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3 August 1966

CIA Comment on
State Department Paper on Indonesia
(For NSC Action 4 August 1966)

Summary: The State Department paper is a well-argued statement of problems and policy recommendations on which CIA has two major reservations: we consider the paper overoptimistic both in (1) addressing itself to long-range economic recovery, as opposed to the short-range maintenance of a rock-bottom viability; and (2) placing reliance on concerted multilateral action.

Economic Assessment: Our principal difficulty lies with the final three sentences of the State paper:

"We are dealing not with an economic infant but a sick giant with historically proven capacity for quick economic recuperation. We are dealing with a talented and resourceful population, proud, self-confident, and determined to stand on its own feet. We are dealing with an island nation where the circumstances of geography and the incredible productivity of its soil tend to break problems into manageable units."

Indonesia definitely has no historically proven capacity for quick economic recuperation. Its economic problems may be susceptible to palliatives, but they

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are not the kind that can be solved quickly, even with the best domestic talent and liberal foreign assistance. Indonesia has a resourceful capacity, not for economic recuperation, but for economic survival, based on a subsistence economy for 75 to 80 percent of the population. Even the subsistence level has fallen consistently during the Sukarno era because of government mismanagement.

We believe that significantly greater emergency aid than is envisaged in the State paper may be needed to fend off collapse before Indonesia can even begin the long climb toward stability and development.

Also, it is very questionable that Indonesia's problems can be broken down into manageable units. The major problem, in fact, is the tight interlocking of foreign debt obligations, budget deficits, inflation, and the need for more foreign aid.

Political Assessment: We believe that the State paper places unwarranted reliance on the likelihood and efficacy of a multilateral approach to foreign aid for Indonesia. The paper mentions the international meetings held to negotiate the rescheduling of foreign

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debts and extension of new aid, but fails to note that nothing has been accomplished so far. Some of the European creditors have already demonstrated an inclination to go it alone. All of them show a tendency to view Indonesia's economic problems from a narrowly commercial viewpoint.

Progress will be slow, with creditor nations divided into those who take a hard line and those who are sympathetic to Djakarta's problems. Ultimate extension of significant US aid on a bilateral basis may be inevitable, if indeed not imperative, if we are to achieve the objectives so well stated in the Department of State paper.

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We also believe that the paper discounts too quickly the political risks involved in letting the Indonesians [REDACTED] Suharto's new cabinet, to a far greater extent than previous regimes, will be under strong pressure to produce results in the economic sphere. An uncritically favorable US response to all Indonesian requests for aid would of course have the undesirable effect of encouraging the irresponsible elements in Indonesia while undercutting those saner voices

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which counsel moderation and sound economic management. Nevertheless, we recommend avoidance of a generally negative attitude toward Indonesian requests for longer-term aid; each request should be viewed on its own merits and in relation to the degree of economic stabilization the US considers necessary to achieve its political objectives in Indonesia.

We fear the Department may be overly sanguine in stating, in Paragraph 19, that continuing economic deterioration would promote internal reforms. It would be more likely to generate political confusion and contribute to a critical public attitude toward the present army-controlled regime. Rightly or wrongly, the Indonesians could also blame the deterioration on US rejection of aid requests.

Specific Comments: Paragraph 5 notes that Indonesia has applied to rejoin the International Monetary Fund, but fails to mention a major obstacle to re-admission, a \$47.5 million "entrance fee." The Fund has suggested that some of the creditors might provide this as part of their aid program; leading creditors have not been responsive.

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Paragraph 6: We would agree that there is no immediate danger of a food shortage. The comment that rice may be short in winter months without imports appears to be a considerable understatement, in the light of State reporting that Indonesia may need to import 500,000 tons of rice this year to avoid a shortfall.

Paragraph 15 et sequi: No mention is made of the requirements of the Indonesian transport system. This is probably the most important sector of the economy to be rehabilitated, and one where the provision of US equipment and spare parts would be most helpful.

Paragraph 16: Military consumption of 60 to 70 percent of the budget is an overstatement; about 50 percent would be more likely, and even this might be on the high side.

Paragraph 18: We question whether "Indonesia's capable trading community and its cadre of Western-trained performance-oriented economists" really know what is required. We suspect that their "preaching the need for forceful domestic efforts to cope with the economic situation" reflects more a desire to get the Americans in a receptive mood than a knowledge of the precise reform steps they would take.

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Paragraph 21: Djakarta now seems very close to ratifying the Bangkok agreement, although reports conflict as to whether it will be signed with or without change. Even after a formal end of confrontation, we expect the Indonesians to support subversion in the Malaysian Borneo territories.

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