

## OFFICE MEMORANDUM

TO: Files

DATE: February 25, 1964

FROM: Maung Maung Hla *MM*SUBJECT: INDONESIA - Review of Recent Economic Developments

1. On the basis of data published by the Central Bureau of Statistics (see Table 1 in the Annex) estate production of the principle crops in 1963 showed a general decline except sugar and a few minor crops. The International Rubber Study Group reported that rubber production (including that of small holders) totalled 620,000 tons in 1963 compared with 668,000 tons in 1962 - a decline of about 7%. The rice crop for 1963/64 was estimated at around 7.5 million tons, about 10% less than in previous year. The fall in production was reported to be due to droughts and pests which necessitated imports of around 1.06 million tons in 1963 (valued at \$110 million or 16% of 1962 exports.) Rice imports averaged 730,000 tons during 1958-61. To make up for the current deficit and the increase in population, Indonesia would probably need to import about 1.5 million tons of rice in 1964. In view of the acute shortage of foreign exchange and the recent firmness in the international market for rice it is doubtful whether Indonesia could import the quantity she needs in the world market. (Recent news reports indicate widespread shortage of rice and famine conditions in Central Java.)

2. In 1962, crude oil production rose by 7% to 22.7 million tons. A further increase of 8% was estimated for 1963. After protracted negotiations an agreement with the foreign oil companies - Caltex, Standard Oil and Shell Indonesia - was finally reached in June 1963. Under this agreement, the three oil companies will be permitted to continue their oil production activities, not as concessionaries, but under 20-year contracts providing for 60% profits to the State and 40% to be retained by the companies.

3. No information is available on the level and composition of industrial production in 1963. However, industrial production also must have declined considerably, considering that some industries had to operate well below capacity - sometimes as low as 20% of capacity - owing to obsolete equipment, lack of spare parts and raw materials, inadequate transportation facilities, price controls and rising labor costs.

Recent Financial Developments

4. The stabilization program adopted in May 1963 resulted in a brief period of improvement in the financial situation in June-August, but it soon deteriorated again when the amount of foreign aid assumed in the Program did not materialize. The shortfall in planned foreign aid

contributed mainly to a shortfall in Government receipts resulting in a large cash deficit and borrowings from the Bank Indonesia, which exceeded the ceiling stipulated in the standby agreement between the Fund and Indonesia. The Government cash deficit for the period May 29 - October 23, 1963 was Rp. 50 billion, while the permissible cash deficit under the ceiling was, for the period May 29 - November 1, 1963 Rp. 9 billion. Between May 1963 and January 1964, money supply increased by 65% to about Rp. 270 billion. For 1963 as a whole, money supply increased by 97% compared with 92% in 1962. As a result of exceeding the stipulated credit ceiling, further drawings on the Fund under the standby agreement were suspended in September 1963.<sup>1/</sup> (It is estimated that Indonesia can now count on \$166 million of foreign aid instead of the \$411 million, inclusive of \$100 million of debt postponement, required for the period covered by the standby agreement.)

5. On September 23, 1963 Indonesia declared its intention to sever economic relations with Malaysia, and adopted a policy of "confrontation" against Malaysia. This policy has led to a sharp deterioration of the Indonesian economy, characterized by run away inflation resulting mainly from increased budget expenditures and reduced foreign trade and aid.

#### Impact on Foreign Trade

6. Malaysia was Indonesia's largest market and provided vital entrepot trade, processing, financial and transportation facilities for Indonesian products. About one-third of Indonesia's exports normally go to Malaya and Singapore. More than half of Indonesia's small holders' rubber exports were traditionally processed in Singapore and most of its tin was smelted in Penang. During 1960-62, total exports to Singapore averaged M\$910 million (US\$300 million) of which more than half consists of rubber. (See Table 2).

7. The immediate impact of the confrontation policy was felt on Indonesian exports. The value of export contracts (excluding oil products, tin and bauxite) fell from a monthly average of \$70 million in June - September 1963 to \$26 million in October-November - a drop of 63%. For 1963 as a whole, total exports were down to about \$600 million as compared with the average of \$830 million during 1958-60.

8. Indonesia is now frantically making attempts to divert her exports to other destinations. Among others, she has taken the following principle steps: (a) decided to smelt its tin ore in Arnhem, Netherlands; (b) reached agreements to sell more rubber to USSR, Czechoslovakia, Poland, China and others; (c) signed an economic agreement with the Philippines, aimed at shifting Indonesia's trade there; (d) sent a number of trade missions to European countries; (e) declared Sabang (northern tip of Sumatra) a free port and, (f) decided to renew economic relations with the Netherlands by signing commercial agreements with a number industrial and

<sup>1/</sup>In previous years Indonesia had drawn amounts totalling \$82.5 million against its subscription quota of \$165 million in the Fund. The standby agreement of May 1963 provides for drawings up to \$50 million, out of which \$20 million had been drawn.

shipping firms; a recent payments agreement between the Netherlands Bank and Bank Indonesia provides for resumption of credit arrangements between the two countries.

9. It is doubtful whether Indonesia will be able to switch her trade to other countries because of a number of technical difficulties, among which trade connections, storing facilities and shipping are significant.

#### Effect on Prices

10. The foodstuff price index for Djakarta increased by 55% between May and December 1963, practically the whole increase took place after August. For 1963 as a whole, the food index increased by 146% and the cost of living by 141%. (The unofficial market rate of the Rupiah depreciated from Rp. 900 per US\$ in July 1963 to Rp. 1,450 in December 1963; the Rupiah was devalued from Rp. 45 to 1US\$ to Rp. 315 per 1US\$ in May 1963.)

#### Effect on Foreign Exchange Reserves

11. Gross reserves held by Bank Indonesia declined by \$38 million between May 29 and September 11, 1963 and stood at about \$60 million on the latter date. (Equivalent to about a month's imports at the 1962 import level.) We have no information on net foreign exchange reserves which in all probability would be negative.

#### Foreign Aid

12. The amount of aid offered by Soviet bloc countries and China and the amount expended up to June 1963 is summarized below:

#### Use of Foreign Credits (up to June 1963) (in thousands of US\$)

	<u>Amount of Economic Credit offered</u>	<u>Amount Expended</u>	<u>Balance Unutilized</u>
USSR	367,500	38,000	329,500
Czechoslovakia	60,075	18,622	41,453
Poland	74,000	39,130	34,870
Rumania	50,000	-	50,000
Hungary	28,000	-	28,000
Yugoslavia	25,000	7,250	17,750
Bulgaria	5,600	-	5,600
China	<u>42,000</u>	<u>12,000</u>	<u>30,000</u>
Total	652,175	115,002	537,173

(Source: British Chamber of Commerce Weekly, June 20, 1963)

13. In addition to the above aid program, which is probably tied to specific projects and not available for balance of payments purposes, the US, under PL 480, had committed a total of US\$314 million during 1956-64. In September 1963, the US suspended its aid to Indonesia except PL 480 commitments of about \$78 million. No information is available concerning the status of the loans promised in August 1963 by France (\$10 million), Germany (\$4 million) and Japan (\$12 million) and of the negotiations for debt postponement, except for the agreement concerning the postponement of \$38 million of debts to non-members of the Fund and for \$30 million of short term loans which are expected to be rolled over.

14. To summarize: the suspension of trade relations with Malaysia and lower production of the main export commodities have caused sharp reductions in Indonesian exports. Considering the low level of exchange reserves and poor prospects for foreign aid, further cuts in imports will be necessary. Given the reduction in imports and reportedly poor paddy crop and running down of stocks on the one hand, and substantial increases in the Government cash deficit and money supply on the other, the task of stabilizing the Indonesian economy would be several times greater than it appeared possible in May 1963. There is no indication so far, in terms of Government political and economic policy, to ensure that the deteriorating economic situation will be checked in the near future.

cc: Messrs. Cargill, Lejeune, Gilmartin/Edelman, Sagne/Gibbs/Blobel

Table IEstate Production of Principle Crops  
(in metric tons)

	<u>1960</u>	<u>1961</u>	<u>1962</u> <u>Jan./August</u>	<u>1963</u> <u>Jan./August</u>
Rubber	216,772	229,341	140,716	137,030
Tea	46,141	43,139	30,124	25,691
Coffee	17,612	18,579	6,586	12,693
Cocoa	1,016	878	386	452
Palm oil	140,754	145,780	86,445	89,064
Palm kernals	33,029	34,365	20,120	19,550
Hard fibres	20,005	16,814	6,203	3,127
Sugar	675,961	642,351	514,710	572,485

Source: Central Bureau of Statistics

Table 2

Singapore - Indonesian Trade  
(M\$ million)

	<u>1960</u>	<u>1961</u>	<u>1962</u>
<u>Indonesian Imports</u>			
Oil products	19	51	70
Textiles	20	36	40
Rice	20	19	31
Road vehicles	6	6	25
Others	<u>56</u>	<u>83</u>	<u>126</u>
	121	195	292
	—	—	—
<u>Indonesian Exports</u>			
Rubber	556	408	461
Oil products	242	218	201
Coffee	33	32	28
Copra	50	33	22
Pepper	29	42	15
Others	<u>89</u>	<u>196</u>	<u>77</u>
Total	999	929	804
	—	—	—

Source: Chief Statistician, Singapore.

N.B. M\$3.06 = US\$1

Table 3

Export Contracts (excluding petroleum, tin and bauxite)  
(million of rupiahs)

	<u>1963</u>
January	1,684.9
February	1,107.6
March	2,269.2
April	1,078.1
May	1,921.9
June	3,495.5
July	3,392.0
August	2,820.8
September	3,375.0
October	702.2
November	1,344.7
December	1,282.2

Source: British Chamber of Commerce Weekly Reports.

Note: Calculated at Rp. 45 = 1US\$

Table 4

Djakarta: Weighted Indices of Retail Prices  
of 19 Foodstuffs  
(1953=100)

December	1960	388
December	1961	760
December	1962	1,897
January	1963	2,319
February	"	2,543
March	"	2,682
April	"	2,700
May	"	3,010
June	"	3,096
July	"	3,041
August	"	3,133
September	"	3,569
October	"	3,786
November	"	4,617
December	"	4,674

Rice Prices in Djakarta  
(in Rps. per litre)  
Quality: Krawang BA NOI

End Period

August	1963	65.00
September	"	83.75
October	"	88.75
November	(mid)	136.25
December		162.50

Source: British Chamber of Commerce Weekly Reports.