GENERAL AGREEMENT ON
TARIFFS AND TRADE

Committee on Balance-of-Payments Restrictions

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

1. In accordance with its terms of reference, the Committee conducted the consultation with Indonesia under paragraph 12(b) of Article XVIII. The Committee had before it a basic document (BOP/73 and Addenda 1, 2, 2/Corr.1 and 3) and documents supplied by the International Monetary Fund as referred to in paragraph 3 below.

2. In conducting the consultation the Committee followed the plan for consultations recommended by the CONTRACTING PARTIES (BISD, Seventh Supplement, pages 97-98). The consultation was completed on 20 October 1967. This report summarizes the main points discussed.

Consultation with the International Monetary Fund

3. 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. 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 Fund invites the attention of the CONTRACTING PARTIES to the Executive Board decision of July 12, 1967\(^1\) and particularly to paragraphs 4 and 5 which read as follows:

'\(\text{The balance-of-payments position in 1967 has benefited from agreements to reschedule most of the debt falling due and from foreign aid commitments of about $200 million. The Indonesian balance-of-payments position is difficult, and substantial foreign assistance is a critical need.}\)"

\(^1\)The full text of this decision is contained in Annex I.
'The Fund welcomes the progress made in simplifying the exchange system, in liberalizing import policies, and in the increasing reliance on market forces. However, there is scope for further simplification of the exchange régime. There is also a need to keep under review the effects of the spread in exchange rates on the foreign trade sector.'

"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."

Opening statement by the representative of Indonesia

4. The full statement of the representative of Indonesia is contained in Annex II to this report. It summarizes the history of the difficulties encountered by Indonesia in the past four years and the measures which have been taken since October 1966 to restrain inflation and restore equilibrium in Indonesia's external accounts. The representative of Indonesia emphasized that notwithstanding the bold and determined efforts which have been made; it could not be expected that the precarious economic condition in which Indonesia found itself could be cured quickly. He hoped that the Committee would recognize, through the principles and measures now guiding Indonesian policy, the seriousness and goodwill implied in Indonesia's effort.

Balance-of-payments position and prospects

5. Members of the Committee expressed their thanks and appreciation for the very perceptive and clear analysis of the extreme difficulties confronting Indonesia which had been presented and welcomed the determination with which the Government had now set out to overcome them. They welcomed alike the internal measures by which efforts were being made to combat inflation, the increased play which was being given to market forces in the allocation of resources, and the various measures taken to bring the fiscal sector into balance and to simplify and unify exchange rates. They also recognized fully the point that quick results could not be expected, but were favourably impressed with progress recently made in rehabilitating the economy and expressed interest in knowing how the Government of Indonesia proposed to continue its work of rehabilitation.

6. In reply the representative of Indonesia indicated that there was in effect a major question of priorities, since certain additional steps could not very well be taken until prior conditions had been fulfilled. In particular, the Government had made very considerable progress in unifying exchange rates, about which a specific question had been asked, but further progress really
required as a prerequisite that the Government first find other sources of revenue that the tax on exports which is currently levied through the preemption of 25 per cent of the proceeds of major Indonesian exports. Those directing Indonesia's policy were well aware that they could not continue indefinitely to burden exports in this way without an adverse effect on Indonesia's competitive position vis-à-vis neighbouring countries which also export the same range of goods, but it had been a great step forward to have allowed the local currency to find a realistic rate of exchange, and the intention was to complete the process by removing the present tax burden as rapidly as might be possible in the light of progress in other forms of tax collection. On the import side, the problem was somewhat less difficult; it represented much progress that the BE rate had become the major effective rate for external payments for goods, and recently for some services also. The widening of the range of goods for which BE exchange could be used for payment of imports, as mentioned in the opening statement, had definitely narrowed the premium which traders were willing to pay for supplementary exchange in the DP market, and making BE exchange valid for service claims had had a further effect in the same direction. It was true that a lower rate was applied to petroleum companies, but these companies also enjoyed certain special privileges which to some extent compensated for that disadvantage. For instance they were allowed to keep all of their export proceeds abroad, deduct their foreign exchange costs of necessary imports and services and their depreciation, so that the (lower) exchange rate applied only to their purchases of local currency to meet their domestic expenditures. In other words, the 25 per cent tax on export proceeds was not applicable to them. The only tax they had to pay was the 40 per cent Government share of the net profit. Nevertheless, the Indonesian Government was seriously contemplating making the free BE exchange rate applicable to these companies also. It was a measure of Indonesia's progress, that even now there were only three operative import exchange rates: BE, DP and the oil rate.

7. On a related question, successive increases in the proportion of export proceeds made available to exporters for their declared exports had brought significant lessening of the revenue loss which the Government experienced through smuggling, as it had made the profits of such practices less attractive. It was obvious that the problem would disappear completely whenever the Government could provide for its revenue needs by means other than the export levy, e.g. by an income tax or company taxes; but as already explained this levy could not be foregone at once or in its entirety, and until that happened there was bound to be a continuing loss to the Government, when free markets were close at hand, from smuggling, which enabled exporters to obtain the full foreign exchange equivalent of goods sold.
8. The discussion then turned to ways in which the Government proposed to build up more adequate reserves of foreign exchange for working capital purposes. In reply to questions, the representative of Indonesia pointed out that it would necessarily be a long process for Indonesia to begin accumulating reserves. Export proceeds were not expected to equal amounts required to pay for current goods and services for several years to come, not to mention any servicing of past debt, so that for several years to come foreign aid would be required even to make ends meet. Beyond that time, there might be hope that exports, especially of petroleum, might grow enough so that there might be a small overall surplus on current account after 1972, provided nothing had to be paid on service and reduction of debt. If allowance had to be made on those accounts, then even a modest surplus would be farther away.

9. Members of the Committee noted that nothing had been said of increased returns from other exports and that recent estimates of Indonesian exports also looked toward a declining trend in Indonesia's exports of products other than oil; they inquired whether this was to be attributed exclusively to lower world prices of some of Indonesia's major exports or whether there might be some reflection here of a shortage of working capital or of growing infrastructure difficulties, as in transport and shortage of spare parts. The representative of Indonesia acknowledged that world prices were a part but not all of the explanation. Spare parts shortages had been largely overcome by enlarging the list of products importable with BE exchange and by financing essential imports through foreign aid. But the repair and extension of road, harbour and railway facilities was not so easy to bring about, in spite of obvious needs, for these called for large expenditures by the Government just when it was important to keep down public expenditures both on budgetary and on anti-inflationary grounds. Thus, no budget provision whatever had been made for such work in 1967, but in some cases, it had already become evident that the cost of bringing exports to ports and of loading them on vessels was so excessive, due to lack of proper facilities, that the poor transport organization was entailing excessive losses of exports and of foreign exchange. Consequently, in one way or another, possibly through use of some project aid, something would certainly have to be done about this problem in 1968. On that basis, it was hoped that there may be some possibility of increasing certain exports other than oil.

10. In other cases the high cost of financing trade might have operated as an additional obstacle to expansion of exports, the representative of Indonesia added, with special reference to the case of estate rubber. Curbing the rate of inflation had necessitated raising interest rates to very high levels, but this had made it harder for export enterprises to keep costs competitive, and some easing of credit facilities was contemplated where higher exports would be the result. In the case of rubber plantations, some further spreading of ownership to private hands might be useful, and more foreign experts were being sought. The former owners of estates taken over by the Government had in some cases been helpful by making their skills available as buyers of the products of the estates.
11. With respect to agricultural improvement programmes, about which questions were asked, the representative of Indonesia said that the BIMAS programme was definitely continuing in its effort to improve foodstuff production through introduction of better seed, use of fertilizer and pest control. An irrigation scheme in the Northern part of West Java should soon bring much unused land into rice production in an area where there was otherwise too long a dry season. A new fertilizer plant would be helpful, as domestic production was currently not over a third of total needs. A plant started, but not completed, in 1965, should be in operation by the middle of 1969.

12. Because of the importance of rice in the diet of all the population, Indonesia's whole economy was much affected by the price of this staple, the representative of Indonesia added. One might think that with 70 per cent of the population engaged in food production, the balance of advantage might lie with maintaining relatively high prices for the output. But the opposite was the case, as was seen not long ago, when both rubber and tin output were adversely affected by sudden increases in rice prices at a time when there was shortage in the whole area and Public Law 480 shipments arrived too late. Consequently, greater efficiency and increased production of rice were of key importance and would continue to have high priority.

Alternative measures of restoring equilibrium

13. Members of the Committee congratulated the Government of Indonesia on the courage and determination to control hyper-inflation which had made it possible to greatly reduce the progress of inflation in the second quarter of 1967, not so very long after a time when Government deficits had at one point exceeded total revenues. They believed the Government's recent budgetary performance had been creditable, and they expressed the hope that the Government would be able to resist pressures for increased expenditures, which might tend to cancel out the other elements of its stabilization programme. The representative of Indonesia confirmed that in May 1967 the price index had registered no increase over the preceding month, and that the expenditures of the Government were still well controlled. He acknowledged however, that it had since been necessary to resume the granting of some credit to industry to avoid the closing down of enterprises which would otherwise have been unable to keep production going. As a result, the money supply might show an increase of some 65 per cent for the whole year, but that would still represent a very great improvement over 1966, when the increase was something like 650 per cent.

14. With respect to Government borrowing from the Central Bank, a continued effort was being made to avoid increased resort to this expedient. The State enterprises had in principle been cut off from access to this resource, but there remained the expenses of the Government itself, especially for maintenance
of civil and military employees. Finding alternative productive employment for
this labour force would undoubtedly be much facilitated by bringing additional
investment into the country, and private organizations in other countries had
shown much interest in trying to bring potential investors into touch with
enterprises in Indonesia, but this would be a long process.

15. In answer to a question whether interest in new foreign investment could be
taken as evidence that there would be less direct control of the economy in
Indonesia, the representative of Indonesia replied in the affirmative. In
response to questions regarding the outlook for increasing and diversifying
revenues, he also referred to an effort to make taxation more largely a matter
for individual responsibility and initiative. Among other efforts to improve
tax collection, Indonesia was just now beginning a system of expecting
individuals and enterprises to prepare their own tax returns and to pay income
tax in advance. Heretofore, taxes had been paid only after assessment, but
beginning now, in order to leave nothing undone, the obligation was to be placed
on taxpayers in the first instance to calculate their expected earnings and to
pay. Not much result was expected in the villages, but it was hoped to stimulate
some sense of collective effort and responsibility by this measure, at least in
urban centres.

16. With reference to the mention that State enterprises had been cut off from
access to Government finance, the question was asked how these enterprises could
be expected to carry on if denied credit facilities. Further, would they not
inevitably raise their prices and so continue the inflationary pressure? The
representative of Indonesia replied that the cutting off of credit was intended
to stimulate the enterprises to liquidate unproductive assets and to find other
ways of financing their own commercial activities. Those producing for export
could in many cases obtain pre-financing from their customers, others could
exercise ingenuity in other directions. As for the danger of their increasing
prices as a way out, to some extent this might not be undesirable, but it was a
difficult problem to find the right balance. Inflation was probably irreversible,
even if further general price rises could be avoided, and those prices which up
to now have remained at or near old uninflated levels might perhaps as well be
gradually adjusted upward along with the adjustment in the exchange rate. The
only alternative would be massive Government subsidization. Actually, with
respect to financing the enterprises, the Government would not go so far as to
forego possible export increases by denying borrowing facilities. To a further
question, the representative of Indonesia stated that about 30 per cent of
production for export was by State enterprises, mainly former Dutch plantations
and a tin enterprise which had always been Government-owned. Rice was all
privately produced. Industry was mainly of the small craft type, privately
operated, or was carried on by large foreign privately-owned enterprises. The
few State import and trading enterprises conducted perhaps 35 per cent of all
import trade. Utilities were largely public, but recently private foreign air-
lines had entered Indonesia to help provide internal service. Five large
commercial banks were State-owned, but there were also some 140 private banks.
17. In answer to questions about areas in which foreign investment was welcomed, the representative of Indonesia stated that it was welcomed in all but a few fields and those excepted would be mainly in the area of national defence. Even as to public utilities, though in theory this area was reserved for State investment, in fact the Government was flexible and would accept offers of foreign investment in certain circumstances. As to the system known as "production-sharing", the representative of Indonesia said that this system as practised before the new economic policy began had been abandoned in favour of straight investment. This system, he said, was in fact one whereby foreign credits were extended to Indonesian companies and repaid out of future export proceeds. This kind of arrangement would of course only be suitable for enterprises producing for export and had been used successfully in logging and sea fisheries. However, it was not considered suitable in other fields, and besides it contained many features less favourable than straight investment whereby no pledging of future export proceeds was required for repayment and interest.

System and methods of restrictions

18. Members of the Committee appreciated the considerable efforts which the Government of Indonesia had recently made to simplify its complex restrictive system to re-establish the authority of the Central Bank over foreign exchange, and to establish more realistic exchange rates. Acknowledging that considerable progress had been achieved they expressed, however, regret that Indonesia had not been able to establish a fixed unitary value for the currency; they felt that the export exchange rate, in particular, was still rather unrealistic.

19. It was asked whether the Government of Indonesia was prepared to proceed to further liberalization and greater reliance on market forces and whether action would be taken by merging the BE and DP rates to introduce a unitary exchange rate.

20. In reply the representative of Indonesia stated that it was his Government's long-run policy to eliminate all artificial barriers to the natural development of rates, thus to obtain realistic exchange rates and once this objective had been achieved, to establish a unitary exchange rate. He said further that at present no fixed rate could be established since Indonesia would not be able to support it adequately for lack of foreign exchange reserves. As to the present export exchange rate system the representative of Indonesia recalled that for revenue reasons the export tax could not yet be abandoned. But it was his Government's intention to adjust the tax in such a way as to avoid overburdening Indonesia's export trade and to gradually do away with it as the revenue situation improved.
21. On the import side two different exchange rates were still in existence which it was hoped would gradually converge. The BE exchange, by far the most important, had its source exclusively in that part of export proceeds retained by the exporters and was intended for financing the largest part of imports. Additional exchange was provided for by the so-called DP exchange, the supply of which was mainly from invisibles, but also from repatriation of capital and from overprices. The latter, comprising the excess gained by exporters over weekly minimum export prices fixed by the Government, would necessarily continue to form a source of DP exchange so long as minimum prices needed to be fixed. For even though the Government was trying to fix prices at realistic levels, it would be impossible to adjust the fixed prices as rapidly as market quotations fluctuated. He did not consider that complete elimination of a slight differential between BE and DP rates would necessarily be of advantage just yet, incidentally, for as matters now stood the higher DP rate offered some bonus to repatriation of capital; as such, it helped a little to replenish Indonesia's foreign exchange resources.

22. Several members of the Committee inquired concerning the import régime for passenger vehicles. The representative of Indonesia answered that the import of passenger cars was prohibited unless it was financed with privately-owned exchange, that is, with exchange held in foreign banks. Under this régime a private importer was allowed to import one passenger car per year. Unassembled jeeps, trucks and buses could be imported on BE exchange. Under certain conditions a special licence was issued for the import of assembled vehicles of this kind. The representative of Indonesia added that apart from passenger cars only ceramic tiles were banned from import if DP-exchange was used.

23. To another question on the restrictions resulting from the exchange rate régime the representative of Indonesia replied that the former classification of goods into five categories had been abandoned. Today, with BE exchange, one could import any item on the BE list (sub-divided into goods for consumption and other goods), whilst with DP exchange one could import any goods except the two items just mentioned.

24. In answer to a further question the representative of Indonesia said that the retribution tax on goods which were imported subject to tariff rates bound under GATT had been abolished.

25. With regard to the recent development of Indonesia's bilateral payments arrangements he stated that the bilateral agreements with East Germany and Poland were terminated officially on 30 June 1965 and on 20 June 1967 respectively. The payments agreements with Pakistan, the Philippines, Czechoslovakia, and North Korea were still in force but had been inactive for lack of trade as was the case with Mainland China.