Committee on Balance-of-Payments Restrictions

DRAFT REPORT ON THE CONSULTATION UNDER
ARTICLE XVIII: 12(b) WITH INDONESIA

1. In accordance with its terms of reference the Committee has conducted the consultation with Indonesia under Article XVIII: 12(b). The Committee had before it (a) a basic document (MGT(61)9/Rev.1) and (b) documents provided by the International Monetary Fund as mentioned in paragraph 2 below. In conducting the consultation the Committee followed the "Plan" recommended by the CONTRACTING PARTIES. The consultation was completed on 27 April 1961. The present report summarizes the main points discussed during the consultation.

Consultation with the International Monetary Fund

2. Pursuant to the provisions of Article XV of the General Agreement, the CONTRACTING PARTIES had invited the International Monetary Fund to consult with them in connexion with this consultation with Indonesia. In accordance with the agreed procedure, the representative of the Fund was invited to make a statement supplementing the Fund's documentation concerning the position of Indonesia. The statement made was as follows:

"The International Monetary Fund has transmitted to the CONTRACTING PARTIES the Executive Board decision of July 27, 1960 taken at the end of the last consultation with Indonesia under Article XIV of the Fund Agreement, and the background material prepared in connection with that consultation. The Fund has also transmitted a supplementary paper, dated April 13, 1961, relating to developments since the last Fund consultation.

"With respect to Part I of the Plan for consultation, relating to balance of payments position and prospects, and with respect to Part III, relating to system and methods of the restrictions, attention is called to the information contained in the supplementary paper supplied by the Fund. As indicated in that paper, net official reserves, after increasing from $153 million at the end of 1958 to $326 million at the end of July 1960, fell by about 30 per cent to $233 million on March 15, 1961. The decline was due in part to lower export value, mainly because of the fall in rubber prices in the second half of 1960, and to some import liberalization. In these circumstances, the general level of restrictions of Indonesia which are under
"reference does not go beyond the extent necessary at the present time to stop a serious decline in its monetary reserves.

"With respect to Part II of the Plan for consultations, relating to alternative measures to restore equilibrium, pending the conclusion of its current consultation with Indonesia, the Fund has no comments on alternative measures."

Opening Statement by the Representative of Indonesia

3. In his opening statement, the full text of which is annexed to the report, the representative of Indonesia stated that this was the first time that his country was consulting with the Committee. He explained that the economic policy of his Government and the measures for controlling imports should be seen against the overall economic situation of the country, Indonesia with a population of 90 million was among the countries with the lowest per capita incomes. The policy followed, and in particular the measures introduced in the latter part of 1959, were designed to guarantee a sufficient supply of essential goods for satisfying the immediate needs of the population within the shortest possible time while at the same time providing the means for an adequate development of domestic industries in the long term. The effect of these policies on trade and payments had been a considerable increase in imports, rising in 1960 by as much as $113 million, or 20 per cent, over those in 1959. For 1961 imports were estimated to be again 20 to 25 per cent higher than in 1960.

4. In 1960 it had been possible to cover the greater part of increased import outlays by increased export earnings. Foreign exchange reserves which had shown a considerable increase in 1959 had recorded a further increase in 1960. The improvement in the country's foreign reserve position had created an improved basis for implementing the Government's policy objectives as contained in the Eight Year Development Plan. However, in view of the downward trend in world market prices for some of Indonesia's main export commodities such as rubber, pepper and coffee export realizations in 1961 were expected to be lower. The balance of payments for 1961 was expected to show a sizeable deficit.

5. On the other hand, the availability at reasonable terms of foreign credits for financing part of Indonesia's import needs and the possibility of paying for part of the needed rice imports in national currency under an agreement concluded between the United States Government and Indonesia were factors which could be counted upon to assist the Government in implementing its food and clothing programme. Furthermore it was expected that the gradual elimination of the internal security problems which had confronted Indonesia in recent years would create a better climate for increasing national production and income. Increased availabilities of rice and oil from domestic
production were expected to contribute to export earnings and to economize on foreign exchange. It was hoped that these developments would make it soon possible to increase imports of those products which at present still had to be curtailed.

6. As regards recent changes in Indonesia's trade and payments control system, the representative of Indonesia stated that essential as well as non-essential imports had benefited from the increased import facilities established in 1960 and further import facilities for both groups of imports were provided in the 1961 import policy. Despite the improvement in the foreign reserve position, it was still necessary to control import expenditures in order to assure the most desirable allocation of import outlays among different import categories. One measure for achieving this objective had been the establishment of a depreciated rate of exchange of Rp. 200 per US $ 1, (four and a half times the basic rate) for imports of luxury goods. For a further range of "less essential goods", effective rates were also depreciated somewhat by certain modifications put into effect on 4 April 1961. The purpose of these measures was to adjust landed costs to prices actually paid by consumers and to have the Government absorb the excess profits and liquidity formerly accumulating to traders.

7. The representative of Indonesia stated that despite certain large problems which still existed, the favourable development in the Indonesian economy in the last two years was expected to continue, provided no untoward external developments intervened. In conclusion, the representative of Indonesia stated that in the view of his Government, the policy followed by Indonesia over the years had been in accordance with the spirit of the General Agreement.

8. The Committee thanked the representative of Indonesia for the clear and concise statement in which he had outlined his country's main problems and general policy.

Balance-of-Payments Position and Prospects

9. In discussion of Indonesia's balance-of-payments position, members of the Committee noted the increase in export earnings from $ 817 million in 1959 to $ 895 million in 1960, and enquired about the factors responsible for this increase and about future prospects. The representative of Indonesia stated that whilst the increase in exports in 1960 over the 1959 level was gratifying, it should be noted that 1959 exports had been below the normal level, even though they were substantially higher than in 1958. A more reliable basis for comparison would be 1957 when exports had amounted to approximately $ 850 million. The higher export earnings in 1960 were primarily due to higher world market prices for rubber during the first half of the year which had largely offset the reduced volume of rubber exports. Export earnings from tin, copper, tea, tobacco, oil palm products and sugar, also increased slightly. The favourable export price for rubber had, however, not been maintained during the second half of 1960 and export values of rubber and mineral oils, despite a higher export volume for the latter, had declined appreciably.
10. The representative of Indonesia, in outlining the development of his country's reserve position, explained that according to preliminary returns, the export surplus for the first eleven months of 1960 amounted to $237 million compared to $379 million in the corresponding period in 1959. For 1960 as a whole, although exports had increased by about $78 million over those of 1959, imports had increased by about $113 million.

11. The statistics before the Committee showed that the net official reserves, which had been rising up to the middle of 1960 and reached the high level of $326 million, had rapidly declined thereafter, to about $300 million by the end of 1960 and to approximately $233 million by the middle of March 1961. Asked to comment on the reasons for this rapid decline and future outlook, the representative of Indonesia stated that the decline in reserves was partly caused by the fall in export earnings resulting from lower rubber prices but was primarily due to unusually large import payments in the last two months of 1960 and the first two months of 1961, following the liberalization measures taken in the middle of 1960. For 1961 as a whole, reserves were expected to decrease possibly by as much as $150 or $160 million to approximately $150 million at the end of 1961. It was not intended, however, to arrest this decline in reserves during the remainder of 1961 through the tightening of import restrictions, since the latent import demand for many of the items liberalized in 1960, as was evident from a decline in licensing applications, had already been largely satisfied. Even after the envisaged decline, reserves would still be about twice the minimum foreign exchange holdings prescribed by the Bank of Indonesia Act of 1953, which was the equivalent of the total value of imports of three months, based on average total imports during the three preceding years.

12. Members of the Committee discussed with the representative of Indonesia the market prospects for rubber, petroleum and petroleum products and tin ore which accounted for about one half of the country's export earnings. They noted that there appeared to be some prospect for an improvement in the rubber market, and that tin prices in the London market had remained relatively favourable. The representative of Indonesia explained that Indonesia's export estimates made some provision for an improvement of rubber prices from the low of about 29¢ per pound quoted towards the end of 1960, prices possibly stabilizing at around 32 or 33¢ per pound. Also, there appeared to be little prospect of an increase in export prices of petroleum and petroleum products. He agreed that tin prices in the London market had remained relatively favourable. Export realizations from tin were expected, however, to be smaller than in 1960, because larger exports in that year had primarily been due to higher export quotas for that year under the International Tin Agreement. On the other hand, after time-charter arrangements with shipping lines and measures for a strengthening of the Indonesian merchant marine, a lack of shipping was no longer a limiting factor. Other difficulties, such as smuggling and unofficial barter which had previously affected the country's capacity to export, had largely been eliminated.
13. Members of the Committee enquired to what extent the investment in agriculture and in import-substituting industries which had been undertaken in recent years, could be counted upon to permit a reduction in imports. The representative of Indonesia explained that rice production, as a result of the efforts made to increase output, had increased in 1960 by about 4 per cent. It was hoped that by 1962/63, the country would again be self-sufficient in rice. A fertilizer plant which was at present under construction was expected to start production in about three years. A hydro-electric power project was expected to be completed in 1962. This project, in addition to electric power, would also provide irrigation for several thousand hectares and would permit two or three harvests a year from the irrigated area.

14. Members of the Committee discussed with the representative of Indonesia the foreign exchange implications of the Eight Year Economic Development Plan launched on 1 January 1961. More specifically, they enquired about the phasing of the investment outlays of an anticipated total of Rps. 240,000 million. The representative of Indonesia explained that the rupiah and foreign exchange components of the investment outlay were estimated to be in about equal proportions. While no detailed calculations had so far been made for the phasing of investment, it was not expected that the allocations would be made in equal proportions over the eight year period. While the budget for 1961 made provision for investment outlays under the plan of Rps. 30,000 million, it was expected that due to various initial physical and administrative bottlenecks in implementing the plan, actual disbursements might fall appreciably short of this figure. Members of the Committee also enquired to what extent the implementation of the plan would depend on capital imports from abroad. The representative of Indonesia explained that it was hoped to cover about 90 per cent of the foreign exchange requirements of the development plan from export earnings. In response to another question, he explained that apart from certain investments by foreign oil companies, private foreign investment did not figure to any significant extent in the plan as a source of finance. This did not mean, however, that private foreign investors were excluded from investing in Indonesia.

15. Members of the Committee noted that during the past two years Indonesia had been able to secure longer maturity periods for its new loans as well as longer time lags before the beginning of amortisation payments on various loans. They enquired in this connexion about the effect of these facilities on the level of annual repayment obligations in the next few years. The representative of Indonesia explained that these more favourable credit facilities had eased the carrying of the burden of repayment of Indonesia’s payments commitments. Payments for debt servicing and amortization were expected to decline in coming years from their present high level. In clarification of information contained in the background documents concerning the net contribution of private capital inflows to the balance of payments, the representative of Indonesia explained that the data contained in the Fund document of 13 April 1961 were based on the latest figures available. He also explained that the main items responsible for the deficit listed under
services, were mainly transfers on foreign investment incomes, remittances by foreign workers, expenditures for foreign travel, certain Government expenditures abroad and, since 1953, expenditures for transportation and insurance.

Alternative Measures to Restore Equilibrium

16. Members of the Committee welcomed the tax measures and expenditure economies which had been introduced by Indonesia to reduce the budget deficits. They noted in this context the Decision of the Executive Board of the IMF of 27 July 1960, that in view of the serious inflationary situation there was urgent need for measures to achieve and maintain economic stability. They invited information on measures which the Government had taken to alleviate inflationary pressures. The representative of Indonesia explained that the inflationary pressures which had been particularly acute in 1958 and 1959 had been the result of large Government deficits and the need to restrict imports severely. The Government had attempted to counteract inflationary pressures through liberalizing imports and through increased taxation, as well as improved revenue collection. Exchange rates had been modified to permit the Government, through an adjustment of the landed cost of certain of these imports to absorb excess profits formerly accumulating to traders. In the monetary field, the Government had taken measures to control bank credits, for example through the introduction of penalty rates for credits not paid back by their due date. Also considerable efforts had been made and continued to be made for stimulating private savings.

17. Members of the Committee noted that the 1961 budget again showed a large deficit of Rps. 16,700 million. They expressed the view that with the envisaged considerable fall in foreign exchange reserves in 1960, it was particularly desirable to eliminate the strains which continuing inflationary pressures would impose on the balance of payments. They enquired about prospects for the Government of reducing this budget deficit and about measures which might be taken to deal with the situation. The representative of Indonesia stated that the Government shared the view that budgetary deficits were undesirable in the present circumstances. The Government was further improving revenue collections and the Government was prepared to further step up taxation, if necessary. On the other hand, it appeared unlikely that under the present economic structure of the country, a rapid rate of economic development could be achieved without some deficit financing. He pointed out in this context that the estimated accounting deficit of Rps. 16,700 million for 1961 made allowance for developmental outlays of Rps. 30,000 million. As indicated earlier, it was now thought that actual developmental disbursements might fall appreciably short of this amount, possibly by as much as Rps. 10,000 million. Thus it was not unlikely that the actual budget deficit could be held to Rps. 6,000 - 7,000 million. In response to a question about the increase in money supply in 1960 and in the first half of 1961, the representative of Indonesia explained that money supply had increased in 1960 by Rps. 12,400 million to a total of Rps. 47,100 million; this was an increase of about 32 per cent over 1959; Rps. 7,600 of this increase had occurred in the first half of 1960. During the first two and a half months of 1961, the money supply had risen further by about 2.3 per cent to Rps. 48,200 million.
18. In discussing the reasons for the increase in money supply, members of the Committee pointed out that the rise in exchange reserves had been one of the major factors behind this expansion. They stated that further import liberalization appeared desirable, therefore. The representative of Indonesia stated that the effect which the increase in exchange reserves had had on the level of money supply had been taken into account in drawing up the import policy for 1960 and 1961. He pointed out again that imports in 1960 had been about 25 per cent higher than in 1959 and that for 1961 as much of an increase again as in 1960 was expected. It was estimated that the reserves accumulated in 1959 and in the first half of 1960 would be used up by these increased imports. In response to another question, the representative of Indonesia expressed the view that the system of import controls applied by Indonesia was sufficiently flexible to permit imports to increase at a rate sufficient to prevent the accumulation of unwanted foreign exchange reserves.

19. Commenting on the prospects of eliminating the multiple exchange rate structure, the representative of Indonesia stated that his Government was aware of the desirability of a unitary rate of exchange. In effect the multiplicity of exchange rates had already been reduced. The necessity to differentiate the import treatment for different categories of imports, coupled with the administrative convenience of achieving this differentiation through the exchange rate had, however, prevented the Government from considering at this time the adoption of a unitary rate.

System and Methods of Restrictions

20. The Committee noted that the Indonesian control system had been substantially changed on 29 August 1960 and further modified on 4 April 1961. The description of the new system was given in the "basic document" (MGT(61)9/Rev.1). Members of the Committee discussed the system with the Indonesian representative and sought clarification on various points. The information supplied by the Indonesian representative in supplement of that contained in the document is briefly summarized in the following paragraph.

21. Under the new system, imports were classified into two main categories. Category A imports, comprising essential products, were subdivided into three groups, subject to the official import rate of exchange and, in the case of groups II and III, also a special "Komponon Harga" levy of 25 and 60 per cent respectively. All these imports were subject to quantitative restriction. Category B goods were subject to payment at an exchange rate of Rps. 200 per US dollar which was substantially higher than the effective rates for category A imports, but imports of these products were free of quantitative restriction although subject to licensing control, licences for these goods being issued automatically. In the foreign exchange budget for each license period, provisions were made for category A imports to cover the quotas for all the products in this category. For category B imports, comprising mostly non-essential products, there being no quota restrictions, only an approximate tentative estimate was made of total imports in the category, which was subject to regular review in the light of licence applications received. Whenever necessary, additional funds would be provided to cover demand.
22. A member of the Committee commented that those products which were intended to be free of import restrictions should be exempted from the licensing requirement since this inevitably constituted an impediment to the free flow of goods. Furthermore, these arrangements, under which essential imports were subject to restriction while non-essential goods were free of restriction, would appear to be somewhat unusual and not fully consistent with the criteria set forth in the relevant provisions of the General Agreement governing the use of import restrictions for balance-of-payments reasons. The hope was expressed that when the first opportunity presented itself for the relaxation of restrictions, the Indonesian Government would promptly dispense with the restrictions on those essential products and discontinue the licensing requirement.

23. The representative of Indonesia explained that since the non-essential imports were already subject to the penalty exchange rate of Rps. 200 per dollar, no quantitative restriction was required under present circumstances. The recent rise in this category of imports from 9 per cent to 14 per cent of total imports did not represent increased imports but was the result of the transfer of more items into this category.

24. As regards the essential products which were subject to quantitative control, the Indonesian representative explained that the quantitative control had been maintained for the purpose of ensuring adequate supplies of these products to the local population at reasonable prices rather than for the purposes of restricting these imports. These basic requirements of life, i.e. cheap textiles and fish, were generally subject to price control, and provided very low profit margins for importers who normally would find little incentive to import them in sufficient quantities if they were left free of all controls.

25. Members of the Committee noted that, since 23 April 1959, the import of certain categories of the country’s most essential imports had been entrusted to State-controlled import houses and asked about the proportion of total imports involved. The representative of Indonesia stated that, while an accurate calculation was difficult to make on the basis of available data, indications were that about 25-35 per cent of total imports, including almost the totality of category B imports subject to the Rps.200 per dollar rate, remained in the hands of private importers. The State-controlled import houses were, therefore, responsible for about 65-75 per cent of Indonesia’s total imports. Members of the Committee commented that, in view of the high proportion of imports subject to State trading, the Indonesian Government should ensure that operations by these firms were guided by the commonly accepted commercial consideration in accordance with Article XVII of the General Agreement. The representative of Indonesia, agreeing to this view, advised the Committee that these firms, although subject to State control, were essentially trading firms well versed in the commercial practices and usage. Their personnel were generally recruited from the business community and they could, therefore, be trusted to be more swayed by business consideration.
26. The Committee noted that, while the general import control system in Indonesia might be said to involve no discrimination, it was stated in the documents before the Committee that the licensing authorities, in issuing licences, took account of bilateral trade agreement commitments. Invited to comment on the import of this statement, the representative of Indonesia stated that the use of bilateral agreements had been much wider in earlier years and had been progressively reduced until, at present, only two trade and payments agreements continued to be in force, and that these agreements contained only indicative lists and no quota commitments. While the available supplies indicated in the agreements and the maximum targets set were kept in mind by the licensing officials, no attempt would be made to compel the importer to purchase from any particular source rather than from other sources. In effect, therefore, these agreements did not involve..
not involve any discriminatory application of the restrictions. The purpose of these agreements at present was limited and their effect was no more than the formalization of existing patterns of trade between Indonesia and the countries concerned. These agreements would probably also be discontinued in the near future. Members of the Committee commented that bilateral arrangements, whether or not they involved effective discrimination, constituted at least a psychological barrier to traders in other countries. They called attention to the statement of the IMF Executive Board decision of 27 July 1960 that the Fund believes that Indonesia should pursue policies which will provide a basis, inter alia, for reduced reliance on restrictions including those arising from the use of bilateralism.

Effects of the Restrictions

27. Members of the Committee referred to the statement in the "basic document" that "the importation of certain commodities which are produced domestically in adequate quantities is prohibited", and expressed the view that the exclusion of foreign goods from the local market simply because local supplies were available might have serious harmful effects on the national economy in that it might afford undue protection to local industries which might or might not be competitive and economical. They also called attention to the provisions of paragraph 10 of Article XVIII requiring that all products should be permitted importation at least in minimum commercial quantities.

28. The representative of Indonesia stated that the Indonesian Government was fully aware of the importance of avoiding the development of uneconomical industries. If the restrictions had the effect of protecting certain industries, these few infant industries had been set up mostly within the framework of general economic planning, account being taken of the country's natural resources and other conditions of development. Protection was sometimes necessary on account of the consumers' natural preference for established brands of foreign products and it was more of a question of facilitating marketing than protection. The Indonesian Government was not in a position to grant subsidies to such industries. The protection afforded would certainly be of a temporary nature. Furthermore, the provision quoted in paragraph 26 above did not mean that the goods in question would be absolutely debarred from importation. The import of these products could be and had been admitted under licences issued at the discretion of the Ministry of Trade. Members of the Committee commented that it would be desirable if such discretionary permissions were regularized and codified into a system of "token imports".

General

29. The Committee expressed appreciation for the frank and helpful manner in which the Indonesian delegation had engaged in this first consultation. The Committee noted that despite a decline in foreign
exchange reserves since the middle of 1960 from the high point reached at that time, exchange reserves remained substantially higher than the legally prescribed level. Members of the Committee hoped that Indonesia would soon be able to further expand its imports and to make further progress in import liberalization. Members of the Committee welcomed the efforts made by Indonesia in counteracting inflation, and expressed the hope that these efforts would be continued in order to restrain and overcome the continuing inflationary tendencies in the economy.

30. The representative of Indonesia thanked the Committee for the spirit of understanding and sympathy with which the consultation had been conducted. He stated that he had taken note of the view expressed at the consultation and would convey them to the attention of his Government.