National
Foreign
Assessment
Center

Secret

25X1

East Asian Journal

25X1

2 December 1981

Secret

EA EAJ 81-023
2 December 1981

Copy 249

25X1

Page Denied

[redacted]

25X1

East Asian Journal

25X1

2 December 1981

[redacted]

25X1

[redacted]

25X1

Approved For Release 2008/09/03 : CIA-RDP03T02547R000100020001-9

Approved For Release 2008/09/03 : CIA-RDP03T02547R000100020001-9

25X1

Page Denied

Next 5 Page(s) In Document Denied

Indonesia: Economic Options and Constraints in the 1980s

25X1

President Soeharto's strategies for reducing poverty, creating jobs, and promoting more even distribution of income are increasingly limited:

- With half of Indonesia's 154 million people under 16 years of age, labor force growth throughout the 1980s will reach unprecedented levels.

- Oil exports, the foundation of Indonesia's development drive, could drop by half in the 1980s, as rapidly rising domestic consumption bumps up against a stagnating production ceiling of 1.6 million b/d.

Keeping a lid on rising social and economic tensions on Java, the archipelago's most populous island, will be enormously complicated.

Soeharto's development strategy grafts populist measures—such as subsidies on food and petroleum products and quotas on exports to assure domestic supplies of consumer items—onto a capital-intensive industrial development program. This will aid his drive for a decisive popular mandate in parliamentary elections next May, but rapid labor force growth and reduced oil exports make it an unsuitable long-term strategy. If Soeharto takes the advice of his Western-educated technocrats, he will shift to more market-oriented policies after the presidential election in 1983. If he does not, only another substantial OPEC price increase will spare Indonesia a severe balance-of-payments squeeze that would drastically limit Jakarta's ability to remedy social grievances. As Java's cities become more crowded and job creation lags, racial riots and other urban violence could take on increasingly antigovernment overtones

25X1

Economic Policy in the 1970s

The quadrupling of OPEC oil prices in 1973-74 and the near tripling in 1979 provided Indonesia two revenue windfalls. Although the Pertamina oil scandal in 1975 dissipated much of the first windfall, the second has been spent on rural infrastructure and capital-intensive industrial projects, as well as on consumer and farm subsidies. Subsidizing domestic fuel prices rather than passing OPEC price hikes on to consumers, however, has increased budget outlays and slowed the buildup of foreign exchange reserves. Worse, artificially low domestic energy prices have promoted 12- to 14-percent annual growth in oil consumption since 1970.

25X1

Indonesia: Domestic Oil Product Prices — US Dollars Per Gallon

	1979	1980-81 [a]
Premium gasoline	0.85	1.33
Regular gasoline	0.61	0.91
Kerosene	0.15	0.23
Diesel (automotive)	0.21	0.32
Diesel (industrial)	0.18	0.27
Fuel oil	0.18	0.27

[a] Effective May 1980.

25X1

25X1

Nonetheless, cheap energy and oil export revenues helped the economy record 7.4-percent annual growth during the 1970s. Import substitution spurred even faster expansion in manufacturing, as the economy developed large textile, electrical appliance, and motor vehicle assembly industries. Outright bans on imports of products such as television sets and lightbulbs have protected markets for domestic producers, but have also promoted inefficiency and corruption, which have increased manufacturing costs and weakened Indonesia's international competitiveness. By 1980 manufactures still comprised less than 5 percent of Indonesia's exports despite the lowest manufacturing wages in Asia.

25X1

Continuing Social Strains

Notwithstanding the oil revenue windfall of the 1970s, Indonesia remains poor. Each $1 billion advance in export revenues raised per capita income by a mere $7. It now stands at $420, about three-fourths that of Egypt.

25X1

25X1

Oil revenues, moreover, have produced social strains even though Soeharto's long-term economic objectives—to reduce poverty, promote employment, and share income more evenly—are aimed at promoting social stability. The World Bank estimates that income inequality worsened in the 1970s despite Jakarta's attempts to transfer wealth from foreigners and the relatively prosperous Chinese minority to ethnic Indonesians. One study found that the poorest 10 percent of the population shared only 1 percent of the decade's advance in income, while the wealthiest 10 percent enjoyed nearly half. Living standards in the countryside grew only half as rapidly as those in urban areas. Only large and rapidly growing remittances from migrants at work in the cities to family members remaining in the countryside prevented this disparity from growing even worse.

Competing Views on Development Strategy

The mostly US-educated technocrats are Soeharto's preeminent economic advisers and head key economic ministries. Even so, they compete for influence with top political advisers who favor strong central control of the economy and influential groups outside the government that advocate social welfare and equity programs.

Within the government, Planning Minister Widjojo Nitisastro and Finance Minister Ali Wardhana lead the technocrats advocating market-oriented approaches to development. Since they began advising Soeharto in 1966, the technocrats have alienated populists by subordinating rising demands for equity to the need for economic efficiency.

Outside of the government, several privately sponsored research institutes support a populist approach to development policy. This case is probably best articulated by Muslim activist groups, who advocate rural development as an alternative to industrialization and large-scale foreign investment. Intellectuals at Gajah Mada University, one of the country's leading academic institutions, are equally vehement in arguing the case for agriculturally based development from the bottom up and are probably most attuned to conditions in the countryside.

25X1

25X1

The World Bank remains the primary outside advocate of a market-oriented development strategy and economic diversification. Its April 1981 report called for a restructuring of the economy, warning that liberalization of trade policy and an overhaul of Indonesia's often prohibitive foreign investment regulations are required to avert both a sharp slowdown in growth and serious balance-of-payments problems in the medium term. Jakarta is resistant to such suggestions in the present preelection climate and squelched the scheduled May 1981 publication of an even more critical Bank report that censured Jakarta's industrial and trade policies. More recently, Jakarta signaled its unwillingness to substantially simplify the complex investment code by issuing a written rebuttal to complaints voiced by a visiting team of potential British investors.

25X1

25X1

25X1

25X1

25X1

25X1

[1] Some 60 percent of the household income of rural migrants is derived from remittances.

Indonesia: Public Finance

Billion Rupiah Per Fiscal Year [a]

	1975-76	1976-77	1977-78	1978-79	1979-80	1980-81	1981-82 [c]
Revenues	**2,201**	**2,877**	**3,508**	**4,266**	**6,697**	**9,055**	**12,274**
Of which:							
Oil taxes	1,205	1,593	1,947	2,309	4,260	6,430	8,575
Trade taxes	310	421	483	587	843	829	1,142
Expenditures	**2,672**	**3,654**	**4,278**	**5,301**	**8,076**	**10,557**	**13,900**
Routine	1,247	1,610	2,121	2,744	4,062	5,529	7,501
Of which:							
Oil subsidies	NA	35	65	197	535	828	1,511
Food subsidies	50	39	NA	44	125	170	310
Development [b]	1,425	2,044	2,157	2,557	4,014	5,028	6,399

[a] 1 April to 31 March.
[b] Includes fertilized subsidies.
[c] Projected.

25X1

Economic Constraints and Options

Demographic trends and the near certainty of declining oil exports portend challenges to economic management in the 1980s even more formidable than Soeharto has faced in the past. Half of Indonesia's 154 million people are under 16 years of age, with many on the verge of entering the labor force. Net labor force expansion during the 1980s probably will reach 2 million workers a year versus 1.4 million in the 1970s. Moreover, because the population age groups which will produce the growth are already in place, there is nothing Jakarta can do to slow the expansion.[2]

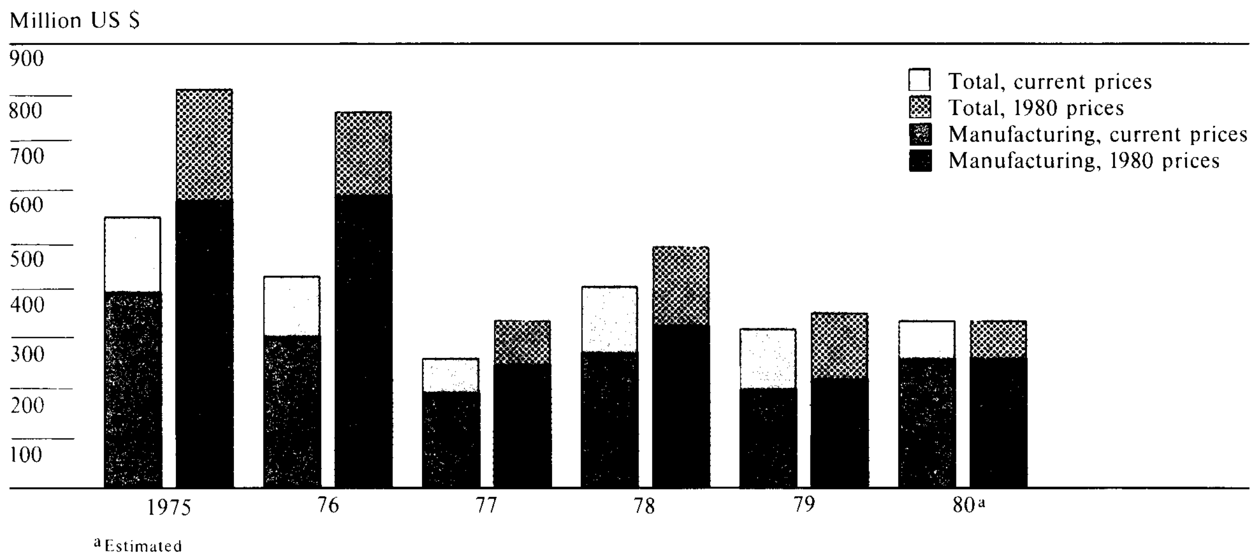
Nor can Jakarta escape declining oil exports, a development that will significantly reduce economic policy options at a time of increasing demand for social welfare programs. Maximum sustainable oil production is stagnating at about 1.6 million b/d. Although the surge in exploration activity under way since 1978 reversed three consecutive years of declining output early in 1981, most of Indonesia's oil resources are in small fields that are quickly depleted. Development of natural gas, coal, and geothermal resources will probably not slow the growth of oil consumption below 10 percent annually before the late 1980s. Under these circumstances, ballooning domestic oil consumption could reduce oil exports to about 600,000 b/d by 1990, roughly half the current level. 25X1

Budget stringencies would by then force an end to, or at least sharply curtail, domestic fuel and fertilizer subsidies unless Jakarta can improve its poor record of developing a nonoil tax base. Nonoil domestic taxes are only two-thirds of 1970 levels in real terms. Despite support from technocrats for reversing this trend, shifting the tax burden to Indonesians would prove enormously unpopular. Equally foreboding is the other option if subsidies are eliminated: allowing food prices to rise more rapidly than prices for industrial goods in order to assure adequate production incentives for farmers. This would squeeze politically strategic urban interests, a potentially dangerous move for the government. In addition, increases in the prices of oil products and electricity are opposed by the rapidly growing and politically important urban middle class. 25X1

25X1

25X1

Indonesia: Foreign Non-oil Investment



25X1

585821 12-81

Although Indonesia requires massive investment to create jobs, the petroleum boom has helped dampen foreign investment outside the oil sector. Nonoil foreign investment fell 26 percent in real terms during 1975-80 from levels recorded in the early 1970s and has yet to repeat its 1975 level of $547 million. Although corruption, bureaucratic inefficiency, and a widespread resentment against foreigners are all reponsible, Jakarta must also contend with a more subtle obstacle to investment: as long as oil export revenues remain large, balance-of-payments considerations will work against an exchange rate that would promote labor-intensive exports. For example, an exchange rate set to reduce the $3 billion balance-of-payments surplus recorded in 1980 and the smaller surplus expected this year would require appreciating the rupiah, thus promoting cheap imports and discouraging labor-intensive exports.

Looking Ahead

With an international reserve cushion of $7 billion in mid-1981, the parliamentary elections in May 1982 and the presidential election in 1983 are shaping Soeharto's decisions on economic matters. Assured of electoral success by a pervasive network of political control, Soeharto views the elections as a symbolic device to extend his mandate and attaches considerable importance to an orderly election process. Outbursts of social unrest or controversy over the conduct of the elections, although not a threat to the regime or to its election prospects, would deny Soeharto the decisive mandate he seeks. His decisions early this year to maintain food and fuel subsidies at existing levels and to raise the wages of civil servants underscore this political view. Soeharto's actions carry a heavy price, however. Including forgone foreign exchange earnings, the hold on domestic fuel prices alone is costing Jakarta $3.5 billion this year—nearly 6 percent of GNP 25X1

25X1

Prospects for a preelection devaluation are remote. When it became apparent last September that the economy's nonoil exports fell 50 percent in volume compared to the first half of 1980 because of depressed international markets and Jakarta's own export quotas, a prominent member of parliament called

Approved For Release 2008/09/03 : CIA-RDP03T02547R000100020001-9

on Jakarta to squelch rumors of a devaluation. Planning Minister Widjojo responded the following week that no devaluation was under consideration.

Jakarta could reduce the financial pain of slower growth in oil earnings by trimming a planned series of resource-based heavy industry projects that would require over $10 billion in capital outlays by 1985 or by accelerating foreign commercial borrowing. Any slowdown in construction of oil, liquefied natural gas, petrochemical, or fertilizer projects, however, would not only damage Soeharto's prestige but also impede economic planning in other sectors that depend on the program's completion. Increased foreign borrowing is an attractive option. Jakarta has maintained an active position in the Eurodollar market in the last few years, and its most recent loan, a $300 million syndication, reinforced its favorable credit rating.

Over the medium term, even the shift in economic policies advocated by the World Bank and the technocrats would entail considerable risks. The moves required to accelerate job creation and place government finances on a surer long-term footing—devaluation, phasing out subsidies, and boosting domestic taxes—would be inflationary and thus politically disruptive in the short run. Jakarta nominally welcomes foreign investors, but most Indonesians strongly resent their role in the economy. Thus the regime probably will not ease the complex regulations imposed on foreign investors or lower the barriers protecting state-owned or military-affiliated firms.

25X1

25X1

Soeharto's mix of development policies contains the seeds of a balance-of-payments squeeze by the close of the decade that would limit Jakarta's ability to remedy social grievances and meet rising expectations. As more Indonesians crowd into Java's cities and fail to find jobs, racial riots and other urban violence that could easily take on antigovernment overtones will increase. For now, the regime appears capable of handling the security problem, but without another oil windfall, social strains will almost certainly prove far more difficult to handle later in the 1980s.

25X1

25X1

25X1

Approved For Release 2008/09/03 : CIA-RDP03T02547R000100020001-9

25X1

Page Denied

East Asian Briefs

China

Containerized Portal to the Trans-Siberian Rail System

25X1

[redacted]

The testing companies—both prime shippers across the Trans-Siberian line—have been seeking a shorter route for containers from the Far East that now must enter the Trans-Siberian system at the Soviet port of Nakhodka. In addition to providing connecting rail service to container ships calling at Chinese ports, the overland route could accommodate shipments of containerized goods to and from China. When regular service is established, shipping costs, transit time, and cargo loss all are expected to be less than on alternate sea routes. First, however, the Chinese must develop container handling and distribution services, and the Soviets must complete the Baikal-Amur rail line—scheduled for the late eighties. Only then can the Trans-Siberian Railway significantly expand its container operations. [redacted]

25X1

Rail Passenger Service Improves

During October China added 64 new passenger trains and doubled the number of express passenger runs. The new trains, which can carry up to 120 million additional passengers each year, will just meet current demands. Rail passenger traffic has averaged a 5.5-percent annual increase since 1975 and is expected to rise at a 6-percent rate through 1985. In 1980 China's railroads—the predominant form of public transport—carried 912 million passengers. [redacted]

25X1

Beijing Cracks Down on Bonus Payments

In his economic report to the National People's Congress, which convened on 30 November, Premier Zhao Ziyang will urge greater restraint in issuing worker bonuses—an action that could fuel future labor unrest. 25X1

Widespread abuses in the bonus system during 1981 have added to budget problems and to inflationary pressures while the program has done little to lift sagging productivity. To preclude a yearend surge in payments, China's leadership issued new guidelines in early November aimed at restricting the size of the bonuses and linking them to productivity. 25X1

Beijing's directives to factory managers to adjust work quotas and bonus payments will heighten tensions between workers and management. Although there have been few actual work stoppages this year, production has suffered from high absenteeism and lackadaisical work habits. The 40-percent increase in tobacco and liquor prices, announced on 17 November, will add to worker dissatisfaction, especially if they and the new restrictions on bonuses are seen as anticonsumer policies.

25X1

Disappointing Prospects for World Bank Loans

Although Beijing recently signed its first loan agreement with the World Bank—$200 million for educational projects—China's prospects for obtaining additional concessional loans for port improvements and to expand energy production are bleak, at least for the next two years. Low-cost funds administered by the International Development Association, the Bank's soft loan facility, were already heavily committed when China joined in 1980, and reductions in donor funds have further dimmed Beijing's chances.

25X1

25X1

China Pushing Export of Nonferrous Metals

Beijing wants to sell a broad range of metals, including titanium, tungsten, columbium, tantalite, and germanium, to private firms and to the US Government for the strategic reserve. World prices for some of these metals are depressed. If it

Approved For Release 2008/09/03 : CIA-RDP03T02547R000100020001-9

is to greatly expand exports of nonferrous metals, China will have to adopt a more flexible pricing system and become better attuned to trading standards and practices in the international metals market. [redacted] 25X1

To this end, China recently transferred control of the nonferrous metals industry from the Ministry of Metallurgical Industry to a new organization, the General Administration for Nonferrous Metallurgical Industry, that reports directly to the State Council. Under the old ministry, the nonferrous metals were greatly overshadowed by iron and steel, which China produces in much larger volume. [redacted]

25X1

[redacted]

25X1

New Statement of Naval Mission Reflects Improved Capabilities

The Chinese are now officially referring to the mission of their Navy as "defensive" instead of their traditional reference to "coastal defense." A senior officer in the East Sea Fleet said this could include offensive operations conducted a significant distance from shore. [redacted] 25X1

The new line reflects the marked improvement in naval capabilities that has occurred over the last five years. By building large ocean-going auxiliaries and high-power communication facilities, the Navy probably can support open-ocean operations almost anywhere. [redacted] 25X1

[redacted]

 25X6

Page Denied

Next 1 Page(s) In Document Denied

25X1

Southeast Asia

Philippine Foreign Debt Dilemma

Medium- and long-term debt repayments will rise by $480 million to $2.4 billion next year—well above Manila's self-imposed legal limit of 20 percent of 1981 foreign exchange earnings. Prime Minister Virata told Philippine financial executives in mid-November that foreign borrowing would have to be curtailed next year to keep debt service within statutory limits, barring an unexpected rebound in export earnings or foreign debt restructuring. Even a complete moratorium on new foreign borrowing, however, would reduce next year's repayments by only $19 million. Manila's solution will probably be to amend the statutory ceiling, an option which it has used before and which many private foreign bankers have already allowed for in setting their lending limits.

25X1

Sabah Issue Again Clouding Philippine-Malaysian Relations

Philippine Defense Minister Enrile's allegations last month that an anti-Marcos terrorist training camp is operating in Sabah, Malaysia, is being played down for now by both governments. His charges followed the arrest of two members of the leftwing Social Democratic opposition who were caught attempting to infiltrate the Philippines from Sabah. Enrile claims that the terrorist training camp was recently set up with the apparent blessing of Moro National Liberation Front Chairman Nur Misuari. If the claims are true, this would be the first evidence of cooperation between Muslim rebels training in Sabah and the non-Communist opposition to Marcos. It would also represent a sharp shift in Malaysian policy, which for many years has restricted use of Sabah as a sanctuary for Muslim rebels. Although Enrile stopped short of accusing Malaysia of direct complicity in terrorist activities directed against the Philippines, his statements provoked Kuala Lumpur to state publicly that Malaysia would not allow any group to use its territory to carry out clandestine activities against any government.

25X1

Philippine Church Leader Criticizes US Policy

In a widely disseminated letter of 2 October, Cardinal Jaime Sin said that Philippine youth "no longer see America in a liberating role but as one who arms our soldiers to kill their fellow Filipinos. . . . I see a new generation of Filipino leaders arising who, unlike my generation, will erase the long tradition of friendship

25X1

between our two countries." Bishops and priests have recently complained to the Cardinal that the US provides military assistance that is being used by the Marcos government to "militarize" rural areas.

The Cardinal claimed that by giving priority to the Soviets, US policymakers have shifted their focus away from the economic and political injustices that are the root causes of problems in the Philippines. An outspoken moderate who espouses cooperation with the Marcos government, Cardinal Sin's views are widely respected by the majority Catholic population in the Philippines.

25X1

Approved For Release 2008/09/03 : CIA-RDP03T02547R000100020001-9

Calendar of Coming Events

25X1

December

7-9 December
Australian Deputy Prime Minister Douglas Anthony to Washington.

7-11 December
US-Japan Trade Facilitation Committee and Trade Subcommittee meet in Tokyo.

25X1

12 December
Second anniversary of the "headquarters coup" in which Chun Doo Hwan—then a major general—and a group of key combat commanders seized control of the South Korean Army, thus paving the way for Chun's ascension to the presidency.

25X1

14-15 December
Meeting of DOD-JDA Systems and Technology Forum in Tokyo.

25X1

15 December
Chinese Vice Premiers Gu Mu and Huang Hua lead delegation to Tokyo for Japan-China ministerial talks; agreement will be announced on settlement of controversy caused by Chinese plant cancellations.

25X1

22 December
Target date for presentation of budget to Japanese Cabinet.

25X1

29 December
Target date for Japanese Cabinet approval of the budget.

25X1

Late December
Regular Diet session opens in Tokyo; before year's end expected to ratify annual fishing agreement with USSR and to approve National Personnel Authority recommendations on pay raises for public employees.

25X1

Approved For Release 2008/09/03 : CIA-RDP03T02547R000100020001-9