

This package contains background cables and memos which you may wish to give to the Vice President.

#1 is a precis of cable #144 from Ambassador Green. The contents of this cable may have prompted this visit by Vice President Humphrey.

#2 is the full text of the above cable.

#3 is an earlier cable from Djakarta giving the embassy's estimate of major political and economic developments to be expected in Indonesia during the next three months.

#4 is a State cable in reply to Ambassador Green's cable #144.

The memos are:

A. Indonesian Requirements for Short-Term Economic Assistance, October 1965. (S) It is an earlier CIA statement which is comparable to cable #144 from Ambassador Green.

B. Indonesia's Foreign Debt Crisis, May 1966 (S/NFD)

C. The Dutch-Indonesian Claims Dispute (informal)  
(S/NFD/BUO/CD)

State Dept. declassification & release instructions on file

Précis of Djakarta 144 from Ambassador Green

A proposal for US short-term (3-4 months) aid to Indonesia.

Indonesia is in confusion, but we cannot hold back assistance until the situation is resolved.

We must neither be too soon with too much nor too late with too little. This government is better than anything for ten years. We must convince government that we will help to meet critical needs but that they must produce to assure continuation of our aid.

Long-term aid program should await outcome of multi-lateral debt rescheduling and evaluation of short-run progress.

The objectives of such an aid program are: (1) to meet critical present needs, (2) to prepare for economic reconstruction, (3) to cut away some of the despair, (4) to encourage other countries to help also, and (5) to strengthen the leadership and maintain US influence with them.

The immediate aid recommendations are: (1) a series of education programs aimed at civic action, (2) rice and cotton exports to assure supplies of food and clothing, (3) military assistance for civic action and for spare parts to restore US equipment to operation, (4) a small food-for-work program to initiate agricultural reconstruction in the critical rice region (Central Java), and (5) spare parts for American manufacturing and transport equipment to restore most urgent operations.

The first recommendation is to be initiated immediately and it will require a presidential determination.

The Indonesian Government will understand our reserved response in this program despite their wish for more.

Comment: We concur in the basic judgments as well as the urgency and scope of this proposal. The economic recommendations are generally consistent with those in our Indonesian Requirements for Short-Term Economic Assistance, CIA/RR CB 65-65 of October 1965.

Table 1

Medium-Term and Long-Term Debts of Indonesia  
as of December 1967

		Million US \$	
International Monetary Fund 102.4 <u>a/</u>			
Free World		Communist Countries	
Japan	203.8	USSR	992.8
United States	166.3	Yugoslavia	97.8
West Germany	142.6	Poland	94.6
France	107.2	East Germany	61.4
Italy	98.6	Czechoslovakia	57.9
United Kingdom	36.9	Hungary	17.4
Netherlands <u>b/</u>	25.4	Rumania	15.0
India	8.5	Communist China	13.9
Austria	6.9	Bulgaria	1.0
Sweden	3.1		
United Arab Republic	3.0		
Switzerland	20.2	Total	<u>2,276.7</u>

a. Net drawings. Indonesia's original gold contribution offsets part of this sum, making actual payment obligations \$63.5 million.  
b. Figures do not include Dutch claims for seized property and debts transferred at the 1949 Round Table Conference.

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Table 2

Short-Term Debts of Indonesia  
as of November 1965

Million US \$

Free World		Free World (Continued)	
Japan	119.0	Sweden	0.2
United States	47.2	United Arab Republic	0.2
Netherlands	26.4	Australia	0.1
Pakistan	21.6	Canada	Negl.
West Germany	14.0	Mexico	0.1
Italy	20.1	Communist Countries	
Switzerland	3.7	Czechoslovakia	15.2
France	3.0	USSR	17.5
Hong Kong	0.9	Yugoslavia	10.2
India	2.0	Poland	6.2
Zanzibar	1.5	East Germany	3.6
Philippines	1.4	Hungary	3.6
Belgium	1.3	Bulgaria	1.7
Norway	1.2	Romania	0.9
Austria	0.7	Other	Negl.
Finland	0.3		
Denmark	0.3		
Iraq	0.4	<b>Total</b>	<u>324.8</u>

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20 July 1966  
S-1957

The Indonesian Economy

Summary

The Indonesian economy is in chaos. Production has declined in all major sectors of the economy except petroleum. Prices have increased six-fold in the last six months. The country has no foreign exchange reserves, and \$160 million in foreign obligations are in default. Much of the Indonesian population, however, is immune to the chaos in the money economy. Almost 80 percent of the population live in rural areas, producing a bare subsistence from the land and bartering for their other needs.

The prospects for economic stabilization and development are bleak. The greatest hope for some movement toward stability rests on the present regime's recognition of the magnitude of its problems.

Current Situation

The Indonesian economy continues to be characterized by declining production, galloping inflation, a complete absence of foreign exchange reserves, and a tremendous foreign debt. The new Indonesian government has taken some initial steps to reduce economic distress in the country, but the situation continues to worsen. Industries are operating at less than 30 percent of

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capacity. Even agricultural production, which dominates the economy (60 percent of the national income), has declined in recent years. It is now lower than in the period prior to World War II. Only petroleum which remains largely under foreign management has prospered.

Runaway inflation is the most pervasive characteristic of the Indonesian economy. The Djakarta cost of living index increased six-fold in the last six months, and there is little prospect that this rate will decline. Despite periodic wage increases, <sup>many</sup> urban workers can only purchase daily necessities by moonlighting and petty thievery in off hours. Inflation also discourages exports and reduces the hard currency earnings needed to buy food, raw materials and machinery abroad.

The government and central bank are unable to meet all obligations on foreign loans. ~~¶~~ Industry is seldom able to secure the

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An effort to renegotiate Indonesian debts to the Free World -- now in progress in Tokyo -- will produce little more than the framework for more extensive negotiations in the fall.

Most of the population, however, remains largely untouched by the chaos in the money economy. Indonesian society is essentially peasant, with about 80 percent of the population living in rural areas, producing a bare subsistence from the land, and bartering

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for their other needs. They will survive so long as there is law and order whatever the state of the economy.

Principal Problems

The most important economic problem facing the Indonesian government is the lack of managers, skilled labor, and entrepreneurial talent. The Dutch provided little training for the Indonesians, and the Indonesians have aggravated the shortage by ousting foreigners with managerial and technical skills. Repressive actions against the Chinese since the coup have further reduced the ranks of traders and entrepreneurs.

The nation needs widespread restoration of roads and railroads to carry rice into the cities, move export commodities to seaports and supply villages with consumer goods. Almost 55 percent of all Indonesia's motor vehicles are broken down because of the lack of spare parts. Many roads have reverted to jungles, and less than 5 percent of the railroad track is considered safe.

Inflation originates in persistent government budget deficits. Expenditures are often two to three times revenues. There is no adequate system of revenue collection. The central bank finances the difference by simply printing more banknotes. The recent currency reform has only reduced the number of digits.

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Grandiose (and unproductive) public works projects of the Sukarno era and expenditures associated with the Indonesian military have been the most important items in the government budget. With military leaders in control of the government, there is little prospect that expenditures for the maintenance of armed forces personnel can be reduced. Expenditures for sophisticated military hardware may be curtailed. In addition, it may be possible to use military personnel in civic action programs to aid economic recovery.

The Indonesian government faces foreign payment obligations far beyond its ability to pay. Outstanding obligations for long and medium term loans (repayments spread beyond one year) totalled \$2.3 billion at the end of 1965. (Of this by far the largest share was owed to the USSR for military assistance credits.) Short-term obligations total about \$350 million. 1966 debt servicing requirements are estimated at about \$550 million, more than Indonesia's current export income.

#### Prospects

No quick, easy solution is available for the Indonesian economy. Recovery will require years of effort if the best domestic talent and liberal foreign economic assistance are made available.

Some progress has been made, however. An end to the confrontation against Malaysia is in sight. Trade with Singapore is to be resumed.

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Trade regulations have been altered to encourage exports. The government has reapplied for membership in the International Monetary Fund. The Fund will send an expert team to help mold a financial program to restore international credit and domestic financial responsibility on readmission.

Indonesia has fled from crisis to crisis for years. The country can do so again. The most encouraging sign is that the present leadership seems inclined to ~~flee~~<sup>face</sup> to reality. They recognize the sources of the present economic chaos if not its full magnitude.

Indonesia has the climate, land and people to build a comfortable if not a flourishing economy. Organization and motivation of the population will be difficult. Foreign aid can give the country hope and tools. It cannot give them will and dedication.

Given short-run foreign economic assistance, the government can restart its factories, increase its control over the banking system, and try to strengthen agriculture. This much achievement would represent an unqualified success. Government credit would be restored. The long climb toward restoration and modernization could begin.

Assume the government fails in these efforts. It is not lost. Most of the people live outside modern economic institutions. They will go on as before. The central government might well survive. Its authority will then turn on its ability to administer a tax and police system.

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The Dutch-Indonesian Claims Dispute

The Dutch-Indonesian claims dispute has been by far the most important issue hampering an increased Dutch presence in Indonesia. The Dutch claims against Indonesia fall into two major categories. The first consists of the debt initially transferred to Indonesia at the Round Table Conference of 1949 granting independence to the republic. The second part of the Dutch claim results from the 1958 Indonesian decision to nationalize the Dutch enterprises that had been taken over in 1957 and 1958 in retaliation for Dutch intransigence on the West Irian issue. Although Indonesia has admitted the validity of at least some of the Dutch claims, there has been no agreement as to the amount.

Since the resumption of diplomatic relations between Indonesia and the Dutch in 1963, three meetings have been held concerning the claims dispute. During the first meeting in November 1964 at the Hague, little progress was made; most of the discussion concerned the implementation of a Dutch 100 million guilder credit issued in August 1964. The second series of talks in August and September 1965 also failed to reach a specific agreement on the claims issue. In May 1966, an Indonesian economic delegation led by Umarjadi, the Deputy Foreign Minister, arrived in the Hague to discuss the possibility of additional economic assistance. The Dutch apparently hoped that some settlement could finally be reached on the claims issue, but again no final agreement was reached despite

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reported substantial concessions on the part of the Dutch. These concessions included the scaling down of claims from 4 billion guilders (\$1,105 million) to approximately 1.2 billion guilders, (\$332 million), a grace period for as much as four or five years, and 25 to 30 years for repayment. During the discussions, the claims figure was further reduced to 900 million guilders (\$250 million), which the Dutch say is their final offer. The Indonesians, however, insist that this be reduced still further to 250 million guilders (\$69 million) -- a figure which the Dutch Foreign Minister Lans has said is both inequitable and politically impossible for the Dutch to accept.

Indonesia's most immediate problem, however, with regard to its foreign creditors is the burden of current repayment obligations for long and medium term loans. Without a settlement of the Dutch-Indonesian claims dispute, the Dutch will probably decline to participate in the multi-lateral consortium that now appears to be the most likely mechanism for rescheduling these obligations and for considering additional aid. Nevertheless, even without Dutch participation, a meaningful rescheduling agreement could be reached because debts to the Netherlands, other than those involved in the claims dispute, are but a small part of Indonesia's outstanding debts.

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