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529 Fifth Avenue, New York, N.Y. 10017 U.S.A.

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**INDONESIA ADJUSTING**

**William H. Overholt  
Vice President  
Political Assessment Group**

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## INDONESIA ADJUSTING

Indonesia is a huge, sprawling archipelago of 13,700 islands populated by more than 150 million people from several hundred discrete ethnic groups. Under Sukarno, 1945 to 1965, these diverse groups were infused with a fierce nationalism, but the economy remained primitive and the country was torn by terrible ideological divisions among the world's third largest Communist party, powerful forces supporting an Islamic state, and conservative and moderate groups who rejected both Communism and Islam as state ideologies. Following a bloody explosion in 1965-66 during which hundreds of thousands of members of contending ideological groups, social classes, and religious groups were slaughtered, President Suharto instituted economic reforms, constructed a national economic infrastructure, and, with the help of high oil prices, undertook a vast program of industrial modernization and agricultural improvement. The overall result of four decades of independence has been extraordinary political and economic development. At the same time, because Indonesia began from such a low level, it remains a poor country, dependent on oil for 70 percent of exports and 80 percent of government revenues, with some of the world's worst overpopulation and underemployment in Java and Bali. Much of the country's political management is delegated to a small group of Chinese Catholics, and an extraordinary proportion of the nation's economy is owned and managed by members of the Chinese minority who constitute only 3 percent of the population.

Indonesia faces two crucial transitions in the 1980s. The first is a short-term financial transition necessitated by the decline of oil prices. The second is a large scale political-economic-social transition needed to cope with unemployment, Chinese-pribumi tensions, and generational change.

### The Short-term Outlook

The world recession reduced prices for Indonesia's non-oil commodities and of course cut the price of its oil. Similar circumstances, in a less difficult social context, led to the temporary financial collapse of Indonesia's oil exporting sisters, Mexico, Venezuela, and Nigeria. However, unlike those three countries, Indonesia moved swiftly to implement reforms and austerity measures. The currency was devalued 27.6 percent against the U.S. dollar. An austerity budget was decreed. The subsidies on oil products, fertilizers, pesticides, and certain foods were reduced. Exit fees were introduced at the airport to cut down on shopping sprees in Singapore. Forty-seven capital-intensive development projects were reassessed with a view to saving \$10 billion over the next few years. Interest rates were freed, and discriminatory interest rates were abolished, in the hope of raising more capital domestically.

This list of measures, taken in advance of a crisis, is impressive given the political impossibility of implementing such a program in most countries with similar economic problems and at a similar stage of development. This naturally raises a question as to whether the program is politically sustainable. Interviews in Indonesia confirm that the program as a whole is intact and is sustainable:

The devaluation has been implemented and nothing has been done which would vitiate the beneficial consequences of the devaluation in holding back

imports. The devaluation does not affect the standard of living of most of the population. Likewise, the airport exit fees have been implemented, and in conjunction with the devaluation appear to be cutting on foreign travel and foreign shopping. The evidence for this is the pain being expressed in Singapore.

While the elite and the civil service are hit somewhat by these measures, their interests are not seriously damaged and they are under the effective control of the political leadership.

The most disturbing apparent sign of political response to austerity is the government's resort to a campaign of summary executions to cope with a nationwide problem of increasingly brutal crime. This is widely believed to be a reaction to a recent upsurge in crime caused by the recession. However, closer investigation reveals that the upsurge in crime began years before the recession. The police were too easily bought, and the judicial system was bogged down. Most important, a key government minister had found it useful to foster youth gangs, protecting them from prosecution, in order to use them for political provocations, for demonstrations, and to provide security at Golkar political meetings. The gangs' crime gradually became excessive, the minister lost office, and his successor resorted to brutal means in cleaning up the problem. Therefore, the crime problem does not endanger the government's stability or interfere with its austerity measures. But the summary executions bear watching, because they could potentially cause longer term problems.

The cutbacks in big projects also appear to be effective. The full results are not yet known, so the goals of \$3 billion of savings in the current fiscal year and \$10 billion over the next few years cannot be fully substantiated, but there is clear evidence that difficult decisions are being taken. The cutbacks affect the interests of some of the nation's most powerful families, including the family of President Suharto.

The austerity budget affects virtually all aspects of the government, including the military. The general pattern is that base salaries have been maintained, but the "development budget," which provided crucial supplementary benefits, has been slashed. Initially the government was considering not giving civil servants their 13th month bonus pay this year, but in the end it relented. The response from the civil servants has been one of resignation and reduced morale rather than active resistance. In the universities and certain other parts of the civil service, sporadic failure to show up for work is occurring, and this is being tolerated because it is felt that reduced pay naturally lowers motivation and that increased transportation costs make coming to work every day an unacceptable burden for many people. On balance, however, the austerity budget appears likely to stick.

Cuts in subsidies present a more mixed picture. Petroleum subsidies were cut even before the 1982 parliamentary election and were cut again recently, along with fertilizer, pesticide, and some food subsidies. The effect on the government budget of the reduced fuel subsidies has largely been offset by the devaluation. Petroleum subsidies still represent by far the largest single item in the government budget. Moreover, maintaining the generous availability of low-priced rice is the government's single highest political priority.

On balance, the government's short-term management appears competent, tough-minded, and well within the realm of political viability.

### The Longer Term Outlook

Indonesia's longer term political outlook has also improved somewhat, but the key issues have only begun to be addressed: succession to President Suharto, generational change, diversification of exports, and shift to an economic development strategy which will address the country's horrendous unemployment and income maldistribution problem.

Suharto has begun to address the related problems of presidential succession and generational change. Since the beginning of 1983, he has changed virtually the entire top leadership of the military, with such skill that the outside world barely noticed. He has retained the technocratic leadership of the major economic and financial institutions, even though that leadership was under some pressure. (He eliminated the powerful independent figures from his cabinet and shifted the cabinet in the direction of bureaucrats, but did not diminish the emphasis on professional expertise.)

Suharto also replaced flamboyant civilian Vice President Adam Malik with clean if unexciting General Umar. Malik would have been unacceptable as chief of state in the eyes of the military, whereas Umar is acceptable to the military and has an image of being "Mr. Clean" in the eyes of civilians. This, together with a strong emphasis inside the military on following regular procedures in making personnel and policy decisions, increases the likelihood of a smooth, relatively constitutional succession.

The leadership has not yet come to grips with the related needs to diversify the tax base and the sources of foreign exchange away from oil and to shift toward an economic strategy which would ameliorate unemployment. Until the country does so, there will be continuing risk that sometime in the 1980s foreign exchange shortage, unemployment, anti-Chinese sentiments, and leadership changes could coalesce into a period of crisis.

In summary, the country's short-term management is impressive, and its longer-term outlook has improved in important ways, but the term risks which we have identified in the past remain serious concerns.