital Subscription

Total: \$19.8 million. No release due to balance of payments difficulties.

(f) Holdings of World Bank Bonds

None.

(g) I.F.C.

Membership withdrawn November 6, 1961.

(h) I.D.A.

Not a member.

(i) Access to Private Capital Markets

Not applicable.

V. POLITICAL SITUATION

In May 1964, President Sukarno joined the President of the Philippines and the Prime Minister of Malaysia in a summit conference in Tokyo that was organized as another attempt to help resolve the dispute over the formation of Malaysia. The conference collapsed over Indonesian insistence that military confrontation should be allowed to continue even while a four-country conciliation commission was at work.

The collapse of the Tokyo meeting was not only a severe blow to those who had argued that Indonesia, despite its belligerent posture, would be receptive to any suggestion of a face-saving way out of its position. It appears also that it marked the victory of the more irresponsible elements in Indonesia that have gathered around Dr. Subandrio, the Foreign Minister. The losers seem to be the forces around Mr. Chaerul Saleh, the Minister of Basic Industries and Mining, who favored a settlement in Tokyo, even a temporary one, in order to give Indonesia time to attend to its urgent economic problems. The losers may also include President Sukarno, who, together with the army, is believed to have wanted a breathing space during which the military effort against Malaysia could be organized.

Earlier in the year, Dr. Subandrio had already won his struggle against General Nasution, the Defense Minister, and Dr. Abduljani, the Information Minister, who were removed from their important positions as chairman and deputy chairman of a committee set up to reorganize Government administration. Dr. Subandrio also seems to be enjoying the support of the strong Communist Party which has recently begun to toe the Peking line and has come out strongly in favor of crushing Malaysia.

It is as yet unclear what these developments might mean for the internal balance of political forces which President Sukarno has been able to maintain so far by adroitly playing off the army against the Communist Party, the only two large organized forces in the country. However, it seems clear that, for the time being, foreign policy issues have regained their dominant position in the Indonesian political scene and that domestic problems, including the economic situation, will run a poor second.

On the positive side, the rapprochement with the Netherlands appears to continue. The Dutch Government has recently undertaken to guarantee commercial credit to Indonesia totalling about \$28 million. There has also been a considerable increase in business activity, including joint ventures with Indonesian enterprises, and Dutch banks have recently negotiated a six-month credit of \$7 million without the guarantee of the Dutch Government. Further decisions depend on the still unscheduled visits of the Dutch economic and finance ministers, whose main topic for discussion will reportedly be the issue of compensation for expropriated Dutch property in Indonesia.

VI. ECONOMIC SITUATION

(a) Total population: about 100 million

GNP per capita: approximately \$50-60 equivalent

(b) After years of stagnating output, rampant inflation, and successive foreign exchange crises, there was a brief period around the middle of 1963 when relief appeared in sight and the restoration of a sound economy seemed a real possibility. In May 1963, the Government announced a stabilization program. This program was established in connection with a stand-by agreement with the IMF which enabled the Government to draw up to \$50 million from the Fund over a twelve-month period (following earlier drawings of the gold and first credit tranches of \$41.3 million each in 1961 and 1962), provided certain conditions were met. Apart from measures which the Government had to take in order to reduce the budget deficit, to increase domestic production and to stimulate export earnings, vital parts of the program were a moratorium of service payments on part of the foreign debt (\$1.6 billion, excluding disputed debt to the Dutch Government and claims of compensation for expropriation) and additional foreign assistance of about \$260 million. Under DAC auspices, a consortium was to be formed for providing such aid, and preliminary discussions were held in July 1963. These hopes were shattered abruptly when Indonesia began its policy of confrontation against Malaysia. The DAC consortium was never formed. In September 1963 the IMF notified the Indonesian Government that drawings beyond the first \$20 million in August were suspended because the conditions of the stand-by agreement were not being met.

In the absence of large-scale aid and with the resumption of military action against Malaysia, there has been a renewal of severe financial instability. In March 1964, money supply was 65-70% higher than in May 1963. During the same period, net domestic assets of Bank Indonesia increased by Rp. 114 billion, while under the stand-by agreement a rise of Rp. 21 billion was permitted in the twelve month period beginning June 1, 1963. This increase was almost entirely the result of a huge Government cash deficit of Rp. 105 billion, instead of the Rp. 9 billion agreed with the IMF. Prices once again soared. In 1963, the cost of living index jumped by 119%. There were further severe increases early in 1964, but food prices declined thereafter as the new rice crop was being harvested.

Exports continued in 1963 at the low 1962 level (around \$700 million) because production stagnated and export shipments were hampered by the loss of Singapore's facilities that resulted from the break of relations. This loss is only slowly being overcome by the conclusion of direct trade agreements, particularly with Eastern-bloc countries and the Netherlands. However, severe restrictions on imports apparently prevented a further loss of exchange reserves in 1963. Gross reserves remained at \$60 million, equivalent to just more than one month's imports. In recent months, foreign exchange receipts have increased somewhat. It is believed that this improvement largely reflects the stimulating effect on exports of changes in the exchange system which were made in January 1964.

In this general context of a deteriorating economic and financial situation and of the difficult and uncertain position of British enterprises in Indonesia, it is interesting to note that foreign investors continue to be attracted by Indonesia's rich natural resources. Following agreement of the foreign oil companies with the Government on a profit-sharing arrangement, investors from the Netherlands, Germany, and some Eastern-bloc countries concluded agreements on joint ventures under a new program initiated last year by the Indonesian Government. Most of these ventures are small, but the fact that such investments are being made shows that Indonesia has remained attractive despite generally adverse circumstances, and underscores the possibilities that would exist if the Government were to improve its economic and financial policies.