

Declassified in Part - ^{VT} _____ 25X1
Sanitized Copy Approved for [REDACTED]
Release 2011/10/31 : [REDACTED]
CIA-RDP85T00875R00160003

Declassified in Part - [REDACTED]
Sanitized Copy Approved for [REDACTED]
Release 2011/10/31 : [REDACTED]
CIA-RDP85T00875R00160003

CIA/OER/IM 70-60 Doc/SER

~~Confidential~~



25X1



DIRECTORATE OF
INTELLIGENCE

Intelligence Memorandum

Indonesian Debt Settlement:

A Precedent For Other Less Developed Countries ?

~~Confidential~~

ER IM 70-60

April 1970

Copy No.

50

WARNING

This document contains information affecting the national defense of the United States, within the meaning of Title 18, sections 793 and 794, of the US Code, as amended. Its transmission or revelation of its contents to or receipt by an unauthorized person is prohibited by law.

GROUP 1
EXCLUDED FROM AUTOMATIC
DOWNGRADING AND
DECLASSIFICATION

CONFIDENTIAL

25X1

CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence
April 1970

INTELLIGENCE MEMORANDUM

Indonesian Debt Settlement:
A Precedent For Other
Less Developed Countries?

Introduction

A debt repayment agreement reached on 24 April 1970 between Indonesia and its chief Western creditors has broad policy implications for both major foreign aid donors and other less developed countries now facing debt repayment problems. For the first time, creditor nations have agreed to a long-term debt repayment schedule which realistically takes into consideration the economic position of the debtor nation. Past debt rescheduling arrangements have largely been temporary, short-term expedients which essentially formalized de facto debt defaults and almost guaranteed a need for additional rescheduling. This memorandum gives the background for the agreement and its implications for Indonesia and the world's major foreign aid creditors and recipients.

Indonesia's Debt Problem

1. As have several other less developed countries, Indonesia has amassed a foreign debt with a repayment schedule clearly beyond the country's

Note: This memorandum was produced solely by CIA. It was prepared by the Office of Economic Research and was coordinated with the Office of Current Intelligence and the Office of National Estimates.

CONFIDENTIAL

25X1

CONFIDENTIAL

capability. Under former President Sukarno, Indonesia by mid-1966 had incurred foreign medium-term and long-term liabilities totaling \$1.7 billion (see Table 1). More than half the debt was owed to Communist countries and arose mainly from purchases of military equipment. Western donors, accounting for the other half, gave loans mainly for economic development projects and for importing foodstuffs and other consumer goods. Although most of the credits received from both Communist and non-Communist sources were on liberal terms -- principal repayment over several decades and low interest rates -- debt servicing obligations nevertheless rose to about \$250 million in 1965, or the equivalent of 40% of Indonesia's annual export earnings. This was clearly an impossible amount, given the state of the country's economy.

Table 1

Indonesia:
Estimated Medium-Term and Long-Term
International Debt as of 30 June 1966

Total: \$1.7 Billion

	Percent
Western countries	<u>47</u>
United States	10
West Germany	8
Japan	7
Italy	7
France	6
Yugoslavia	5
United Kingdom	1
Holland	2
Other	1
Communist countries	<u>53</u>
USSR	39
Other	14
<i>Total</i>	<i>100</i>

CONFIDENTIAL

2. When Suharto took over in 1965, Indonesia was already in default on most of its debt and during 1966 was unable to make any debt service payments. To forestall further defaults, Western creditors agreed in December 1966 to a three-year moratorium on the repayments on all medium-term and long-term debts due before the end of 1967. Actual repayments would then be stretched out over eight years. Even these terms, however, were clearly beyond Djakarta's means and additional moratoriums had to be granted in 1968 and 1969. While the Communist countries were not parties to these rescheduling agreements, the USSR and the East European countries generally had agreed in bilateral negotiations in 1966 and 1967 to re-schedule Indonesia's debt due to them. Meanwhile, to stabilize the Indonesian economy, Western sources provided new loans which increased the outstanding debt to about \$2.4 billion by the end of 1969 (see Table 2).

Table 2

Indonesia:
Estimated Medium-Term and Long-Term
International Debt as of 31 December 1969

Total: \$2.4 Billion

	Percent
Western countries	<u>59</u>
United States	19
Japan	13
West Germany	8
France	5
Italy	5
Yugoslavia	4
Holland	2
United Kingdom	1
Other	2
Communist countries	<u>41</u>
USSR	30
Other	11
<i>Total</i>	<u>100</u>

CONFIDENTIAL

3. Although repeated debt postponements and new loans gave Indonesia breathing space for a few years, and the state of the economy improved considerably, the country in early 1970 was still unable to meet scheduled repayments. Under terms already agreed upon at the rescheduling sessions, Indonesia during the next nine years (1970-78) would have had to repay an average of about \$220 million annually, of which \$175 million would be on the Sukarno debt.

The New "Paris Club" Agreement

4. In view of Indonesia's obvious inability to meet the repayments due during the 1970s, a long-term solution was essential to avoid either repeated moratoriums and reschedulings or defaults. In late 1968, Djakarta's major Western creditors, the so-called "Paris Club," requested Dr. Herman Abs, former head of the West German Bundesbank, to prepare a plan aimed at resolving the Indonesian debt question. Dr. Abs submitted his solution late in 1969. He proposed that interest on the Sukarno debt (some \$450 million) be waived and that the principal (about \$1.7 billion) be repaid in 30 equal annual installments. No distinction would be made between military and economic debt or between Communist and non-Communist creditors. The post-Sukarno debt was excluded from Abs' re-scheduling plan because he said its inclusion would obviously discriminate against Western countries that had continued giving aid to Indonesia in favor of Communist countries that had not.

5. The agreement finally reached between Indonesia and the Paris group which met on 23-24 April 1970 comes close to the Abs proposal. The key element calls for stretching out repayment of the principal on the Sukarno debt over a 30-year period beginning in 1970. All interest on that debt, contrary to the Abs proposal, will have to be repaid, but the interest payments will not begin until 1985. Under the agreed plan, Indonesia's repayments to both Communist and non-Communist creditors on the Sukarno debt would amount at a maximum to only \$57 million annually through 1985. The plan further provides that repayments of up to a cumulative total of \$164 million can be deferred at Djakarta's option, although in any one year such deferments cannot exceed 50% of the payments due. If Indonesia uses this option

CONFIDENTIAL

immediately, as seems highly likely, actual repayments on the Sukarno debt could be as low as \$28 million annually during 1970-75 (see Table 3).

Table 3

Indonesia: Service Payments on the Sukarno Debt a/

Million US \$

<u>Year</u>	<u>Original Schedule</u>	<u>Schedule as of 31 December 1969</u>	<u>Schedule Under 1970 Paris Plan <u>b/</u></u>
1965	250		
1968	209		
1969	190		
1970	189	149	28
1971	149	178	28
1972	115	175	28
1973	89	177	28
1974	80	177	28
1975	70	179	33
1976	64	173	57
1977	52	180	57
1978	14	188	57
1979	8	127	57
1980	5	101	57

a. Excluding payments due as compensation for nationalized properties.

b. If Indonesia, as allowed in the Paris plan, chooses to defer 50% of annual payments due during 1970-75 until total deferments reach a cumulative value of \$164 million.

Repayments on debts incurred since 1966 would raise debt servicing to about \$65 million annually during this period.

6. The Paris plan goes a long way toward resolving the problem of Indonesia's debt burden in the years immediately ahead. The program is not binding on creditor countries, however, and Indonesia must still reach final agreement through bilateral negotiations. Western countries will almost certainly accept the essential elements of the plan. Although Communist countries took no part in the

CONFIDENTIAL

Paris meetings, they would seem to have little choice but to go along with the principles of the plan. Djakarta would probably refuse to make any debt repayments whatsoever to them if the USSR and the East European countries reject the repayment schedule.

A Precedent for Debt Relief
in the Less Developed World

7. Although under the new Paris plan Indonesia must finally resume debt repayments, the amounts are relatively small. These limited repayments should have little adverse economic effect. Average annual debt repayments through 1975 -- including those on the post-Sukarno debt -- will amount to only about 7% of expected export earnings if Djakarta exercises its option of making smaller payment on the Sukarno portion of the debt. Repayments for the remainder of the 1970s would increase, but Indonesia should have little problem meeting them, especially with rapidly increasing oil export revenues and continuing large foreign aid. An additional feature of the debt agreement that calls for a review of Indonesia's economic progress and debt repayment ability in 1980 leaves an opening for a further rescheduling should one be needed then.

8. Perhaps the major significance of the Paris plan is that it has probably set a precedent by recognizing the inability of certain debtor countries to meet their foreign obligations. In Indonesia -- as elsewhere -- most previous debt rescheduling involved relatively high repayments after only a few years of moratorium, which merely postponed but never solved the problem. The recent Indonesian agreement, on the other hand, is problem solving in that it allows for modest payments -- which are demonstrably within the country's capabilities -- to be made over a relatively long time period. This approach also alleviates the constant creditor-debtor friction and uncertainty arising from frequent debt renegotiations and allows for more realistic long-term planning in developing countries. Undoubtedly, other developing countries with large and binding debt repayment problems now will seek a solution similar to the Indonesia arrangement.

CONFIDENTIAL