(Ind - Ntgs + Corr)
✓ Ind - Indebt
orig - gen nego w/ attachment

Mr. J. Burke Knapp (through Mr. B. B. King) October 20, 1967

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INDONESIA - Investment Conference of November 2, 1967

The material distributed by the sponsors of the Conference looks to me very useful and covers a good deal of ground. Mr. McDiarmid's memorandum of August 24, 1967, sums up the general position of the economy, recent events, the stabilization program, and the debt position.

I attach a note on the history of Bank relations with Indonesia. For use as reference I also prepared some further notes on Debt Rescheduling and New Aid, and some explanatory remarks about the Exchange Rate System.

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Bank Relations with Indonesia

The Bank has made no loan to Indonesia, and there is no prospect for Indonesia to become eligible for Bank lending in the near future, because of her external indebtedness.

Indonesia joined the Bank in April 1954 and IFC in December 1956. The first Bank economic mission visited Indonesia in 1955. It concluded that economic performance was not encouraging. The economy grew at 1½-2% per annum. Investment was 5% of GNP. The infrastructure was highly inadequate, skills and administrative capacity were low, and imports were declining. Foreign debt was only about $300 million in 1956, and debt service was 4-5% of export earnings. The report concluded that substantial outside capital was required to achieve a satisfactory rate of growth.

Subsequent changes in government, failure to prepare suitable projects, and a number of short-lived stabilization programs, implying the cutting down of public investment programs, were factors which made it difficult for the Bank to envisage a lending program. Another difficulty was the issue of Indonesia's earlier repudiation of debt to the Netherlands, which could not satisfactorily be discussed.

Prospects of economic performance as a condition for lending further deteriorated from 1958 onwards after the final expulsion of the Dutch over the West Irian controversy, and the outbreak of rebellion in Sumatra. Indonesia entered a period of virtually no economic growth and declining income per head.

Two earlier initiatives for possible Bank/IFC assistance were finally put aside. One was a multipurpose dam at Djatiluhur in Java, a project which had been proposed in 1959 but never reached the stage of appraisal, and the other was a request for technical assistance in the establishment of a development bank, made in 1960, which was abandoned for lack of information. The bank was subsequently established without technical assistance.

Indonesia withdrew from membership of IFC already in 1961, and from the Bank in August 1965. This was the time of the Confrontation with Malaysia, and of withdrawal from the United Nations.

The period of separation from the Bank lasted less than 2 years. Indonesia became a member again in April 1967. Prior to that, the Bank in November last year had sent a mission to Indonesia to assist the government in evaluating import requirements for 1967. At the same time Indonesia received technical assistance from the IMF in setting up a stabilization program.

An economic reconnaissance mission visited Indonesia in July this year, in preparation of a larger economic mission which is presently in the field. Its task, besides evaluating the economy as a whole, sector by sector, is to set up guidelines for the resumption of investment activities in the public sector, specifically for the rehabilitation of the country's economic infrastructure.

Discussions have been resumed with IFC on the possibility of assistance to Indonesia's development bank, but they are at a very early stage. Similarly, the possibility of the Bank's executing a transportation survey is being explored. While no Bank lending to Indonesia is presently envisaged, there is little doubt, if the present stabilization program is successfully implemented and a reasonable policy for economic development initiated in the near future, that Indonesia will be eligible for future IDA assistance.

Rescheduling of Debt and Provision of New Aid

Several meetings have been held among Western creditors and Japan to reschedule Indonesia's current payment obligations, under the chairmanship of the IMF. Other meetings have been held by the Intergovernmental group sponsored by the Dutch Government to provide new financial assistance. Both groups have taken a year-to-year approach and have only dealt with 1967 in the first round. Presently, however, meetings are held to deal with 1968. Membership in both groups is the same except that the Bank participates only in discussions of the Intergovernmental Aid group since it is not directly concerned with debt rescheduling.

Amortization and interest payments which were due in 1967 and were rescheduled amounted to $728 million, including arrears. The principle adopted was to relieve Indonesia from interest and amortization payments on credit of more than 180 days, to introduce a 4 year grace period for rescheduled amounts, and to spread repayments over 8 years starting 1971. Bilateral agreements were concluded by each creditor, namely France, Germany, Italy, Japan, the Netherlands, the U.K. and the U.S. An agreement was also concluded with the Soviet Union on similar lines.

Payments due in 1968 and agreed on the part of the Western creditors to be rescheduled at the October 15 meeting, amounted to $179 million, equivalent to one third of export earnings. If new borrowing in future were not more than $200 million a year on moderate terms (3% interest, 25 years, 7 years grace) debt service would still rise up to $400 million by 1978. This would mean a net outflow of official capital from Indonesia throughout the next ten years by an average $65 million a year. It is obvious that such a prospect would not make for great hopes for economic development in Indonesia. Rescheduling of service payments on all old debt is therefore envisaged for at least another 2 years.

New external assistance pledged for 1967 at the Scheveningen meeting earlier this year is composed as follows (in million US$).

West Germany	29.0
India	8.0
Netherlands	33.3
United States	65.0
United Kingdom	1.4
Japan	60.0
Others	3.0
Total	199.7

The amount of $200 million is adequate this year to keep the economy from sagging while the stabilization program is carried out and all major investment activities are suspended. The next step will have to be a modest resumption of investment. To make this possible, aid requirements in 1968 will be larger than in 1967.

Exchange Rate System

Indonesia has two floating exchange rates. With galloping inflation gradually being brought under control, rate movements have been relatively moderate this year. The principal rate (BE) moved from about Rp. 100 in January to about Rp. 150 at the end of September.

The BE (Bonus Export) rate now applies to all merchandise exports and to the majority of non-luxury imports. Its name originates from the time when only a fraction of export earnings could be sold in a free exchange market. The remainder had to be surrendered at a fixed rate. In several steps the Bonus percentages, as well as the Bonus import list, were expanded, and in July 1967 the surrendered part of export earnings was made a tax, presently equivalent to 22% of aggregate earnings.

A subsidiary rate called DP (supplementary exchange) formerly applied to export earnings realized in excess of government-determined "check prices" for exports, and to invisible earnings. Today it applies only to invisible earnings, but on the import side it applies to all items not on the BE list. The DP rate is also a floating rate, quoting at Rp. 165 in September. (Besides these 2 rates there is also a black market rate, slightly above the DP rate.)

The BE import list has served as a vehicle for the utilization of foreign aid in the absence of possibilities for project financing. The rate at which importers can purchase aid funds is however set by the government. In order to speed up the utilization of aid, this rate recently has been kept lower than the general BE rate. In September the Aid-BE rate was about Rp. 130.

The most important aspect of the October 1966 exchange rate reform, besides the increase in the retention rates for export proceeds, was the virtual elimination of a preferential import rate for government imports. This made foreign exchange 9 times more expensive and specially affected manufacturing industry, much of which is government owned.

The most recent measure in the exchange rate field was a further reduction in government claims on export proceeds in July 1967. The resulting revenue loss was made up by increased surcharges on non-essential imports. We feel that these measures went in the right direction.

BASIC DATA OF INDONESIA

(provisional)

Area (in square miles)

and Density of Population (per square mile in 1966)

	Area	Density
Java and Madura	51,032	1,390
Sumatra	182,859	98
Kalimantan	208,286	22
Sulawesi	72,986	110
Other Islands 1/	220,218	36
Total	735,381	150

1/ incl. West Irian

Population (1966 estimate) 110 million
rate of growth 1960-1966 2.4% per annum

Net National Product (at constant 1966 market prices, converted at predominant 1960 exchange rate)

	1960	1966
	$8.8 billion	$9.9 billion

rate of growth 2.0% per annum

(Note: The values of National Product are somewhat questionable, particularly if converted into dollars at the old rate. The above would give per capita income of about $90 against a general belief that it is close to $110.)

Net Domestic Product by Origin, 1966 (in percent)

	%
Agriculture	52
Mining	3
Manufacturing	9
Construction	2
Transport/Communication	3
Trade	17
Other services	14

Use of National Resources (in percent of Net National Product)

	1963	1966
Gross investment	5.6	6.3
Gross savings	2.8	4.8
Balance of payments current account deficit	2.0	2.5
Investment income payments	0.8	1.0
Central Government tax receipts (excl. oil)	1.3	1.4

Money and Credit:

Exchange rates: July 1967

BE 1$ = 135 Rupiahs
DP 1$ = 150 Rupiahs
Curb rate 1$ = 165 Rupiahs

	1963	1964	1965	1966	1967 2/
Total money supply 1/	263	675	2,582	21,024	33,156
Rate of increase	157	283	714	58 3/	
Current deposits	88	222	615	5,304	8,289
Rate of increase	152	177	762	56 3/	
Rate of change in prices (Djakarta consumers index)	130	594	635	40 3/	

1/ End of December
2/ End of June
3/ Half year

External Debt:

Total external debt	$2.3 billion
Total debt service 1968 prior to second rescheduling	$185 million
Debt service ratio 1968	31 percent 1/

1/ Remaining above 30% for next 10 years.

Balance of Payments ($ million):

	1966	1967 Forecast
Total merchandise exports	543	571
of which: foreign oil companies, net	(53)	(60)
Total merchandise imports	- 565	- 645
Invisibles, net	- 130	- 157
Current account balance	- 152	- 231

	1966
Commodity concentration of exports (rubber)	39%

	March 1967
Net foreign exchange reserves	minus $77 million