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INDONESIA 1966-70 : ECONOMIC MANAGEMENT AND THE ROLE OF THE IMF

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INDONESIA 1966-1970 : ECONOMIC MANAGEMENT AND THE ROLE OF THE IMF[1]

This case-study differs from the others in the present volume in that it is an historical study, concluding at approximately the period when the others commence. The reasons for its inclusion are three. First, it provides an intrinsically interesting example of a successful anti-inflation programme and demonstrates that stabilisation can be achieved even when starting from a position of acute disequilibrium. Secondly, it illustrates the close interplay of economic and political factors in stabilisation attempts and re-emphasises that firm government commitment to a stabilisation programme is a pre-requisite for success. Thirdly, since the role of the IMF in supporting the stabilisation programme, in the negotiations on re-scheduling Indonesia's foreign debt, and in securing foreign assistance was significant it allows analysis of the extent and nature of Fund support in this pre-oil crisis programme.

The study is in five parts. Part I outlines the economic and political background to the crisis of 1965-66 and describes the situation immediately prior to the inauguration of the stabilisation programme. Part II analyses the content of the stabilisation programme implemented between 1966 and 1970. Part III evaluates its impact on the rate of inflation, the balance of payments, growth, income distribution and structural adjustment. It also discusses briefly the weakening of stability in 1973 and the consequent stabilisation measures adopted in 1974. The study stops at this point as thereafter discussion of macro-economic policy-making in Indonesia must focus on the role of oil revenues in the economy - a subject which does not fall within the orbit of our project. Part IV analyses the role of the Fund in relation to the successive Stand-By Arrangements in place between 1968 and 1974 and the meetings of the Inter-governmental Group on Indonesia, (IGGI). Part V summarises the study and offers some conclusions.

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1 Draft chapter of a study of Economic Management in Developing Countries and the role of the IMF, currently in progress at the ODI. I am very grateful to the Indonesian Ministry of Finance for supporting this study financially, providing documentation, and facilitating discussions with Indonesian officials.

I - The Economic and Political Background

In terms of the macroeconomic performance of the Indonesian economy, the twelve years between 1962 and 1973 divide clearly into three sub-periods. As illustrated by Table 1, the first five years were ones of acute disequilibria. The rate of increase of consumer prices rose from 27% in 1961 to over 1000% in 1966; the balance of payments (basic balance) was, with the exception of 1965, in deficit from 1961, net foreign exchange reserves were negative from 1963 and from the beginning of 1966 Indonesia was unable to service its foreign debt; real per capita GDP declined at an average annual rate of 1.3%; and the gross investment ratio averaged 8.8% per annum implying a declining capital stock. By contrast, during the last four years of the period, real per capita GDP grew at an average annual rate of 5.8%; consumer prices rose at an average annual rate of less than 6% and the rate of investment increased to 16.5% per annum. Although by 1970 the foreign debt had been rescheduled and substantial new aid commitments secured, the improvement in the balance of payments was not so marked during this period with the basic balance continuing in deficit until 1971 and net foreign exchange reserves remaining negative until 1972. (The major turnaround in the balance of payments came in the wake of the 1973-74 oil price rises: between 1972 and 1974 the level of net foreign reserves increased five fold while the surplus on basic balance grew six fold.) During the intervening sub-period Indonesia experienced fundamental political change, in the wake of which economic stabilisation became the primary governmental objective. The programme of stabilisation and rehabilitation implemented between October 1966 and April 1970 and the role of the IMF in supporting it, is the prime focus of this study. We begin however, by examining the causes of the disequilibria that manifested themselves in the mid-1960s.

The principal cause of the hyperinflation of the 1962 to 1966 period was government budget deficits financed by money creation. The average annual rate of price increase (as measured by the 62-commodity Jakarta Cost of Living Index) was [illegible]% in those years while the [illegible] of growth of the money supply (currency plus demand deposits) averaged 278% per annum (see Tables 1 and 2 and figure 1).[2]

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2 Statistical data from official sources such as International Financial Statistics is incomplete for the period covered in this section. As a result it relies heavily on data presented in the Bulletin of Indonesian Economic Studies and an unpublished thesis by Newmann (1974).

Table 1. Indonesia: Selected Growth, Inflation and Balance of Payments Indicators, 1960-74

	(1) Real GDP Growth %	(2) Real GDP Growth per capita %	(3) Gross Fixed Capital formation to GDP%	(4) Jakarta Cost of Living Index % increase	(5) Balance on Current Account (US $ mn)	(6) Basic Balance (US $ mn)	(7) Net official foreign exchange reserves (US $ mn)
1960	...	...		37.7	-84	98	328
1961	5.1	2.5	20.0	26.9	-526	-169	129
1962	2.4	-0.1	7.7	[illegible]	-248	-126	117
1963	-2.4	-4.8	9.4	118.7	-227	-104	-6
1964	3.8	1.3	14.3	104.7	-229	-52	-39
1965	0.0	-2.5	8.3	305.5	-247	24	-60
1966	2.3	-0.3	4.4	1044.7	-123	-52	-42
1967	2.3	-0.3	8.0	171	-283	-16	-56
1968	11.1	4.3	8.8	12.8	-251	3	-51
1969	7.1	4.8	11.7	15.9	-383	-69	-86
1970	7.5	3.2	13.6	12.3	-376	-20	-34
1971	5.9	6.6	15.8	4.4	-418	5	-91
1972	9.4	8.5	18.8	6.5	-386	566	285
1973	11.3	4.9	17.9	25.8	-531	45	783
1974	7.6	2.3	16.8	40.7	568	1090	1472

SOURCES: Cols. (1), (2) and (3) IFS, various issues; col (4) for 1960 -'66 Newmann, 1974, Table 27 and for 1967-74 IFS; from 1967 the base is September 1966; cols (5) and (6) IMF, Balance of Payments Yearbook various issues; col. (7) unpublished Fund documents, except 1970 -'72 for which source is B.I.E.S., Vol X, No. 2, July 1973.

In 1962, the government current budget deficit was equivalent to 63% of current revenue and to 74% of that year's increase in the money supply. By 1966 the deficit was equivalent to 128% of revenue and 85% of the increase in the money supply. The ratio of the change in net claims to government to the change in the domestic money supply ranged between 65% and 98% in the four - year period (Johnson and Salop, 1979, p.53) Central government current revenue averaged 4.6% of GDP from 1962 to 1966 while expenditure averaged 9.8% (Sundrum, 1973, Table 1.) The very large military outlays during these years were not included in the budget so that these formal deficits understate the extent of the imbalance between revenue and expenditure.

Table 2. The government current budget deficit and the money supply, 1960-1965 (bn old Rp .) and 1966 (bn new Rp.)

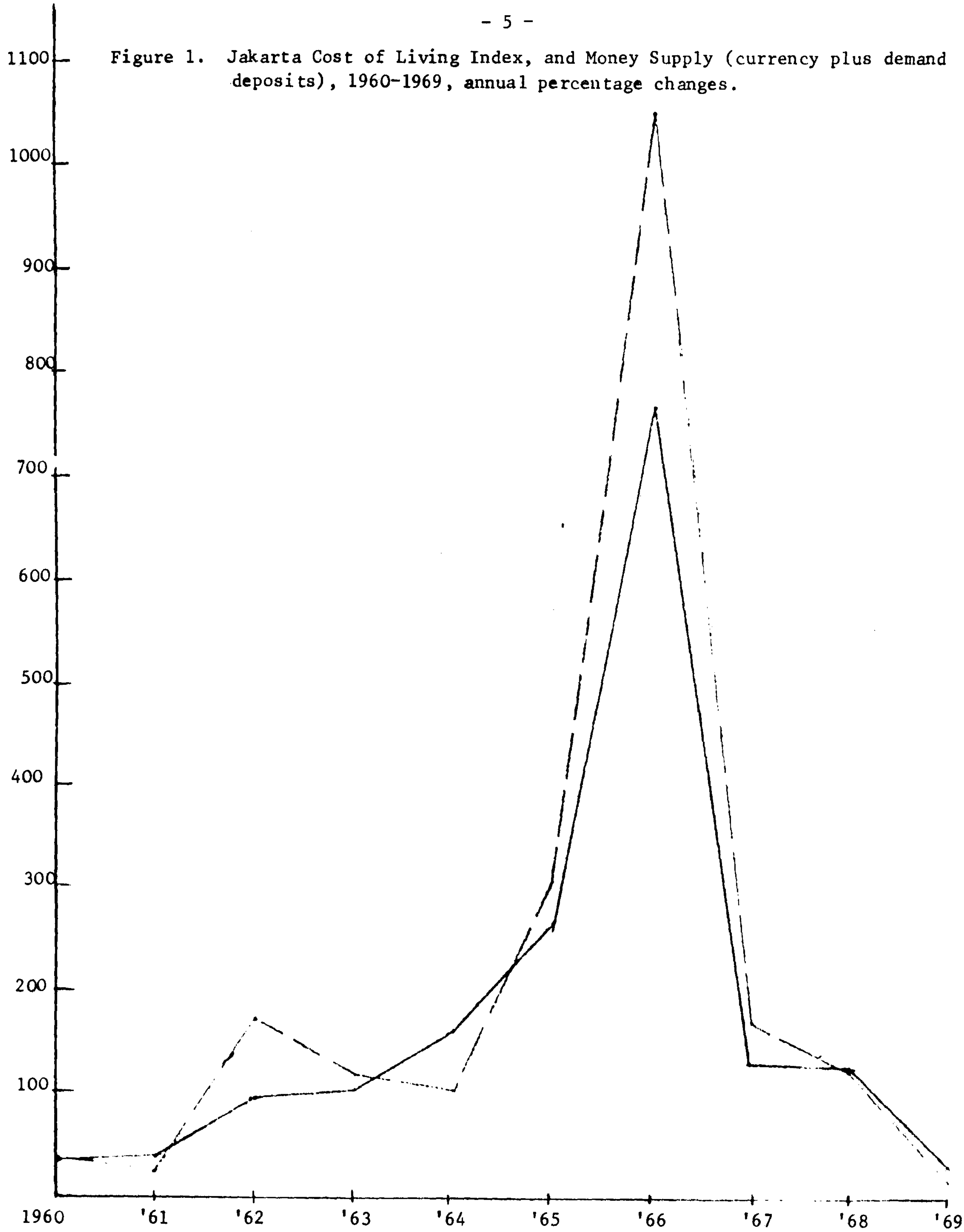
	(1) Government current budget deficit	(2) % change	(3) Deficit as % of revenue	(4) Money supply (currency plus demand deposits)	(5) % change	(1) as % of Δ (4)
1960	10.2	-26	20	47.8	37	79
1961	26.3	158	42	67.0	40	137
1962	47.2	79	63	131.1	96	74
1963	167.7	255	97	267.2	104	123
1964	397.9	137	140	703.1	163	91
1965	1602.9	303	173	2572.0	266	86
1966	16.7	943	128	22.2	763	85

SOURCE: Adapted from Newmann, 1974, Tables 13 and 29.

1 new Rp = 1,000 old . New Rp were introduced in December 1965 (see below p. 14)

As the rate of inflation increased and price expectations adjusted, the income velocity of circulation, which had averaged roughly 9% in the 1958 to 1961 period, increased to over 13% in 1962 and to 25.5% in 1966 (Sundrum, 1973, Table 4). As a result prices began to rise faster than the money supply, for example in 1962, 1963, 1965 and 1966 (see Tables 1 and 2).

Figure 1. Jakarta Cost of Living Index, and Money Supply (currency plus demand deposits), 1960-1969, annual percentage changes.



- - - = Jakarta Cost of Living Index

____ = Money Supply

Despite the size of the budget deficits, expenditure as a percentage of GDP declined from 18.7% in 1961 to 10.6% in 1965, while revenue declined from 13.3% to 3.9% (Sundrum, 1973, Table 1). One reason for the decline in the government's command over resources was the performance of the foreign trade sector upon which it depended heavily for tax revenue. (Up to 60% of current revenue typically emanated from taxes on imports and exports.) As Table 3 indicates export earnings declined steadily between 1960 and 1964. A number of factors contributed to the poor export performance.

From 1958, rubber and petroleum had accounted for about 70% of Indonesia's export earnings. Rubber was produced both on planations, which were, by and large, Dutch-owned up to 1958, and by smallholders. Estate production declined steadily from 1953 to 1963. The decline was attributable to ageing of the trees and a reluctance to replant in a politically uncertain climate (see below). Smallholders production increased throughout most of the period but the increase was not sufficient to compensate for both the fall in estate production and the steady decline in the world price between 1960 and 1965. The volume of rubber exports increased by 23% between 1960 and 1965 while earnings declined steadily from $307 mn to $222 mn. Export earnings from petroleum peaked in 1958. Domestic consumption increased its share of total production of refined petroleum products from 33% in 1959 to 58% in 1964 (Thomas and Panglaykim, 1973, Table IV-8). Further, from the point of view of government finance, the gross figures for export earnings from petroleum and petroleum products overstate the amount of foreign exchange available to the government since they include foreign exchange used by the foreign companies to purchase imports and to remit abroad. (Thomas and Panglaykim, (1973, p.85) estimate that in the 1958-1965 period, at least US $100 mn could be deducted from petroleum export earnings each year to obtain the net contribution of this product to government finance.) While the volume index of exports showed a 9% increase between 1960 and 1966 the terms of trade index showed a 24% decline over the same period.

Another factor affecting export performance was the overvalued exchange rate which acted as a tax on exports. Detailed estimates of the degree of overvaluation are not available. However, Mackie (1971, p.64) records that the black market rate for the Rupiah was generally

Table 3. Indonesia : Year to Year Changes in Balance of Payments Magnitudes

1960-61 to 1969-70 (US $ mn)

	1960-61	1961-62	1962-63	1963-64	1964-65	1965-66	1966-67	1967-68	1968-69	1969-70
Exports (fob)	- 115	- 55	- 55	- 25	2	81	57	102	122	178
Imports (fob)	- 307	319	135	13	- 20	13	- 210	- 25	- 164	- 121
Invisibles and Transfers	- 20	14	- 59	10	0	30	- 7	- 45	- 90	- 50
Total Current Account	- 442	278	21	- 2	- 18	124	- 160	32	- 132	7
Long-term capital	175	- 235	2	55	93	- 200	196	- 13	60	42
Basic Balance	- 267	43	23	53	75	- 76	36	19	- 72	49
Foreign Reserves	- 199	- 12	- 123	- 33	- 21	18	- 14	5	- 35	52

Source: IMF, *Balance of Payments Yearsbook*, various issues.

Note: A minus sign indicates a change that worsens the balance of payments in the region of 300% of the official effective rate until about 1958 and thereafter varied between four and twelve times the official rate. The deterioration of infrastructure and transportation facilities due to lack of maintenance also contributed to the poor performance as did the introduction of progressively more complex bureaucratic procedures and exchange controls in an attempt to ration scarce foreign exchange. The value of imports also declined steadily from 1961 to 1964. In 1965 the foreign exchange constraint was such that imports of rice, Indonesia's staple food, were banned.[3] Net foreign exchange reserves were negative from 1963 and the successive balance of payments deficits were financed by foreign borrowing. By the end of 1965 Indonesia's foreign debt was estimated to be in the region of \$2.4 bn of which 92% was medium and long-term debt. Almost 60% of the total was owed to Eastern bloc countries (B.I.E.S., No. 4, June 1966, Table 1).

What were the reasons for the huge budget deficits of the 1960-65 period? Sundrum (1973, pp.74-75) emphasises the revenue side of the budget. He argues that it was the decline in revenue between 1960 and 1962 (from 13.6% to 4.3% of national income) that precipitated the expansion in budget deficits as the government, unable to secure sufficient resources from the public through taxation sought to "bid them away by offering higher prices". Once this strategy was embarked upon it generated progressively greater increases in the money supply as in order to command a higher level of resources the government had to increase the money supply sufficiently to cover the value of those resources at the previously prevailing prices plus the increase in their price resulting from the increase in the money supply. There was also increasing pressure on the expenditure side of the government budget deriving from the rate of population growth in Indonesia (of 2.5% per annum) and the historical role of the government sector as a major employer. Between 1958 and 1966 Indonesia's population increased from 88.43 mn to 107.83 mn. Roughly 10% of the rapidly growing workforce was employed in the services sector which included the civil service and the armed forces. It was estimated that the level of over-staffing in government departments and agencies was up to 30% in the mid-1960s, so that "government employment, both civil and military ... constituted a vast system of unemployment relief ..." (B.I.E.S., No.4. June 1966, p.28). The size of the civil service and armed forces resulted in routine expenditure on wages and salaries absorbing a large part of government expenditure, even though in the hyperinflation years the remuneration of civil servants lagged far behind the rate of inflation. For example,

3 Between 1960 and 1964 rice imports had averaged 1,066 metric tons or 10% to 12% of domestic production.

in 1965 salaries of civil servants totalled Rp.450 bn equivalent to 49% of government revenue (B.I.E.S., No.3, Feb., 1966, p.7). Another factor was that the nationalisation of Dutch enterprises in 1957 had placed virtually all the large - scale industrial enterprises and half the plantations in the governments' hands. Nationalisation of British and American companies in 1963, further increased government ownership. Subsidisation of government estates and industries increased rapidly. For example, government credits to state enterprises increased from Rp.10.2 mn in 1960 to Rp.95.8 mn in 1964 (Thomas and Panglay kim, 1973, p.118). While these economic and social factors contributed, a further major part of the explanation resides in the political sphere.

The period from Indonesian independence (1949) to the adoption of the Stabilisation and Rehabilitation Programme in October 1966 divides, in political terms, into two sub-periods. The first, usually referred to as the "liberal" period, was based on a system of parliamentary democracy presided over by a president with limited powers. President Sukarno held this office throughout the period. In 1957, a political crisis caused by widespread revolts in the outer islands born of dissatisfaction with the concentration of power and resources in Java, precipitated the imposition of martial law and the ending of parliamentary democracy. The prevailing political philosophy now became President Sukarno's concept of "Guided Democracy" which he described as a mixture of nationalism, Islam and Marxism. The reintroduction in 1959 of the constitution originally drawn up in 1945 but abandoned a few years later, bestowed wide-ranging powers on the President. Of the previously prominent political parties only the Communist Party (PKI) retained significant influence. It collaborated with Sukarno. Under the new political regime the President shared power with the Army. However, from the beginning there were deep divisions within the army on the stance it ought to adopt towards Sukarno and the Army was, by and large, strongly opposed to the PKI. This three - way alliance was therefore an insecure one and depended critically on President Sukarno's ability to maintain a delicate balance between the interests of the two opposed factions. In economic terms, the seizure by the state of all Dutch property in Indonesia at the end of 1957 marked the beginning of a much more interventionist phase which lasted up to 1965.

The roots of the hyperinflation of the 1962 to '66 period are usually traced to the early years of 'Guided Democracy'. While the government budget had been in deficit each year from 1952, up to 1957 the deficit was equivalent on average to 15% of revenue. The rate of increase of consumer prices was also relatively modest during these years. The Jakarta cost of living index registered an average annual increase of 13% between 1951 and 1956. In 1957 however, the government deficit was equivalent to 24% of revenue and to 51% the following year. The rate of inflation increased from 8% in 1956 to 35% in 1958. Mackie argues that the decision by the government in December 1956 to put aside budgetary restraint in the face of the political challenge posed by the regional rebellions represents a more important turning point in Indonesia's economic and political history than the nationalisation of the Dutch enterprises in December 1957 which is typically viewed as the post-war watershed. Thereafter deficit financing came to be used as a "political safety value" allowing the government to "sidestep awkward questions about how to make ends meet, whenever this might have entailed decisions which would have antagonised elements in the political community whose support (was) essential to the "regime" (Mackie, 1967, p.20). Two costly military campaigns spearheaded by President Sukarno and the PKI and opposed by the Army helped to distract attention from internal disunity towards united action against external agents, and in the later years of "Guided Democracy', from the mounting economic disequilibria. The first was a successful campaign launched in 1962 against the Dutch for West New Guinea which, as West Irian, became part of Indonesia in May 1963. The second was part of the 'policy of confrontation' with Malaysia which lasted from 1963 to 1966. The policy of confrontation resulted from the opposition of President Sukarno and the PKI to the formation of the federation of Malaya, Sarawak, Sabah and (until 1966) Singapore, to become the nation of Malaysia. Sukarno and the PKI viewed Malaya and Singapore as tools of British neo-colonialism and the formation of Malaysia as part of an "imperialist plot" to encircle Indonesia. These military campaigns, contributed to the economic decline. It is estimated that during the first half of the 1960s over one-third of the foreign debt accumulated by Indonesia was used for military expenditure. The decision in 1964 to break off all commercial relations with Singapore and Malaysia as part of the policy of confrontation affected almost half of Indonesia's export trade. Further, Western donors demonstrated their disapproval by reducing their aid commitments. Another significant drain on resources during this period were the prestige projects, such as national monuments, tourist hotels and mosques, which were intended to inspire national pride and unity and were accorded priority in the government budget. These non-productive investments, known as the President's Special Projects, were continued even when expenditure on development projects was being severely curtailed in the later years of the hyperinflation.

There were attempts to reduce the government deficit on several occasions between 1957 and 1965 but each was abandoned before the objective could be reached. Following one such attempt in 1959 involving budget restraint and a monetary purge - which involved reducing the value of all Rp.500 and Rp.1,000 denomination banknotes to 10% of their face value and "freezing" 90% of bank deposits over Rp.25,000 - the money supply was reduced by one-third and the rate of inflation moderated in 1959 and 1960[4]. However a number of factors conspired in late 1961 to provoke a new round of price increases. These included a rice shortage which developed in September 1961 due to drought; increased money creation to finance the military campaign in West Irian which began in early 1962; and speculation brought about by the downward trend in the foreign exchange reserves. From 20% of revenue in 1960 the government deficit widened to 42% in 1961 and 63% in 1962; the money supply almost doubled between 1961 and 1962; and net foreign reserves declined from US$328 mn in 1960 to $117 mn in 1962. This marked the beginning of the period of acute disequilibria.

There was one major attempt to check the inflation during 1963. Stabilisation measures adopted at that time included budget austerity, relaxation of the many controls that had been introduced since 19.8, an emergency programme of imports made possible by foreign assistance and a new exchange rate regime designed to promote exports. The latter was the fourth major attempt since 1955 to reform the complex

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4 Grenville (1976, p.13) describes the 'monetary reform' as having been primarily designed to centralise the finances needed to launch state enterprises in the hands of the government.

multiple exchange rate system[5]. The impact of these reforms - an 86% devaluation in the basic official exchange rate, elimination of existing export taxes, revision of import surcharges and the introduction of a new exchange retention scheme (under which exporters retained 5% of their export proceeds and a further 10-15% was automatically allocated to them for purchasing essential imports) - was estimated to be a depreciation of roughly 40% in the effective export rate and a somewhat larger effective devaluation of the import rate (Kanesa - Thasan, 1966, p.361). The stabilisation measures were introduced in May 1963. Assisted by a good rice harvest in April/May, the measures appeared to be having an impact. In the three months from June to August, the Jakarta Cost of Living Index increased by 5.8% compared with a 26.3% increase in the five months to May (Newmann, 1974, Table 128). However the escalation of confrontation with Malaysia in September 1963 undid the progress that had been made. The planned reduction in the government budget deficit in 1963 and its elimination in 1964 were not achieved - the deficit grew from 63% of revenue in 1962 to 103% in 1963 and 140% in 1964. The new foreign exchange regulations were replaced in 1964 by another system whose main feature was a new export inducement certificate scheme under which exporters were allowed to retain approximately 20% of their foreign exchange earnings. By the end of 1964 there were three

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5 The earlier attempts to remove the exchange rate bias against exporters and reduce quantitative restrictions on imports were in 1955 (when the exchange tax on non-essential imports was increased, a tax imposed on essential imports, and the effective rate for exports devalued); 1957 (when exporters were issued with certificates equal to the full value of their exports which were to be sold in a free market with 80% of the proceeds being retained by the seller and the remainder going to the government as a tax); and 1959 (when the basic official rate of exchange was devalued). Kanesa - Thasan (1966, p.363) describes the exchange rate system immediately prior to the 1963 reform. There were "(1) three different types of exchange certificates valid for different types of foreign exchange payments issued against certain percentage of export earnings; (2) an exchange retention scheme permitting the exporter to retain a small part of his export earnings for use for certain categories of imports; and (3) differential rates of import surcharges applicable to different categories of non-essential imports. There were, as a result, more than 15 separate import rates in operation".

effective buying rates and seven effective selling rates (Johnson and Salop, 1979, p.54).

Thus, the principle cause of the hyperinflation resided in the government attitude to stabilisation. Throughout the period from independence to 1965 internal political struggles took precedence over economic policy. During the "liberal" years (1950-1957) frequent changes of government (eight cabinets, with diverse views on issues such as the respective roles of the public and private sectors and the appropriate stance towards foreign investment, held office) militated against any sustained, choherent approach to economic policy. During the years of "Guided Democracy" the underlying political instability continued to determine the course of economic policy. Thomas and Panglaykim (1973, p.76) sum up the situation thus:

> "The outward stability at the top over the ... years when "guided democracy" and "guided economy" gradually became the state ideology, provided the thin veil hiding the deep-seated antagonisms between competing groups centred around the President, the Army and the Communist Party. Until one group succeeded in uniting the various diverse elements under one banner .... it was futile to expect that much could be done in economic affairs".

The political crisis of 1965-66 paved the way for the introduction of the Rehabilitation and Stabilisation programme of October 1966. On the night of September 30, 1965 there was an attempt by the PKI faction in the ruling alliance to remove by force the anti-PKI leaders within the Army. The attempt, from which President Sukarno had failed to dissociate himself, failed, and within days the Army had carried out a successful counter coup. In an ensuing bloody civil war the Army and anti-Communist civilian groups took revenge on the PKI. It had been the largest communist party outside the Eastern bloc and China with an estimated three million members and seventeen million members of affiliated organisations. It was now virtually annihilated. It is estimated that between 300,000 and 500,000 people alleged to be members or sympathisers were killed, and tens of thousands arrested. Simultaneously, opposition to President Sukarno, born of dissatisfaction with his apparently ambivalent attitude to the attempted left-wing coup, grew. It was ennunciated in the first instance by student groups and ultimately by the Army. In March 1966 Sukarno was effectively replaced by a triumvirate comprising General Suharto (commander of the Armed Forces), Sultan Hamengkubuwono IX (the Sultan of Jogjakarata) and Adam Malik. Sukarno was formally stripped of his remaining powers in February 1967 and General Suharto was appointed acting President. In March 1968, Suharto was appointed President.

In the six months between the coup attempt and the de facto transfer of power, the economic situation had continued to deteriorate. Over this period, the Jakarta Cost of Living Index increased by 510% while the money supply grew by 237%[6]. Domestic industrial production stagnated, as, starved of imported inputs, plants operated at an estimated 20% to 30% of capacity. An ineffectual series of stabilisation measures was introduced in November/December 1965. These included a planned balanced budget for 1966, abolition of subsidies to public utilities and on petroleum products, new taxes, wage adjustments, devaluation and a currency reform.[7] In December Bank Indonesia (the central bank) defaulted on letters of credit held by Japanese exporters (to the value of $2 mn).

In July it was announced that a programme of stabilisation and rehabilitation was to be formulated aimed at controlling inflation and restoring production. However, the major economic policy measures were not announced until October. Between the transfer of power in March and the 'October Regulations' priority was given to consolidating the new political order, ending the confrontation with Malaysia (which was accomplished in August) and addressing the debt problem. Repayments due in 1966 amounted to $530 mn or $100 mn more than anticipated foreign exchange earnings in that year (B.I.E.S., No.4, June 1966 p.4). Efforts to have the debt rescheduled began in May and in July Indonesia's Western creditors met under the chairmanship of the Netherlands. A second meeting in mid-September to which Indonesia was invited, was

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6 Calculated from data in Newmann 1974, Table 31.

7 The currency reform of December 13 involved replacing old Rupiah by new ones with 1 new Repiah being equivalent to Rp.1,000 old. The reason for this "reform" was reputed to be the inability of the printing press to deal with the announced increases in civil service and armed forces salaries and the payment of bonuses for the Lebaran holiday in late January. "The decision to introduce the new Rupiah ... made it possible to put into circulation large stocks of Rp.50 and 100 notes printed in 1960 that had been overtaken by the inflation and never used" (B.I.E.S., No.4, 1966, p.7).

attended by delegations from Japan, United States, West Germany, France, Netherlands, Italy, the United Kingdom and Australia, as well as by officials from the IMF and observers from New Zealand, Canada and Switzerland. Agreement in principle was reached on a moratorium and rescheduling but it was decided to postpone drawing up a timetable until the next meeting in December, in Paris. In October 1966 the Soviet government agreed to a moratorium on debts until 1969. Bilateral rescheduling agreements were subsequently negotiated with most of the other communist creditor countries under which repayment was deferred until 1970. In the meantime "emergency relief of $119 mn for 1966 had been obtained".

During this period Indonesia was not formally a member of the IMF. It had joined the Fund in 1954 and had had Stand-by Arrangements in 1961 and 1963. The latter was in support of the 1963 stabilisation programme but was cancelled when the beginning of the policy of confrontation with Malaysia rendered attainment of the fiscal targets impossible. Indonesia withdrew from the United Nations - and as a consequence from the Fund and the World Bank - in August 1965 in protest at Malaysia's being admitted to membership. In June 1966 a Fund mission visited Jakarta to discuss re-entry and Indonesia officially applied for membership in July. The Executive Board agreed terms and conditions for re-entry at the September 1966 Annual General Meeting and Indonesia formally rejoined the Fund in February 1967. From August/September 1966 however, Fund personnel were assisting in the preparation of the stabilisation programme (Tomasson, 1970, p.47), and at the September meeting of Indonesia's creditors the Fund was asked to prepare forecasts of balance of payments magnitudes which would assist the Western creditor countries in organising re-scheduling.

II - The Rehabilitation and Stabilisation Programme 1966-1970

At the September 1966 meeting of the Western creditor countries, the Indonesian authorities outlined the programme of "rehabilitation and stabilisation" which they proposed to pursue. Its four interrelated objectives were:

"(a) by rendering a more proper role to market forces, (to) create a wider and equal opportunity for participation in the development of our economy by all creative efforts, state and private, domestic and foreign alike;

(b) the achievement of a balanced State Budget;

(c) pursuance of a rigid yet well-directed credit policy of the banking system;

(d) establishment of a proper link between the domestic and the international economy through a realistic exchange rate, and thus creating stimuli to reverse the downward trend of the balance of payments"[7].

As its title suggested the programme had two elements and the schedule (announced the previous month) had explained the order in which they were to be pursued. The programme was to have two phases: The first phase, "rehabilitation" would begin with a period of "resuscitation", lasting from July to December 1966, during which the government would try to ensure an adequate supply of essential commodities. This referred in particular to the so-called nine basic commodities - rice, sugar, salt, kerosene, textiles, rough batik, coconut oil, salted fish and soap. Between January and July 1967 the emphasis would be on improving productivity and increasing the supply of essential commodities. Phase two, "stabilisation" would last from July 1967 to July 1968 at which time the emphasis would switch from stabilisation to development. The September announcement revealed that the rehabilitation programme would be primarily concerned with four sectors : food, infrastructure, exports and clothing. With hindsight, and employing a yardstick more fashionable now than in the late 1960s, a striking feature of the Indonesian programme is the emphasis on supply side measures and structural adjustment. The twin goals of the programme - controlling inflation and restoring production - were pursued in tendem with adjustmentsbeing made whenever it appeared that the desired balance

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7 Press Statement quoted in B.I.E.S. No.5, October 1966, p.4.

between the two elements had been lost.

The extensive changes in the rules governing foreign trade embodied in the 'October 3 Regulations' marked the beginning of the rehabilitation and stabilisation programme, while the unification of the exchange rate in April 1970 can be viewed as marking its completion. Below, we consider the thrust of fiscal and credit policy, as well as the financial and exchange rate reforms introduced, during the intervening three and a half years.

Fiscal policy:

Since budget deficits had been the principal cause of the hyper-inflation, their elimination was a prime target of the stabilisation programme. The budget adopted for 1967 showed total revenue and expenditure balanced at Rp. 81.3 bn. While the realised revenue and expenditure figures reveal a small deficit (of Rp. 2.7 bn) equivalent to 3% of revenue, this was a remarkable contrast to the 1966 outturn which recorded a deficit (of Rp. 16.7 bn) equivalent to 128% of revenue. How was this turnabout achieved?

The expenditure side of the 1967 budget reflected the adoption of a programme of "severe austerity" and strict control over spending. Current expenditure accounted for 81% of the realised total and of this salaries of government employees alone accounted for 45%. The development budget accounted for 19% of total expenditure and within it priority was given to rehabilitating existing productive capacity rather than to launching new projects. Expenditure was concentrated in the four sectors identified as priorities for the rehabilitation programme. Most of President Sukarno's "special projects" were abandoned and the ending of the war with Malaysia presaged a reduction in military expenditure. Control over government expenditure was tightened in a number of ways. Responsibility for the budget was returned to the Ministry of Finance, all government expenditures were to be recorded in one budget; no supplementary or special budgets were allowed; and budgetary allocations were made on a quarterly basis.

In nominal terms revenue increased more than six-fold between 1966 and 1967 and as a proportion of GDP it increased from 4.1% to 10.0%. This improvement was due to a number of factors additional to more accurate recording of receipts and expenditure. During the years of hyperinflation the efficiency of the taxation system had deteriorated. Efforts to improve tax collection had begun in mid-1966. The results for 1967 were better than anticipated in the budget. Realised income tax receipts were more than double the budgeted level while corporation tax realised 154% of the sum anticipated in the budget. Tax reforms and changes in the exchange rate used for determining the local currency value of imports on which customs duty was levied also had a positive impact on government revenue. The import valuation rate was raised from Rp. 10 per US $ in October 1966, to Rp. 90 in March 1967 and again to Rp. 130 in July 1967. The contribution of direct taxes to government revenue continued to be relatively small, in 1967 only 19.8% of total revenue derived from this area. Similarly, dependence on taxes raised in the foreign trade sector continued to be very high with 40.6% of total revenue coming from excises, import duties and export taxes.

A major factor in balancing the 1967 budget was the inclusion of part of the foreign assistance obtained in that year in current budget revenue. In February 1967, Indonesia's Western creditors, now known as the Inter-governmental Group on Indonesia (IGGI), agreed to assist with the rehabilitation programme. Fund estimates had indicated a likely balance of payments deficit of $200 mn in 1967. The IGGI accepted that this was the level of credits required in 1967 and it was expected that bilateral negotiations with individual IGGI members would result in loans and grants to this level becoming available early in 1967. (Immediately after the February 1967 meeting, the United States pledged itself to provide one-third of the total assistance made available and Japan subsequently matched this offer.) In the event commitments in 1967 amounted to $173 mn. The Indonesians proposed that all the aid committed for 1967 should be made available through the BE (Bonus Ekspor) market. This was a free market in export certificates and as part of the move towards decontrolling trade and payments various steps were taken over the life of the programme to enlarge the coverage of this market. Under the BE system (which is discussed in more detail below) exporters exchanged their earnings for a combination of BE certificates, and Rupiah converted at the official rate. The BE certificates could be sold in the open market and used to purchase imports from the BE list of essential commodities and raw materials. As part of the October Regulations, it was announced that Bank Indonesia would create BE certificates against foreign aid funds and sell them on the open market. (It also began to sell some of the foreign exchange which exporters were obliged to sell to it. The difference between the Rp. 10 to the $ rate at which the authorities purchased the foreign exchange and the rate at which they sold it contributed significantly to government revenue in 1967 accounting for 12% of the total.) This procedure they argued, would assist in increasing the supply of essential imports as well as contributing to government revenue. The IGGI donors initially resisted this use of aid funds since it would reduce the scope for aid typing. Although the Indonesians proposed that the certificates be issued for use in a specified country, i.e. the donor country, the importers' freedom to purchase any item on the BE list and the preponderance of consumer goods on that list restricted the opportunity for directing the expenditure of the aid funds into particular sectors.[8] Posthumus (1971) argues that two factors explain the acquiescence of the donors to this use of aid. These were "the strong support of the Indonesian policies, including the specific proposals regarding the forms of aid, by the IMF representatives ... (and) the fact that the Netherlands had already after intensive bilateral discussions with Indonesia, accepted the BE mechanism as the channel through which both its 1966 aid as well as its 1967 aid to Indonesia should be introduced into the Indonesian economy" (p.21). In the event sale of credit BE accounted for 29% of realised budget receipts in 1967. It can be viewed as having financed the entire development budget plus 10% of the current budget.

Thus, relying heavily on foreign assistance the authorities almost balanced the government budget in 1967. However, the official deficit, of Rp.2.7 bn, appears to understate the level of government borrowing in 1967. This conclusion is suggested by the fact that of the total increase in domestic credit of Rp.33 bn in 1967, Rp.8.3 bn went to the government (See Table 4). Arndt, (1968, pp.2-5) quoting much larger figures for government borrowing than those implied by the discrepancy between the fiscal deficit and the increased claims on the government,

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8 The arguments put forward by the donors are more fully discussed in Posthumus, 1971, pp.19-21.

that is Rp.13.6 bn by the central government and a further Rp.4.4 bn by the state enterprises, suggests that the implied extra-budgetary expenditure subsidised the activities of government agencies such as the rice procurement agency (BULOG), the fertiliser distribution agency (PM Pictani) and the sugar producer (PN Gula). Further, an unpublished 1968 Fund report refers to extra-budgetary expenditure of Rp.14.4 bn, Rp.13.4 bn of which was spent on rice procurement. Nevertheless, the virtual balance achieved in the formal budget in 1967, coming as it did after fifteen years of progressively larger deficits, confirmed the government's commitment to economic stabilisation.

During 1967 the rate of inflation moderated significantly. The December to December increase in 1966 had been 635%. In 1967 it was reduced to 112% (see Table 5). However, the target had been a rate of price increase in 1967 equivalent roughly to one-tenth of the previous year's rate. This target appeared to be attainable up to the final quarter of 1967. The quarterly rate of price increase had fallen from 32% in the first quarter to 10% in the second. In the third quarter it rose to 12% and in the final quarter to 31%. A number of factors combined to produce this acceleration. They included a "rice crisis" precipitated by a poor secondary harvest in September coincident with a world shortage; foreign exchange scarcity; depreciation of the Rupiah and rapid monetary expansion during 1967 (see below p. 24).

The acceleration in the rate of inflation in late 1967 necessitated substantial upward revision in the estimates of government expenditure for 1968. The original budget estimates had assumed an inflation rate of 65% in 1967 and 30% in 1968 (B.I.E.S., No.9, p.13). The revised budget showed revenue and expenditure some 30% higher than the original. With a view to increasing government revenue the rate for sales of foreign exchange was raised in January 1968 from Rp.140 to Rp.240 per US.$. The valuation rate for import duties was raised from Rp.130 to Rp.240 per US $ in January and to Rp.275 in June. Also, in April, the prices of petroleum products, electricity and public transport were raised.

The "rice crisis" of late 1967 strengthened the authorities in their view that increasing the supply of the nine "essential commodities" was vital to the success of the anti-inflation programme. In particular, ensuring an adequate supply of rice at stable prices became the priority for 1968. This was to be achieved by increasing domestic production, importing larger quantities and improving the system for distributing rice within Indonesia. In 1967 a new official rice procurement agency (BULOG) had been charged with procuring and distributing the rice required for payments in kind to the civil and military services and with intervening in the market in order to stabilise the price of rice. When the rice shortage developed in the last quarter of 1967 BULOG held inadequate stocks to perform this second function. As a result, provision was made for it to import 600,000 tons of rice in 1968 compared to the 270,000 it had imported the previous year. By mid-1968 it became clear that purchases on this scale could not be financed within the revised budget estimates. Given the symbolic importance attached to formally balanced budgets it was decided to remove BULOG's operations from the budget and to finance them directly from Bank Indonesia credit.

The formal budget for 1968 was then balanced in line with the revised plan. Once again, 81% of total expenditure was on the current budget which was entirely financed from domestic resources. The development budget was financed by foreign assistance and within it priority was accorded to financing production of textiles and sugar, and purchases of fertiliser and pesticides. The contribution of direct taxes to total revenue increased from 19.8% in 1967 to 27.5% but dependence on revenue derived from taxes on foreign trade remained at roughly the same level as in the previous year (39.8% in 1968 compared with 40.6% in 1967). Foreign assistance provided 19.2% of total revenue while the proportion of total expenditure pre-empted by government salaries continued to decline (to 37.2% from 45% the previous year). The December to December increase in the Jakarta Cost of Living Index was 85%.

In 1969 a new fiscal year, running from April 1 to March 30 was adopted.[9] A budget covering the transitional period from December 31, 1968 to March 30, 1969, showed a small surplus of Rp. 143 mn. The budget for 1969/70 showed a small surplus of Rp 91 mn. A surplus of Rp 27.2 bn on the routine budget added to aid funds of Rp 91.1 bn of financed the development budget. Routine expenditure was 45% higher in nominal terms than in calandar year 1968 while development

9 This coincided with the rice crop year and was, therefore better adopted to the seasonal pattern of receipts and expenditure.

expenditure was 232% higher. Once again, foreign assistance accounted for one fifth (19.6%) of total receipts, direct taxes for about one-quarter (27.3%). Taxes raised in the foreign trade sector reduced their contribution to 33.8% (from 39.8% in 1968). Expenditure on personnel declined further to 27.8% of total expenditure (from 37.7% in 1968.) Revenue as a percentage of GDP had remained at around 10% in 1968 and 1969 and increased to 13.2% in 1970, while expenditure continued at approximately 11% (Sundrum, 1973, Table 1).

Credit Policy and Financial Reform:

Credit policy had a dual objective - restraining overall credit expansion while extending credit to increase supplies of essential commodities via imports and increased domestic production. Success was contingent in the first instance on fiscal policy and rapid reduction of the fiscal deficit. As Table 4 illustrates, in 1966, of the Rp. 18.4 bn increase in domestic credit, 68% had gone to the government. In 1967 the government share in the increment fell to 25% and the following year to 5%. In 1969 there was a slight decline in the absolute level of claims on the government while in 1970 less than 5% of the increment in domestic credit went to the central government. (Claims on official entities however accounted for a substantial part - in the region of 30 to 40% - of the increase in domestic credit in both 1968 and 1969).

Steps towards restricting overall credit expansion had been taken in May 1966 with a prohibition on overdrafts and new investment credits. The October Regulations added further restrictions including directives that import credits were to be extended only in special cases; export credits were to be strictly controlled; state enterprises were not to be afforded preferential treatment and the legal minimum reserve requirement of 30% was to be strictly enforced for all banks. Interest rates on loans from State commercial banks were now raised more than three fold to 6 to 9% per month from 25 to 50% per annum. The new rates were still less than one-third of the prevailing 'curb rates' reported to be in the region of 20-30% per month (Grenville, 1976). The restrictive credit policy introduced in October 1966 was relaxed in April 1967. The monthly increase in the cost of living

10 The new rates varied according to the nature of the activity; for food production and industry it was 6% per month; for export production and transport 7.5%; and for financing the distribution of basic commodities, 9%.

Table 4 - Indonesia : Monetary Survey, 1966-1974, absolute annual changes in bns. of Rupiahs

	1966	1967	1968	1969	1970	1971	1972	1973	1974
ASSETS									
Net Foreign Assets	-0.3	2.7	44.6	-4.5	-4.3	-8.8	206.4	74.4	365.7
Domestic Credit	18.4	33.0	100.1	118.1	139.5	129.8	163.8	36.9	387.9
of which:									
Claims on government	(12.5)	(8.3)	(5.4)	(-1.7)	(6.5)	(14.1)	(-53.1)	(-24.5)	(-121.1)
Claims on official entities	(...)	(...)	(37.3)	(36.0)	(-10.3)	(10.5)	(21.6)	(37.1)	(79.3)
Claims on private sector	(5.9)	(24.7)	(57.4)	(83.9)	(143.3)	(105.2)	(195.3)	(356.4)	(429.7)
LIABILITIES									
Money Supply	19.6	29.3	64.7	67.2	66.8	69.0	154.8	197.0	271.4
Quasi Money	.2	2.1	9.8	37.7	30.2	68.4	82.9	109.5	204.9
Other items (net)	-1.8	4.3	70.0	8.7	38.3	-17.1	132.5	137.5	277.1

SOURCE: IFS Yearbook, 1980.

had fallen to 4% in March (compared with 30% in March of 1966). Given this improvement and in response to complaints from the business community that it was facing a liquidity crisis, interest rates were lowered to 4-7% per month. In July, they were further lowered to 3-5% per month.[11]

Domestic credit increased from Rp 36.2 bn at the end of 1966 to Rp 69.2 bn by the end of 1967 (a 91.2% increase), while the money supply increased by 132% (see Table 5). The expansion was particularly marked in the last quarter of 1967. The rate of growth of domestic credit increased from 13.6% in the third quarter to 50.3% in the fourth quarter, while the rate of growth of the money supply increased from 20.4% to 32%. Some progress was recorded in redirecting credit towards the private sector: it grew by 353%. Comprehensive data on credit utilisation in 1967 are not available. However, Newmann (1974) estimated that between the last quarter of 1966 and the last quarter of 1967 roughly one-half of the total credit extended was Bank Indonesia credit and that of this, 40% went to agriculture, which had been identified as the priority sector.

Table 5 Indonesia: Consumer Prices, the Money Supply and Domestic Credit, 1966-1977 (annual percentage changes)

	Jakarta Cost Living Index			
	Yearly	December to December	Money Supply (M2)	Domestic Credit
1966	1044.7	635	753.8	103.4
1967	171.0	112	132.0	91.2
1968	128.0	85	125.6	144.6
1969	15.9	10	57.8	69.7
1970	12.3	9	36.4	48.5
1971	4.4	...	27.6	30.4
1972	6.5	...	48.5	29.4
1973	25.3	...	41.6	51.2
1974	40.7	...	40.4	35.6

Source: IFS, Various Issues and Unpublished Fund documents.

11 Some credits for agricultural production and industrial rehabilitation were made available at rates of 1 to 1¼% in June.

The money supply (M_2) increased by a further 125.6% in 1968 while domestic credit expanded by 144.6%. With a December to December increase in the cost of living index of 85% in 1968 domestic credit expanded considerably in real terms. This trend continued in 1969 and 1970 with domestic credit increasing by 69.7% and 48.5% in these years while the cost of living index increased by 10% and 9% respectively (see Table 5). The prohibition on credits of more than one year was removed with the introduction of a new medium-term investment credit scheme (providing credit for up to five years) in April 1969.

The authorities' control over the supply of credit from the commercial banks was imperfect.[12] However, the private banks accounted for only about 20% of bank credit while Bank Indonesia and the state banks which were more or less under its control, provided 80%. Further, since the commercial banks were "by and large in an overloaned position", (Ismael 1980) this lack of effective control did not jeopardise the stabilisation programme.

Turning to the demand for money, it is evident from Table 6 that as the rate of inflation declined, the income velocity of circulation also declined and the index of real cash balances increased. The downward trend in income velocity was particularly marked from 1968 with the largest reduction - from 24.1 to 17.6 - occurring between 1968 and 1969.[13] The index of real cash balances increased from 66 to 91 (1965 = 100) between these years.[14] From 1969 restored confidence

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12 A banking crisis in August 1967 illustrated the weakness of control over the commercial banks. Twenty-two private banks were found to have ignored the minimum reserve requirements. They were suspended by Bank Indonesia and some of them were barred from resuming banking operations.

13 Sundrum (1973) contends that from 1969 the decline in the velocity of circulation was due less to re-establishment of confidence in the Rupiah then to 'real' factors such as increasing monetisation and structural change resulting in the modern sector becoming relatively more important.

14 As early as 1967 there was evidence of increasing confidence in the Rupiah as the rate of price increase moderated. However, the deterioration in the last quarter of 1967 undid this. An unpublished Fund documents records an increase in the index of real cash balances from 32 in February 1967 to 45 in August (1960 = 100) followed by a decline to 37 by end-November.

Table 6 : Index of Real Cash Balances and Income Velocity of Circulation 1966-1971

	(1) Consumer Price Index (1965=100)	% increase	(2) Money Supply Index (1965=100)	% increase	(2) - (1) Index of Real Cash Balances (1965=100)	(3) Income Velocity of circulation
1966	1086	985.7	861	761	79	25.5
1967	2942	170.9	1993	131	68	23.0
1968	6714	128.2	4407	121	66	24.1
1969	7786	15.9	7064	60	91	17.6
1970	8743	12.3	9343	32	107	15.2
1971	9129	4.4	12114	30	131	12.8

Source: Col. (1) and (2) calculated from IFS Supplement 1972. Col. 3, Sundrum 1973.

in the Rupiah and the consequent change in liquidity preference made the much reduced inflation rates compatible with very much larger increases in the money supply (see Table 6).

Financial reforms introduced during 1968 appear to have been very successful in stimulating the demand for money. The most notable of these was the introduction of time deposits offering positive rates of interest of, initially, 6% per month for twelve month deposits. The scheme was introduced in October 1968 and for the next eighteen months Bank Indonesia subsidised the interest payments. As inflation moderated the rate of interest was lowered in stages and by January 1970 it was 2% per month on twelve month deposits. As Table 7 illustrates the scheme was very successful in attracting funds to the banks. Between 1968 and 1969 the share of time deposits in the money supply (M2) increased from 9.6% to 22.1%.

Table 7. The Components of the Money Supply 1965 to 1970, Rups. bn and % shares

	1965		1966		1967		1968		1969		1970	
M2 (Rups.bn)	2.66		22.55		53.67		125.74		233.9		321.07	
	Rups.bn	%	Rups.bn	%	Rups.bn	%	Rups.bn	%	Rups.bn	%	Rups.bn	%
of which currency	1.81	68.0	14.36	63.7	34.05	63.4	74.5	59.2	114.25	48.8	152.79	47.6
demand deposits	.77	28.	7.85	34.8	17.37	32.4	39.21	31.2	68.0	29.1	88.27	27.5
time deposits	.08	3.0	.34	1.5	2.25	4.2	12.03	9.6	51.61	22.1	80.01	24.9

Source: IFS Supplement 1972

The structure of the banking system was also being reformed over these years as part of the general policy of 'decontrolling' the economy. The Banking Act of 1967 dissolved the 1965 merger of Bank Indonesia and the state commercial banks as a prelude to re-establishing Bank Indonesia as a genuine central bank divested of its commercial banking operations.[15] Data in Grenville (1976) suggests that over the period 1960 to 1968 Bank Indonesia was providing on average roughly one-third of total bank credit to the private sector. This declined to 9% in 1969. The State commercial banks on the other hand, who up to 1965 had provided on average 47% of credit to the private sector, provided about two-thirds of the total in the 1965 to 1970 period. The responsiveness of the public to the high interest time deposits scheme greatly faciliatated the expansion in the role of the commercial banks.

Exchange and Trade Reforms:

A central element in the policy of 'decontrol' was dismantling in stages the complex multiple exchange rate system and removing controls on foreign trade. Major steps towards these ends were taken in the Regulations issued in October 1966.

Prior to October 1966, it was mandatory for exporters to exchange at the official Foreign Exchange Fund the product of the volume of their exports and the 'check price' for the product exported set by the Department of Trade in foreign currency. Depending on which of three categories the exports fell into - traditional exports (e.g. rubber), primary exports with less established markets (e.g. coffee), or non-traditional exports (e.g. handicrafts) - the exporter received either 20%, 60% or 100% of the foreign exchange proceeds in the form of B.E. (Bonus Ekspor) certificates, and the remainder in Rupiah converted at the very unfavourable official rate of Rp 10 to the US $. The certificates could be used by the exporter to purchase imports on the B.E. list or sold on the open market. Any difference between the official "check price" and the price actually obtained by the exporter could be retained. This was known as the "over price" or

15 In addition to the Central Bank Act, an Act allowing foreign banks to operate in Jakarta was also passed during 1968.

DP (Devisa Palengkap). There were five categories of imports :

- I essentials such as rice and pharmaceuticals
- II raw materials etc. used in foreign exchange earning activities;
- III raw materials etc. used in production for doemstic consumption;
- IV other;
- V prohibited.

Items from categories I, II and III, as well as some from IV could be bought with dollars obtained from the Foreign Exchange Fund at the BE rate. All items in the first four categories could be financed with DP making it somewhat more attractive than BE.

The October 1966 Regulations made changes in the export and import regimes. With a view to promoting exports, the Regulations reduced the proportion of foreign exchange earnings which exporters had to sell to the Foreign Exchange Fund from 80% to 40% for Category I items and 40% to 15% for Category II. Category III continued to be exempt. However, exporters had to sell 10% of earnings to regional authorities (at the Rp.10 to the US$ rate) who could use this to buy imports or sell it on the open market. Bank Indonesia now began to sell foreign exchange from the Foreign Exchange Fund at a rate that closely followed the free market (BE) rate. In addition, as mentioned above, Bank Indonesia began to sell foreign credits through the BE system, again at a rate determined by the government but following closely the BE rate. Import regulations were liberalised and a 200% surtax on imports was abolished. However, with a view to raising government revenue, the exchange rate used for determining the local currency value of imports on which customs duty was livied was raised from Rp. 10 per US$ to Rp. 75 per US$ and 50% of import duties had to be paid in advance. This latter requirement was removed in March 1967 but the import valuation rate was raised from Rp. 75 to Rp. 90 per US$.

Thus, following the October 1966 Regulations there were four principal exchange rates: the Export BE, market-determined rate; the credit BE officially determined rate; the DP market-determined rate; and the officially determined rate applied to the mandatory sales by exporters to the Foreign Exchange Fund and the regional authorities, 'essential' government imports, and the foreign exchange transactions of foreign oil companies. The Export BE rate was by far the most important of the four, typically covering about 70% of foreign exchange transactions. A flexible exchange rate policy was adopted with Bank Indonesia intervention in the market being limited to smoothing out temporary fluctuations.

Import and export regulations were altered again in July 1967. The three-way export classification was replaced by two groupings: In the case of Group A (formerly Category I) the Central Government would receive 15% of the export earnings in the form of a direct tax, rather than as a sale of foreign exchange; in the case of Group B (formerly Categories II and III) the Central Government would cease to receive any of the proceeds. In the case of both groups the Regional Government continued to receive 10% of the proceeds. The July regulations were precipitated by the widening of the disparity between official check prices and the actual prices being obtained by exporters. This difference, the overprice, had been allowed to grow such that an unacceptably large proportion of foreign exchange receipts was being sold on the DP market with a consequent loss of revenue to the government.[16] Under the July regulations check prices continued in existence becoming the basis on which tax due to the Central Government in respect of Group A products was calculated. The check prices were however significantly increased. In the case of Group B products they were abolished. With a view to stimulating domestic production import duties on some finished goods were increased while duties on raw materials were lowered and sales taxes on some domestically produced, import-competing manufactures were reduced or abolished. In view of its importance to the achievement of a balanced budget in 1967 steps were taken to promote the sale of foreign assistance BE credits. For example, the BE list was widened to include capital goods, spare parts and essential foodstuffs; credit BE became available from all foreign exchange banks; downpayments on opening letters of credit were reduced from 100% to 50% in the case of consumption goods and 100% to 25% for other imports. The import valuation rate was again raised, from Rp 90 to Rp 130 per US$. The exchange rate system was further simplified with the abolition

16 It was estimated that by July 27% of foreign exchange earnings were going into the DP market, see B.I.E.S. No.8, October 1967.

of the Rp 10 to the US$ rate.[17]

Table 8 Principal Exchange Rates 1966 Quarter IV to 1970 Quarter II (quarterly averages of month-end figures) Rp per US$.

	BE		DP	Trade Weighted Real Exchange Rate Jan.1968 = 100 (average of monthly figures)
	Export	Credit		
1966 (IV)	85	90	109	...
1967 (I)	102	88	118	...
(II)	139	132	149	...
(III)	143	131	165	...
(IV)	196	137	203	...
1968 (I)	264	238	295	97.9
(II)	296	271	333	83.5
(III)	312		416	92.4
(IV)	326		432	93.7
1969 (I)	326		389	97.1
(II)	326		380	93.4
(III)	326		379	95.0
(IV)	326		378	97.3
1970 (I)	326		378	104.8
(II)	378			

SOURCES: B.I.E.S., various issues, Newmann 1974, Tables R,K-1 and K-2, and UNCTAD, unpublished figures.

17 From December 1966 government imports had been valued at the full rate and the imports of state enterprises were also valued at this rate after March 1967.

The Export BE rate depreciated rapidly during the "rice crisis" of the last quarter of 1967 and the first quarter of 1968 despite Bank Indonesia intervention in January (see Table 8). In May 1968, in an effort to halt speculation, regulations were introduced requiring exporters to sell BE immediately to foreign exchange banks who were required to offer it for immediate sale. Up to May BE certificates had been valid for three months and from May for three weeks. At the same time the distinction between Export BE and Credit BE was abolished with the rates being unified at Rp. 312 to the $. In view of the continuing foreign exchange shortage further regulations were introduced during June and July 1968 designed to alter the pattern of imports by discouraging less essential items, and promote the use of foreign credits. The distribution of the 1968 aid inflow over the year was very uneven with relatively little becoming available in the first half of the year. Japanese credits became available in July and relieved the foreign exchange shortage to some extent. The BE rate depreciated slightly in the third quarter of 1968 before stabilising at Rp. 326 to the $. The DP rate continued to fluctuate until the second quarter of 1969. Thereafter it stabilised at Rp. 378 per $, the rate at which BE and DP were unified in April 1970.[18]

In addition to the exchange and trade reforms mentioned above other steps towards decontrol included the abolition of special treatment for public enterprises in the provision of credit, reduction of subsidies to state enterprises and the promulgation of a new Foreign Investment Law in December 1966. The latter provided for tax holidays, the rights to transfer profits and compensation in the event of nationalisation.

How successful were these policies in achieving the aims of the stabilisation and rehabilitation programme? Below we look at their impact on inflation, the balance of payments, growth, income distribution and structural adjustment.

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18 The previous BE rate of Rp.326 per $ was maintained for aid funds as an incentive to their greater utilisation until December 1970. In August 1971 the basic exchange rate was altered to Rp.415 per US $ and therefore remained unchanged until 1978.

III - The Impact of the Stabilisation and Rehabilitation Measures

Inflation

Guitian (1981) has suggested three possible standards for assessing the sucess of Fund-supported stabilisation programmes. They are first, a positive standard which measures performance by comparing the results achieved under adjustment programmes to the situation that prevailed before the policy measures were introduced. This he calls measuring "what it is" against "what it was", or for brevity the "is/was" criterion. The second of Guitian's measures is normative and compares actual results achieved under programmes to the targets specified in those programmes, that is, "what is" with "what should be" (the is/ought criterion). The third measure is conjectural, comparing actual performance to the probable outcome in the absence of a programme, that is a comparison of "what is" with "what would have been". How does the Indonesian anti-inflation programme score on these three criteria?

On the "is/was" criterion the inflation record is impressive. Over the life of the stabilisation programme the annual average rate of inflation declined from 1045% in 1966 to 12% in 1970 and continued to decline until 1973. Comparing outcomes to targets (the "is/ought" criterion) the record is less good. However, Guitian has urged the necessity of distinguishing between targets and forecasts, pointing out that targets are often formultated with a view to influencing, via expectations, the actual outcome. They may therefore, be set intentionally at unrealistic levels. This is certainly likely to have been the case in Indonesia in 1966 when after the years of hyper-inflation stabilisation depended crucially on breaking expectations. The inflation target for 1967 was a reduction in the December to December increase from 635% in 1966 to 65% in 1967. In the event a substantial reduction was achieved but the target was exceeded by 47 percentage points. As discussed above, the initial target appeared to be attainable up to September 1967. With the exception of February 1967, when in response primarily to an eight-fold increase in petrol prices the cost of living index rose by 19%, the monthly inflation figures were following a downward trend. In the last quarter of 1967 however a number of factors combined to produce a marked acceleration in the rate of inflation.

The growth in the money supply appears to have been the fundamental cause of the acceleration. Grenville, (1979) among others, has argued convincingly that this, rather than the cost push impact of rice prices, was the critical factor in general price formation. He contends that since, at the peaks of both the 1967/8 and the later 1972 rice crises, the non-rice price index flattened out, the impact of the increased rice price was a change in relative prices. He agrees that prior to 1966 rice price increases may have influenced the general price level indirectly through the money supply since, as civil service and military salaries were paid partly in rice, a rise in the rice price would have led to a rise in the budget deficit and therefore in the money supply. However, he argues that since the adoption of the balanced budget policy in 1967, and in the absence of evidence that the money supply rose abnormally during or immediately after the rice crises, this link no longer exists. However, the practice of paying civil and military salaries partly in the form of a rice allowance continued after 1966. The evidence quoted above of considerable extra-budgetary expenditure in 1967 occasioned by the increased cost of the weekly rice rations suggests that the increase in the money supply and the increase in the rice price were not totally independent of each other. More importantly, perhaps, the rice crisis contributed to the apparent loss of confidence in the government's stabilisation policies. The rice price was popularly regarded as "the touchstone of price stability" (Arndt 1968 p.4), and in a still uncertain political and economic climate such evidence of instability threatened to put the entire strategy at risk. Rice accounted for 31% of the weight of the Jakarta Cost of Living Index. Between the end of September 1967 and the beginning of February 1968 when rice prices peaked, the cost of a kilo of rice in Jakarta had risen more than three-fold. A stable rice price was perceived as crucial to the success of the stabilisation programme and its achievement became the priority for 1968. After the rice crisis ended in February 1968, the monthly changes in the consumer price index ranged between +6% and -6% for the remainder of the year. The December to December increase was 85% compared to a target of 55%. For 1969 the target was to reduce by one-half the rate of price increase of 35% recorded during the twelve months ended January 1969. The rate was reduced during calendar year 1969 to 10%. For 1970, the objective was to contain price increases within the 1970 level and this was achieved, the actual increase being 9%.

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19 Cole (1976) argues that the inflation rate could have been reduced to 20-30% in one year had rice supplies been adequate in 1967.

These declines in the rate of inflation were achieved simultaneously with the pursuit of apparently expansionary monetary and credit policies. As we have seen, the money supply increased by over 100% in both 1967 and 1968 and by 58% and 36% respectively in 1969 and 1970. Domestic credit expanded by 91% in 1967, 145% in 1968, 70% in 1968 and 48% in 1970. Thus the real money stock increased over the life of the programme as the demand for money rose and the level of liquidity in the economy increased from the abnormally low level to which it had fallen during the hyperinflation years. The increasing demand for money was successfully stimulated by the financial reforms. McKinnon (1973) cites Indonesia and Korea as examples of the benefits which can accrue from a rapid shift from financial repression to positive real interest rates. He suggests that the Indonesian financial system was not as efficient as the Korean in directing the lending made possible by the real monetary expansion into high productivity investments. Nevertheless, the evidence suggests that the financial reform had a strong positive impact on capital accumulation and output.

What of the third, counterfactual criterion? Guitian suggests that it is perhaps both the most controversial and the most appropriate standard by which to judge programmes. In the Indonesian case however, it is perhaps less controversial than it might be since, by the time the programme was launched the existing path was clearly unsustainable. Instability was undoubtedly having a negative impact on growth and development. Real per capita growth rates were negative in all but one year between 1962 and 1966. The investment rate declined from 1961 (with the exception of 1964) and the country's infrastructre was in disrepair. Negative real interest rates were ineffectual in matching investible funds with investment opportunities. Liquidity preference had been eroded. The very restrictive exchange controls and multiple currency practices combined with the growing instability had led to the growth of black markets, capital flight and speculation.. The overvalued official exchange rate was a disincentive to exporters. Net foreign reserves were negative and in the twelve months to June 1966 the rate of inflation was more than 1,500%. The need for wide-ranging economic reforms and the establishment of a rational system for the allocation of resources was obvious. Thus, the interesting counterfactual in the Indonesian case is less what would have happened without a stabilisation programme than what was the range of alternative policy options open to Indonesia in 1965-66. Some critics of the path actually chosen conjecture that had it not been for the successful counter coup in September 1966, Indonesia might have embarked on a more centrally planned economic development path assisted primarily by Eastern bloc rather than Western creditors. This debate does not fall within the compass of this paper. However, it is interesting to note that in 1963, during the last serious attempt to right the economy before the political upheaval of 1966, the economic policy package negotiated by President Sukarno's government with the IMF was similar in all its central features to the programme adopted after 1965. However, it must be seriously doubted that the authorities were ever fully committed to implementing the 1963 programme. This lack of commitment perhaps reflected a fear that pursuit of economic stabilisation might be politically destabilising, and might threaten the fragile political consensus that underlay "Guided Democracy".

Balance of Payments:

As we have seen the balance of payments position had deteriorated rapidly from 1960. Developments in the trade and current account balances over the years of the stabilisation programme are shown in Table 9. The trade balance was in deficit only in 1967 and the value of both imports and exports increased rapidly over the life of the programme. The terms of trade continued to deteriorate with the index varying between 76 and 68 (1960 = 100). The volume index of exports however, increased steadily from 109 in 1966 (1960 = 100) to 154 in 1970. The improved export performance was due in large measure to increased oil exports, which doubled in volume between 1966 and 1970 as, encouraged by the new attitude to foreign investment, the oil companies initiated new investment programmes. Increased exports were also facilitated by the continuing depreciation of the Rupiah, the lowering of exchange taxes on Category A exports in 1969 (from 15 to 5%) and the rehabilitation of the transportation network. Imports increased by 35% in value terms in 1967 and by a further 3% in 1968, 20% in 1969 and 12% in 1970. In each of these years roughly one-third of total imports was financed by aid receipts.

The commodity composition of imports altered over these years reflecting the successive phases of the stabilisation and rehabilitation programme. Data in Newmann (1974) show that in 1966 "consumer goods" had accounted for 34% of total imports with "raw materials and auxiliaries" accounting for 35% and "capital goods" for the remaining 31%. In 1967 the share of consumer goods increased to 44% as the authorities

Table 9 : Indonesia : Balance of Payments 1966-1970 (US $ mn)

	1966	1967	1968	1969	1970
EXPORTS (fob)	714	771	873	995	1173
IMPORTS (fob)	-596	-806	-831	-995	-1116
TRADE BALANCE	118	-35	42	0	57
Invisibles and Transfers	-241	-248	-293	-383	-433
BALANCE ON CURRENT ACCOUNT	-123	-283	-251	-383	-376
Financing					
Foreign loans and grants	119	265	265	314	407
Misc. capital transfers net	2	30	-23	56	-54
Monetary Movements	2	-12	9	13	23

Source: IMF, Balance of Payments Yearbook, Vol.21 July 1970, Vol.27, July 1976.

concentrated on increasing the supply of basic commodities. Rice comprised one quarter of these consumer goods imports and finished textiles one half. However in the wake of the rice crisis in late 1967 rice imports in 1968 accounted for almost half of consumer goods imports which increased their share of total imports to 46%. Tariffs on imports of finished textiles, which had been raised in April 1967 in response to complaints that local industry was unable to compete, were raised again during 1968. The proportion of finished textiles in consumer goods imports fell from 51% in 1967 to 18% in 1968. Imports of raw cotton and cotton yarn on the other hand increased ten fold (in value terms) between 1967 and 1968. With the achievement of price stability in early 1969, the emphasis of the programme shifted away from stabilistation towards promoting development. This was reflected in the resurgence of capital goods imports as a proportion of total imports. Having fallen from 21% in 1967 to 14% in 1968 it recovered to 29% in 1969 and 34% in in 1970. In line with the policy of trade liberalisation and decontrol alterations in the commodity composition of imports were achieved by relying more on incentives and less on direct controls. During 1968 a number of steps were taken both to reduce the demand for imports (in view of the foreign exchange shortage occassioned in part by much slower than anticipated disbursements of project aid) and to influence the commodity composition. Sales taxes were introduced on most imports, duties were raised, and some commodities were moved from the BE to the DP list. In general, the lower exchange rate for BE commodities, direction of foreign credits into the BE market preferential provision of credit for BE imports and relatively lower import duties on BE commodities, fostered imports of the basic commodities and capital goods essential to the stabilisation and rehabilitation programme.

The small surpluses on the trade account combined with substantial deficits on the services account resulted in current account deficits throughout the period. As Table 9 indicates these deficits were financed primarily by foreign assistance. The negotiations begun with Indonesia's creditors during the second half of 1966 had resulted in the rescheduling of almost all the guaranteed debt incurred prior to July 1966. As a result, debt service in 1966 absorbed $62 mn or less than 12% of the amount due that year prior to rescheduling. The Western creditors had agreed in December 1966 to reschedule arrears and payments due in the second half of 1966 and 1967 with a grace period until 1971. In October 1967 and 1968 agreements were reached on rescheduling pre-July 1966 debt repayments due in the following year, with grace periods of three years and repayment over eleven years. During 1970 a final rescheduling agreement was reached with the Western creditors which obviated the need for further annual negotiations. During 1966 also bilateral negotiations with the USSR had resulted in a rescheduling of outstanding debts with a grace period until 1969. Subsequently, rescheduling agreements were reached with Hungary, Czechoslovakia, Yugoslavia, East Germany, Poland, Romania and China. Repayments on long-term debt were to resume in 1970 and to be made over periods ranging from six to thirteen years. Repayment of short-term debt was to resume in 1968 and to be completed over periods ranging from two to five years. A further rescheduling was arranged with the USSR in 1970.

In addition to the rescheduling agreements, emergency foreign assistance of $119 mn had been secured during 1966. On the basis of balance of payments forecasts for 1967 prepared by the Indonesian authorities with the assistance of the Fund, the foreign exchange gap for 1967 was estimated to be of the order of $200 mn. A request for this amount was made to the IGGI group of Western donors and in bilateral negotiations a total of $173 mn of programme aid was committed. Including commitments carried over from 1966 a total of $195 mn of programme and a further $70 mn of project aid was utilised during 1967. For 1968, $325 mn of assistance was requested from IGGI on the basis of the predicted foreign exchange gap for that year. Commitments exceeded that amount (by $40 mn) but utilisation was at the same level as in 1967 owing to the fact that much of the new commitments was made available too late in the year to be utilised in 1968. As a result the level of imports was lower than anticipated. For 1969 the projected foreign exchange gap was $380 mn but a total of $500 mn in new aid commitments was requested from IGGI. This target was again exceeded but utilisation was somewhat lower than anticipated. At the December 1969 meeting of IGGI the Indonesian authorities requested aid commitments of $600 mn for the period ending March 1971. They described the programme as being at the transitional stage between stabilisation and development and progressively larger proportions of project aid in the requests from 1969 reflected this.

Growth:

The Indonesian programme is often correctly cited as an example of stabilisation with growth. Real GDP growth was 2.3% in each of 1966 and 1967 implying marginal declines in per capita GDP (see Table 1). Over the years from 1968-70 it averaged 8.6% per annum, or 4.1% in per capita terms. Performance in 1969 and 1970 exceeded the targets implied in the first five-year development plan (Repelita I) of an annual average growth rate of 5% over the five year period. The gross investment ratio, which had declined to 4.4% in 1966 increased steadily to 13.6% in 1970.

Income Distribution:

Income distribution data for the years leading up to and immediately following the economic crisis of 1965-66 are not comprehensive. Such evidence as there is however, suggests that at least the degree of inequality did not widen during the stabilisation period: Papanek's (1980) analysis of real wages in industry and plantation agriculture found that by the mid-1960s "wages generally were half or less than half of what they had been eight to ten years earlier" (p.84). Since the mid-1960s workers real wages showed a strong upward trend with industrial workers benefiting from a near doubling of both real wages and employment. He points out that this pattern emerged despite the fact that pre-1966 government policy was pro-labour while the increase in real wages occurred at a time when the power of organised labour was declining. Nominal wages lagged behind price changes both when inflation was high and accelerating from 1953 to 1966, leading to a decline in real wages and when inflation was lower and declining leading to a rise in real wages. Papanek argues that economic stagnation worsened not only the absolute but also the relative position of wage earners while during the economic recovery real wages and income increased more than the increase in average per capita income. Moreover, lower income workers both lost relatively more during the deterioration and gained more during the recovery. He suggests that income distribution probably became more equitable during the stabilisation period. After 1970 however, he suggests that income distribution probably became more inequitable with disproportionate gains accruing to skilled workers in capital-intensive industries.

The conclusions of work by Hughes and Islam (1981) agree in broad outline with those of Papanek. They suggest that urban inequality in Java showed little change over the 1964 to 1970 period but rose very sharpely between 1970 and 1976. For the Outer Islands, they found that urban inequality fell during 1964-'70 and remained unchanged during the subsequent six years. For both Java and the Outer Islands they estimated that rural inequality decreased significantly between 1964 and 1976./ A 1980 World Bank report also found evidence of increasing income inequality* Work by Johnson and Salop (1979) suggests that the stabilisation policies had only a marginal effect on the existing income distribution. There were, however, substantial shifts in distribution in favour of the urban sector, and within the rural sector, in favour of farmers producing non-food export crops.

*between 1970 & 1976.

Structural Adjustment:

As we have seen real GDP grew rapidly over the years of the stabilisation programme with an annual average rate of 8.6% from 1968 to 1970. The fastest sectoral annual average rates of growth from 1966-70 were recorded in construction (17%), and mining and quarying (16%). Transport and communications grew at an average annual rate of 14% and electricity, gas and water supply at 12%, while manufacturing grew at 8% per annum and trade, finance and services at 7% per annum (Johnson and Salop, 1979 Table 15). Agriculture, forestry and fishing grew less rapidly than the modern sectors with production of foodcrops increasing at an average annual rate of 5% and the remainder of the sector at 3%. Four priority sectors had been identified in the programme. These were food, textiles, infrastructure and exports. Rice production increased at an annual average rate of 6% while output of other foodcrops (maize, cassava, sweet potatoes) decreased on average by 2% between 1966 and 1970. Production of textiles increased 139%, very much more than total manufacturing. The high rates of growth in construction, transport and communication and electricity, gas and water attest to the rapid rehabilitation of the infrastructure. Exports increased 63% by value. However, most of the increase was due to oil. Oil exports increased 120% by value and doubled in volume terms while non-oil exports increased 45% by value and less than 40% by volume.

The price stability achieved in 1969 was lost in 1973 as net foreign assets expanded during the commodity boom of 1972 and the subsequent oil price rises.[20] Fiscal policy was not used to neutralise the massive expansion in international reserves and therefore in reserve money. Net foreign exchange reserves increased more than five fold between 1972 and 1974. Rather, the balanced budget policy followed during the previous four years was continued. Reserve requirements proved an inadequate instrument for controlling bank credit and, in April 1974 Bank Indonesia imposed credit ceilings on the entire banking system.[21] Reliance on direct ceilings became progressively greater after 1974 such that they are now the principal instrument of credit policy (Aghevli et al, 1979, p.804). Later, in a reversal of the monetary reforms introduced in 1966-70, Bank Indonesia was, in 1975, instructed to overstep its central banking function and directly finance huge debts incurred by Pertamina, the state oil company, which Pertamina itself was unable to service. Some of the trade

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20 For a discussion of the impact of the oil price rises on monetary policy, see Arndt, 1979 and McCawley, 1980.

21 This was part of a package of stabilisation measures which also included a budget for 1974-'75 designed to produce a surplus roughly equivalent to the anticipated growth in foreign exchange reserves; the introduction of a new eighteen to twenty-four month time deposit bearing an interest rate of 24% with the banks being subsidised from the government budget as deposit rates now exceeded lending rates; and an increase in reserve requirements on demand deposits (from 10% to 30%) and on time deposits (from 10% to 20%).

liberalisation achieved during 1966-70 was also undone in the subsequent four years with a significant increase in the number of prohibited imports designed to protect local manufacturing industry. Dependence on oil for export earnings and government revenue became even more pronounced. In 1974 oil accounted for 70% of export earnings and for at least 40% of domestic revenue in fiscal year 1973-'74. Real per capita GDP growth averaged 6% over these years. However, as indicated above, the evidence suggests that the distribution of income was becoming more unequal.

The 1966-70 programme was, nonetheless, a successful and apparently "low-cost" anti-inflation programme. Its success was assisted by a number of factors. The first was a function of the particular political configuration against which economic policy was designed in the immediate post - 1965 period. The political upheaval of 1965-66 created a climate favourable to the full implementation of the stabilisation programme. It brought to power a government which successfully consolidated its power between September 1965 and March 1966. Thereafter, Indonesia had a strong government committed to economic stabilisation and rehabilitation. The government's economic policies encountered minimal opposition. The groups that might have been expected to oppose the political and economic options chosen by the new government had been silenced. The political parties were in disarray and effective pressure groups drawn from, for example, the agricultural sector or the labour movement, either did not exist or were, for the moment concentrating on re-grouping and re-orienting themselves to the greatly altered politico - economic environment. The business community was virtually the only interest group outside government which succeeded in exerting some influence on the programme. Against this background, a small group of Indonesian technocrats sympathetic to the new political direction and enjoying the strong personal support of President Soeharto had unusually extensive scope to design and implement the stabilisation programme. This is not to suggest that the successful implementation of such a programme was contingent on the bloody events of late 1965 or on the continuation of an authoritarian political order. The crucial difference between the stabilisation programme of 1966-70 and earlier attempts to achieve economic stability, both during the period of "Guided Democracy" and the prior period of parliamentary democracy, lay in the degree of government commitment to economic stabilisation as a policy goal. Given the size of the disequilibria in 1966 and the need to alter expectations quickly, a gradualist approach to stabilisation was considered to be inappropriate. The absence of a political opposition and active interest groups, particularly during the early stages of the "shock treatment" probably contributed to the success of the programme, but there is no evidence to suggest that it was necessary to it.

A second factor contributing to the success of the programme was that there was little difficulty, at least in the early stages, in unambiguously identifying the immediate cause of the disequilibrium. Reducing the fiscal deficit had clearly to be the top priority. A third factor was the support provided by the IGGI group of donors. Between 1966 and 1970 the IGGI members provided a total of $1.2 bn of aid while approximately $550 mn of debt repayment originally due to them over these years was postponed. The availability of such large-scale financing contributed to minimising the inevitable short-run adjustment costs. It also assisted the success of the programme. The use of aid counterpart funds in the routine and development budgets in 1967 and thereafter in the latter only, was vital to the balanced budget policy. The availability of foreign assistance reduced the need for import compression and the acquiescence of the donor countries in the introduction of the aid funds through the BE system contributed to the government's goal of directing foreign exchange expenditure into the purchase of essential imports, thereby relieving shortages on the domestic market and contributing to the rapid reduction in the rate of inflation.

IV - The Role of the Fund

The Fund role in the Indonesian stabilisation programme was three - dimensional, comprising in chronological order, the provision of advice and technical assistance; participation in the meetings of Indonesia's creditors on debt rescheduling and the provision of new aid; and, from 1968, negotiation of six consecutive Stand-By Arrangements. Up to February 1967 Indonesia was not formally a member of the Fund. Nonetheless, from mid-1966 Fund personnel worked closely with the Indonesian authorities in designing and implementing the stabilisation programme. Shortly after Indonesia rejoined, the Fund appointed a Resident Representative to Jakarta and thereafter a small Fund staff was on hand to advise the Indonesian authorities. In addition, during 1967, at least fourteen Fund officials spent periods ranging from three weeks to six months in Jakarta providing technical assistance related to, for example, introducing and administering taxes and improving statistical series.

This close collaboration between the Fund and the Indonesian authorities equipped the Fund to play its second and crucial role as an intermediary between Indonesia and its creditors. The Fund lent its support to the stabilisation programme presented to the September 1966 meeting of the Western creditors and Japan - a programme incorporating most of the elements reportedly included in the advice offered by the Fund officials who visited Jakarta during the preceding two months. Fund officials participated in each of the meetings of the creditor group and made available to it Fund documents reviewing economic developments in Indonesia and commenting on the stabilisation plans of the Indonesian authorities. At the request of the creditor countries, Fund officials prepared statistics on Indonesia's external debt and its balance of payments prospects. Fund support was critical in catalysing assistance from the Western donor group. This was particularly true during late 1966 when rescheduling of Indonesia's debts was proceeding but no new aid commitments had yet been made (apart from some emergency assistance). The importance of Fund support in securing donor agreement to the use of new credits through the BE system at the February 1966 meeting of the IGGI has already been noted. Continued broad support for the stabilisation measures adopted by the Indonesian authorities during 1967 and favourable reports to IGGI on the implementation and impact of these measures contributed to the decision to provide a further $325 mn in aid for the calandar year 1968. Fund support had again been critical in early 1968 when the quickening of the pace of inflation from late 1967 threatened to undermine creditor confidence in the programme.

Somewhat paradoxically, it appears that Fund influence in IGGI was at its height during the early phase of the stabilisation programme before there were formal agreements between the Indonesians and the Fund. By the time the first Stand-By Arrangement took effect the emphasis had begun to shift away from provision of programme aid to support stabilisation, towards development projects. Consistent with this new emphasis the role of the World Bank in IGGI became increasingly important. The Bank had declined to take the lead role in IGGI at its inception on the grounds that Indonesia was not, at that time receiving aid from the Bank. However, following a visit by its President in early 1968 the Bank's activities in Indonesia increased rapidly. In May, the Bank took the, then unprecedented, step of establishing a permanent Bank mission in Jakarta to advise the Indonesian government. The mission was headed by a Resident Representative who came to be held in very high regard by the Indonesian authorities and played a key role in the subsequent deliberations of the IGGI.

The first of the six consecutive one-year, upper credit tranche Stand-By Arrangements between Indonesia and the Fund came into operation in February 1968. The final arrangement expired in May 1974. Financial flows between Indonesia and the Fund are shown in Table 10. Drawings under the Stand-By Arrangements were made in 1968, 1969 and 1970. No drawings were made under the last three arrangements. Two small drawings were made in 1971 and 1972 under the Buffer Stock Financing Facility, but it is the drawings in the previous three years that are of interest here.

Under the terms of the first Stand-By Arrangement (February 1968 to February 1969) a total of $51.75 mn was made available in five installments subject to Indonesia's meeting the performance criteria. The full amount provided for was drawn. (Repurchases were to be made within three years. However, in 1971 the Fund acceded to a request for a rescheduling of repurchases such that repayments would be made between June 1971 and December 1973.) The gross inflow of financial assistance from the Fund during 1968 was $45.0 mn. This was equivalent to roughly 14% of the $325 mm which the Fund estimated as the likely foreign exchange gap in 1968. The net inflow from the Fund was equivalent to less than 5% of the anticipated gap. However, with regard to financial assistance, the Fund role in catalysing aid from the IGGI group and in facilitating debt rescheduling was much more significant than its direct financing role.

The Letter of Intent stressed the government's commitment to achieving a balanced routine budget in 1968 from domestic resources. The government intended to use the counterpart funds from foreign assistance to finance the development budget. Cash salaries of civil servants and military personnel would be held at the level sanctioned at the beginning of 1968 while, with regard to wages in kind, cheaper grains would be substituted for rice as much as possible. The practice of quarterly fiscal reviews adopted in 1967 would continue with expenditure authorisations for each quarter being determined in the light of receipts in the previous quarter. With a view to maintaining the real value of revenue, the valuation for import duties and taxes would be adjusted in line with the BE market rate. Revenue from petroleum products sold domestically would be increased while further steps would be taken to reduce reliance on the foreign trade sector for government revenue. In view of the impact of the rice shortage in the last quarter of 1967 and the first quarter of 1968 the Letter stressed the importance of increasing rice production and domestic and foreign procurement. Policies to promote exports and improve further the commodity composition of imports would be implemented. New debt would be contracted only at low interest rates and with long grace and repayment periods. Regulations affecting exports would be simplified and the workings of the BE market improved. It was the government's aim to establish a par value for the Rupiah as soon as possible and to gradually reduce the divergences among market exchange rates with a view to establishing eventually a unified foreign exchange market. However, the immediate priority was to stabilise the domestic price level, and to improve the balance of payments and introduce new tax measures to replace the revenue currently derived from the spread in the exchange rates. Until price stability was achieved, the government would follow a flexible exchange rate policy. Bank Indonesia would intervene in the market only to smooth out temporary fluctuations and other rates would not be allowed to diverge from the BE market rate by more than 15%.

Table 10 : Financial Flows between Indonesia and the IMF 1968-74
(US $ mn)[a]

	1968	1969	1970	1971[b]	1972[c]	1973[d]	1974
Gross Inflows:							
Credit tranches	45.0	65.8	38.0	-	-	-	-
Buffer stock Financing Facility				2.9	2.9		
Total Gross Inflows	45.0	65.8	38.0	2.9	2.9	-	-
Repayments	30.0	17.6	3.2	15.0	21.7	103.7	38.8
Net inflow	15.0	48.2	34.8	-12.1	-18.8	-103.7	-38.8
Use of Fund Credit (outstanding balance at year-end)	64.0	112.0	138.0	125.0	116	23	-
Quota (year-end)	207	207	260	261	282	310	313
Credit as % of quota	31	54	53	48	41	7	

Other receipts as at end-1974

SDR allocations 90.2 mn.

Sources: IMF, Annual Reports and IFS

Notes: (a) From 1970 converted from SDRs at the average exchange rate for that year. Indonesia's quota in SDRs was 260 throughout the period from 1970 to 1974.

(b) In 1971 a one-year Stand-By of $50.0 mn was agreed but not drawn.

(c) In 1972 a one-year Stand-By of SDR 50.0 mn was agreed but not drawn.

(d) In 1973 a one-year Stand-By of SDR 50.0 mn was agreed but not drawn.

The programme outlined was in the first instance an anti-inflation programme with somewhat less emphasis on the balance of payments than more recent Fund-supported programmes exhibit. This reflects both the nature of the disequilibria in the Indonesian case and the fact that the programme predates the break up of the system of international trade and payments based on fixed exchange rates. At that time, with a view to supporting the fixed parities system the Fund placed relatively more emphasis on inflation control than it has tended to do since the early 1970s. The programme also contained a substantial supply-side emphasis. In supporting the request for a Stand-By Arrangement the Fund staff reported the view of the Indonesian authorities that in order to reduce substantially the rate of inflation it was necessary "to supplement their stronger financial policies by a revival of domestic production"[22] and to use aid counterpart funds to finance production in the textile, sugar and estate sectors, as well as to purchase fertilisers and pesticides. They also reported the view of the Indonesian authorities that "the current level of international reserves (was) not adequate to guard against unforseen contingencies," and that the arrangement requested would provide a much needed element of flexibility and strengthen public confidence in the implementation of their program."[23] There was a very wide measure of agreement between the Indonesian authorities and the Fund on the kind of programme required and the Fund was, in general, satisfied with the progress that had been made during 1967. The Fund staff report on the request noted that "on all outstanding financial and trade issues, the Indonesian authorities (had) clearly chosen policy alternatives which are consistent with the purposes of the Fund."[24]

The performance criteria were five and related to monetary, exchange rate and foreign debt policies. They were :-

- a quarter by quarter ceiling on the net domestic assets of Bank Indonesia, limiting the increase to Rp.24.6 bn or 50% over the life of the agreement.

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22 Unpublished Fund document.

23 Ibid.

24 Ibid

- a quarter by quarter ceiling on the net indebtedness of the government to Bank Indonesia, permitting an increase of Rp 5 bn or 16% over the year;

- a ceiling of $75 mn on new short-term foreign borrowing;

- a requirement that the net foreign exchange position of the monetary authorities not be lower on December 31, 1968 than it had been one year earlier;

- an undertaking that the legal minimum reserve requirement of state and private commercial banks would not be reduced (from the prevailing level of 30%).

In addition there was the standard clause requiring that no new multiple currency practices, bilateral payments agreements or restrictions on payments or transfers be introduced.

The ceiling imposed in the Stand-By Arrangement on the net domestic assets of the Central Bank was exceeded in the second half of June 1968. The Indonesian authorities explained that with a view to having greater reserve stocks of rice during the second and third quarters of 1968 they had increased rice procurement and reduced sales during the harvest season. This resulted in the domestic credit requirements of BULOG exceeding the anticipated level. By the end of June credit to BULOG had preempted Rp 7 bn of the allowed Rp 20 bn increase in net domestic assets between January and July. For the year as a whole net credit to BULOG amounted to Rp 19.4 bn while the ceiling allowed a total increase of Rp 24.6 bn. In view of this trend the Indonesian authorities applied to the Fund for a modification of the original agreement such that, for the period from July 1 to December 30 1968, rice credits would be excluded from the calculation of performance in relation to the net domestic assets ceiling (ie for the purpose of judging performance against the July and October quarterly ceilings). Following protracted negotiations, the Fund, viewing the increase in stocks as "prudent and desirable" agreed to the modification. Towards the end of the year a request for extension of this modification to the end of the Stand-By period also met with a positive response. The extension was necessary because, given the very good secondary harvest, BULOG had not resumed sales of rice and therefore had been unable to reduce its liabilities to the government. Without the modification the December 31 ceiling of Rp 71.5 bn was likely to have been exceeded by Rp. 13.5 bn. The original ceiling on net domestic assets had allowed for an expansion of 46.2% between January and December 1968 (or 50.3% by the end of the Stand-By period). If one adds the Rp. 19.4 bn of rice credits to BULOG outstanding at the end of December to the December ceiling, the permitted increase during 1968 was Rp 42.4 bn or 86.7%.

The period covered by the 2nd Stand-By Arrangement corresponded almost exactly with the 1969/70 fiscal year. The sum made available to Indonesia was $70.0 mn in three installments. Of this amount, $59 mn was drawn. Repuchases were to be made within three years. However, as with the first Stand-By, repurchases were rescheduled, in this case to be completed by October 1974. The gross inflow from the Fund during 1969 amounted to $65.8 mn or 17% of the anticipated foreign exchange gap for that year. (The net inflow was equivalent to 13%).

The Letter of Intent outlined the improvements in the economic situation during 1968 stressing particularly the sharp deceleration of inflation and increased production in agriculture, industry (notably textiles) and mining. It was noted however, that the level of Indonesia's foreign exchange reserves was still very low. The objective for 1969-'70 would be therefore, "to strengthen the balance of payments, improve net official foreign exchange reserves, and to foster higher levels of production in conditions of reasonable domestic price stability.."[25] Food policy would continue to be a cornerstone of the programme. The routine budget for 1969-'70 was expected to show a surplus (of Rp 24 bn) which, together with foreign assistance would finance the development budget. A substantial increase in the development budget was projected to coincide with the introduction of the Five-year Development Plan, with expenditure being directed primarily towards rehabilitation of the existing infrastructure. The Letter of Intent attaching to this second Stand-By Arrangement reads as considerably more assertive than the 1968 Letter. The programme is presented as the plans of the Indonesian authorities for the following year and the various targets and ceiling as emerging from these plans. This may reflect on a reported evolution in relations

25 Ibid.

between the Indonesians and the Fund wherein, as the rate of inflation moderated the former exerted progressively more influence on the design of the stabilisation programme and its priorities.

The performance criteria again related to monetary, exchange rate and foreign debt policies. There was again a quarter by-quarter ceiling on the net domestic assets of Bank Indonesia allowing for an increase of Rp 58.7 bn or 66% over the life of the programme. Unlike in the February 1968 agreement, there was not a ceiling on the net indebtedness of the government to Bank Indonesia, but credit to BULOG was included in the ceiling despite the modification to the preceding Stand-By Arrangement to exclude it. There was a floor on the net foreign exchange position of the monetary authorities permitting a maximum decline of $20 mn from their level in December 31, 1968. The flexible exchange rate policy was to continue with Bank Indonesia intervening only to prevent short-run fluctuations and to contain speculative movements. Thirdly, there was a combined ceiling of $125 mn on short-term trade and banking credits (maturing in twelve months or less) and medium term credits (of up to five years). The Letter also included a statement to the effect that no change was "presently contemplated" in the legal minimum reserve requirement applicable to state and private commercial banks. In addition it contained the standard clause eschewing new multiple currency practices or restrictions on trade and payments.

The performance criteria were met with one exception. The ceiling on the net domestic assets of Bank Indonesia for March 4, 1970 was exceeded by Rp 24.8 bn due to greater than anticipated expansion of credit to BULOG for financing rice imports and covering losses incurred in the Bimas-Gotong-Rojong programme designed to increase rice yields. This failure to observe the quarterly ceiling rendered Indonesia ineligible to draw the final tranche of the Stand-By funds ($11 mn). The actual increase in the net domestic assets of Bank Indonesia was therefore Rp 83.2 bn, an increase of 91% since January 1969. As we have seen rapid credit expansion was compatible with price stability during 1969 owing to the marked increase in holdings by the public of cash balances. However, the rate of increase during the first quarter of 1970 was considered to be excessive. As a result the ceiling on net domestic assets of Bank Indonesia in the third Stand-By Arrangement was considerably more restrictive than the preceding one allowing for an increase of only 32%.

This third arrangement covered the period from April 17, 1970 to April 16, 1971. The amount made available was $46.3 mn (or less than 10% of the anticipated financing gap) in four installments. Of this $30.0 was drawn. Repurchases were originally due to be made within three years but the Fund agreed subsequently to a rescheduling such that repurchases would be completed by June 1975. The Letter of Intent again anticipated a current budget surplus which, combined with foreign credits, would finance the development budget. In addition to the standard clause there were four performance criteria, relating to monetary policy, exchange rate reform, foreign reserves and debt. The ceiling on net domestic assets, excluding credit to BULOG, permitted an increase of Rp 61 bn (or 50%) over the fourteen months ending March 1971. A separate ceiling on credit to BULOG involved a decrease of Rp 7 bn (15%) over the same period. These combined ceilings allowed for a increase of Rp 54 bn in net domestic assets representing a sharp deceleration by comparison with the previous fourteen month period. Secondly, there was a commitment not to reduce the legal minimum reserve requirement for state and private commercial banks. Thirdly, there was again a floor on the net foreign reserve position of the monetary authorities requiring that by March 1971 it be at least $40 mn higher than its level of January 1970 (of minus $61.8 mn). Finally, there was a ceiling on new short and medium term debt such that short term debt (with initial maturity of 181 days to two years) contracted after March 31, 1970 would be limited to $35 mn, while medium term debt (initial maturity exceeding two years up to and including twelve years) would be limited to $70 mn.

A major feature of the 1970 Letter of Intent was the exchange reform which the Indonesian authorities committed themselves to introducing on April 17, merging the BE and DP markets at the higher DP rate the unified market to cover all transactions except imports and services paid for with foreign credits. The decision to devalue was the result of a drain on foreign exchange reserves in the last quarter of 1969 and the early months of 1970 due to increased demand for imports including higher than anticipated rice imports. While the BE rate had been stable at Rp 326 to the $ since October 1968, and the DP rate at Rp 378 since the second quarter of 1969, between

September 1969 and February 1970 Bank Indonesia had had to support these rates by sales, chiefly in the DP market, totalling $88 mn. While the devaluation became a central element in the Letter of Intent, it does not appear that the impetus for the change at that particular time came from the Fund. An advance copy of the Letter of Intent dated March 31, 1970 and annexed to a confidential Fund report recommending approval of Indonesia's request for a Stand-By, made no mention of the exchange reform. In discussions over the previous eighteen months, the Fund representatives had urged the ultimate adoption of a uniform exchange rate. However, it appears certain that the 1970 Stand-By would have been granted without the introduction of the exchange reform.

The performance criteria set out in the Stand-By Arrangement were adhered to up to November 1970,[26] which was the second "test" date. Thereafter, three of the ceilings were not met. By the end of January the ceiling on the net domestic assets of Bank Indonesia had been exceeded and by March 17, 1971 the final "test" date, the ceiling had been exceeded by Rp 6.9 bn. Credit to BULOG, instead of declining, increased marginally so that on March 17 it totalled Rp 48 bn rather than the ceiling of Rp 39.7 bn. Thus the actual increase in the net domestic assets of Bank Indonesia during the fourteen months from January 1970 was 41% rather than the 32% increase permitted under the terms of the Stand-By Arrangement. Thirdly, the Stand-By Arrangement had envisaged that the net foreign reserve position of Bank Indonesia at the end of the period would be $40 mn higher than at end-January 1970. In the event, the net reserve position was minus $41.2 mn, or $19.4 mn below the target. The failure to comply with these ceilings rendered Indonesia ineligible to draw the fourth and final tranche of the credit.

Thereafter, Indonesia negotiated a further three Stand-By Arrangements with the Fund. None of these arrangements were drawn upon. It would appear that they were negotiated because, somewhat in the manner of the commitment to balanced budgets, they had come to have a symbolic significance indicating - both domestically and perhaps to the creditors countries, Indonesia's continuing commitment to economic stabilisation. (From the Fund point of view at least until 1972 the level of net

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26 The April 1970 Stand-By Arrangement was modified in May 1970 to take account of three minor discrepancies between the exchange reform as outlined in the Letter of Intent and the provisions actually introduced on April 17.

foreign exchange reserves indicated a balance of payments 'need'). It is interesting to note the extent to which the ceilings under these later arrangements were adhered to, despite the fact that the credit was not being used. The credit ceilings were not exceeded during the lives of the fourth (April 22, 1971 to April 21, 1972) and fifth (April 17, 1972 to April 16, 1973) agreements. They were however exceeded during the latter half of the final Stand-By period (May 4, 1973 to May 3, 1974). The target for net official international reserves was not reached during the life of the fourth Stand-By but was greatly exceeded over the fifth and sixth Stand-By periods. The ceilings on borrowing were not exceeded during the fourth or sixth agreements but were exceeded during the intervening period. The extent to which the credit ceilings were adhered to up to mid-1973 combined with the rate of domestic credit expansion over the 1966-'70 period strongly suggests that, apart from the difficulties experienced in anticipating BULOG's credit needs, the credit ceilings under the successive Stand-By Arrangements were not restrictive, with the possible exception of the ceilings under the third Arrangement which, as we have seen, demanded a sharp deceleration in the permitted rate of growth. Despite the fact that only the first Stand-By Arrangement could be fully drawn, it appears that the role of Fund conditionality in the success of the stabilisation programme was relatively slight. The impetus for the stabilisation programme had come from the Indonesian authorities and its full implementation reflected primarily the importance attached to stabilisation domestically rather than the disciplines imposed by targets and ceilings negotiated under the Stand-By Arrangements.

V - Summary and Conclusions

This paper has considered some aspects of the Rehabilitation and Stabilisation programme implemented in Indonesia between October 1966 and April 1970.

In Part I the economic and political background to the crisis of 1965-'66 was examined. The principal cause of the hyperinflation experienced between 1962 and 1966 was identified as government budget deficits financed by money creation. Some of the social and political pressures on the expenditure side of the government budget were identified, as were some of the factors depressing government revenue. A major feature of this period in contrast to the following one, was the low priority accorded to stabilisation as a policy objective. While the major causes of the disequilibria were identified as domestic, deterioration in the terms of trade over these years also contributed.

Part II described the policy measures included in the 1966 programme : fiscal and credit policies, and financial, exchange and trade reforms. A balanced budget policy was adopted in 1967. Its implementation relied on the inclusion of the counterpart of foreign aid funds in government revenue, as well as greatly improved tax collection and restraint on government expenditure. In 1967 foreign aid financed not only development expenditure but a part of recurrent expenditure as well. Reliance on taxes raised in the foreign trade sector, which had formerly been a major source of instability was reduced over the life of the programme but taxes on imports and exports still provided 34% of government revenue in 1969-'70. Domestic credit increased more than ten-fold in nominal terms between the end of 1966 and the end of 1970. Such credit expansion was compatible with greatly reduced inflation rates, because as confidence in the Rupiah was restored the income velocity of circulation decreased rapidly and the level of real cash balances increased. Financial reforms, particularly the introduction during 1968 of time deposits offering attractive real interest rates, were very successful in stimulating the demand for money. The complex multiple exchange rate system was reformed and the import controls which had proliferated during the years of acute disequilibria were liberalised. A dual exchange rate system was however, maintained until April 1970. As was the case in a number of the Latin American stabilisation programmes discussed in in Chapter 8, the Indonesian programme was part of a major re-orientation of economic policy towards free-market principles. However, by comparison with the approach adopted in e.g. Chile in 1975, the Indonesian approach, was relatively pragmatic. The objectives included in both instances opening up the economy to the outside world by fostering foreign investment and removing controls. However, the extent of this 'opening up' was less in the Indonesian case; the speed at which it was to be accomplished was slower; and the range of instruments employed was less constrained by the politics economic re-orientation, including as it did the use of price, exchange controls, and increased tariffs as transitional measures.

Part III examined the impact of the stabilisation measures on inflation, the balance of payments, GDP growth, income distribution and structural adjustment. With the exception of one major setback during late 1967 and early 1968, the rate of inflation decelerated steadily, from 1045% in 1966 to 12% in 1970. Improvement in the trade balance over these years owed much to increased dependence on a single, non-renewable export (oil). Substantial current account deficits were financed by aid inflows and to a much lesser extent by capital repatriation. The level of net foreign exchange reserves remained negative throughout the stabilisation period. The real GDP growth rate, which had averaged less than 2% per annum during 1961-'66 averaged 7% between 1967 and 1970 with the highest growth rates being recorded in the modern sectors. The evidence suggests that the degree of income inequality may have decreased over the life of the programme, although subsequently, during the first half of the 1970s, the degree of income inequality increased.

The programme introduced in 1966 was a successful anti-inflation programme. It was suggested that the reasons for its success included the particular political context within which the programme was implemented, in particular the firm government commitment to its full implementation. A second factor was that the immediate cause of the disequilibria was readily identifiable and it dictated the main thrust of the programme. A third factor was the availability of substantial financing which eased the burden of adjustment. The donor countries who were members of the Inter-governmental Group on Indonesia filled between them the successive foreign exchange gaps estimated by the Fund and the Indonesian authorities. Foreign aid financed on average one-third of Indonesia's imports over the life of the programme. In addition, Indonesia's foreign debt to both Western and Eastern bloc countries was rescheduled. A final factor was the concentration on supply-side elements. The programme aimed at rehabilitation of the productive structure and stabilisation of prices. Provision of adequate supplies of essential commodities, particularly rice, by means of increased imports and domestic production, was viewed as central to the price stabilisation objective. Simultaneously, rehabilitation of the infrastructure and sectoral policies designed to increase production of essentials and exports contributed to substantially increased output from 1968.

Part IV considered the role of the IMF in relation to the Indonesian programme. This role was three-dimensional comprising provision of technical assistance, participation in discussions on debt rescheduling and provision of new aid; and the negotiation of six consecutive Stand-By Arrangements, three of which were drawn upon. It was argued that the Fund played an important catalytic role in securing new foreign credits from the Western donors and Japan. With regard to the Stand-By Arrangements it was noted that only the first could be fully drawn, and even that was possible only after a modification had been agreed, the impact of which was to raise the credit ceilings. The credit ceilings were exceeded during the second and third Arrangements. (In addition, in the case of the third Arrangement, pressure on the exchange rate had resulted in a degree of Bank Indonesia intervention in the market that proved incompatible with maintaining the level of net foreign reserves specified in the programme.) Nevertheless, it is argued that the credit ceilings specified in the Stand-By Arrangements, were not, by and large restrictive, and that failure to meet them owed much to problems experienced by the official rice procurement agency (BULOG) in carrying out a price stabilisation function. It was further argued that continued domestic commitment to the stabilisation programme was the primary factor in its success, with the conditionality attached to the assistance provided by the Fund playing a relatively minor role.

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