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production process. The favorable employment effects alone should be justification enough to eliminate these monopoly import licenses.

2. The expansion of the tree crop sector. Indonesia has cheaper labor than Malaysia, and with additional investments in transportation, Indonesia could potentially outcompete Malaysia in the production of rubber and palm oil. In addition to earning more foreign exchange, the strategy of accelerating the growth of agricultural export industries will also promote a more equitable rural-urban, as well as inter-island, growth pattern and ease population pressure on the urban areas.

A final cautionary word on external debt management from the political perspective is pertinent. The Pertamina crisis has led to close supervision by the Ministry of Finance of external borrowing by all state enterprises, making it unlikely that a debt crisis would ever again emerge from the external adventurism of an economic fiefdom. The danger now may be the absorption of private external debts in order to save large domestic firms when they get into financial problems, as in the Indocement case. As we described in chapter 3, in July 1985 Indocement, the biggest cement company in Indonesia, began to experience cash flow problems because the recession-induced collapse of the construction industry led to a cement glut. The response of the Indonesian government was to inject U.S. $325 million in cash to acquire a 35 percent share of the company, and to form a consortium of four state banks to "convert into a rupiah liability a U.S. $120 million syndicated loan that Indocement took out in 1981."[6]

If a few more such rescues are allowed, then the habit may well be impossible to break without the government having to put to the test an important source of its political power—the cohesiveness of the bureaucratic and military elite. Given the widespread participation in large private business ventures by government officials and their family members, the selective use of financial rescue will threaten the political unity of the group. If such political pressure were able to completely eradicate the already blurred line between public and large private enterprises, then the vulnerability of Indonesia to a debt crisis would be greatly increased. External debt management would become impossible because no one would know what the size of the sovereign debt really was, and the size of this debt could increase very quickly given the openness of the private capital account.

Notes

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Wing Thye Woo is responsible for writing chapters 1, 3, 4, 6, 7, and 8. These chapters are partially based on three earlier papers: "The Dead Hand of History in Indonesian Economic Policymaking" and "The External Debt Situation in Indonesia: Performance and Prospects" (no. 43 and no. 48, respectively, in the Applied Macroeconomics Working Paper Series issued by the University of California, Davis); and "The Economic Policy-Making Equation in Indonesia" (Pacific Rim Studies Program Working Paper no. 6, University of California, Davis). Anwar Nasution is responsible for writing chapters 2 and 5. These chapters draw on some materials from "Instruments of Monetary Policy in Indonesia after the 1983 Banking Deregulation" (a paper prepared for the Conference on Financial Research in Indonesia, August 1986) and from *Financial Institutions and Policies in Indonesia*, Institute of Southeast Asian Studies, Singapore, 1983.

Chapter 1

1. The "balanced" budget rule ceased to be a binding constraint on expenditure after the 1973 OPEC-1 price increase. The Indonesian government (perhaps until very recently) was pretty much able to get whatever amount of credit it wanted. This budget rule does not prevent the financing of nonbudgetary expenditure by money creation, e.g., central bank credits to state agencies.

2. The term "Dutch disease" originated with the observation that the 1973–78 growth of the Dutch natural gas industry was accompanied by a steady decline in the traditional export sector.

3. In the case where a private borrower could not come up with the service payments in domestic currency for his private nonguaranteed external debt, we do not consider it a national debt crisis because the government did not cause the default except in the broadest sense of not creating more favorable macroeconomic conditions, if it were able to do so.

4. This is calculated assuming that Indonesia would pay the same effective interest rate as Mexico.

Chapter 3

1. Sachs (1985) argues that it is political considerations which explain why Latin American countries, but not the East Asian countries, pursued exchange rate and trade policies which rendered their economies vulnerable to an external debt crisis.

2. Other viewpoints on the political economy aspects of Indonesian policymaking are: Jackson (1978a, 1978b), Palmer (1978), Mortimer (1974), Glassburner (1978), and Liddle (1987).

3. This characterization of state-society relations is developed in Wing Thye Woo (1988). His article also reviews and tests the competing models of the Indonesian state.

4. Since 1961 there has been a secular decline in the real money stock. See table 11.8 in Arndt (1971).

5. We postpone discussion of the reorganization of the external debt to chapter 7.

6. This figure is not strictly accurate because multiple official exchange rates for different types of transactions still existed at this time. Data is from Arndt (1966).

7. This was calculated by deflating the dollar earnings of nonoil exports by the dollar export unit value of the industrial countries. The absence of a reliable representative exchange rate for 1965 makes the calculation in local purchasing power impossible.

8. The annual real GDP growth rate of the industrialized countries averaged 5.5 percent in the three years prior to 1965 and averaged 4.9 percent in the 1965–68 period.

9. This coup is commonly referred to as the GESTAPU coup, with GESTAPU standing for *Gerakan September Tiga Puloh*—the September 30 Movement.

10. For example, he maintains a working farm for recreational purposes.

11. The great care which Soeharto takes to preserve his country-boy image is seen by the *POP* affair. *POP,* a popular culture magazine, claimed in 1974 that Soeharto was actually a descendent of the Yogjakarta royal family. Instead of ignoring this gossip which would only add to the legitimacy of his rule among the superstitious and conservative peasants, Soeharto publicly rebuked the close confidant who owned the magazine.

12. See Timmer (1975) for an excellent discussion of the political economy of Indonesia's rice policy.

13. *Dwifungsi* is a transliteration of "dual function" and refers to the army's dual role in defense and economic development. Harold Crouch (1978) cites official statements in 1969 and 1970 that the armed forces budget covered only 30 to 50 percent of expenses.

14. Access to these funds may be the reason the defense budget has not jumped dramatically in the face of continued military operations in East Timor.

15. Another important reason for the use of quotas over tariffs is that tariffs would violate the GATT agreement.

16. See *The Asian Wall Street Journal Weekly,* 1 December 1986.

17. *INSIGHT,* 9 February 1987, p. 33.

18. Bank Indonesia, embarrassed by the size of the rescue operations, delayed the release of information about its financial status for over a year.

19. Soekarno, Soeharto's predecessor, had resorted to the inflation tax to pay for government operations.

20. Glassburner (1976) cited this as an instance of managerial incompetence, so he may disagree with our interpretation here.

21. Siregar (n.d., 5) noted that "it was generally believed that while the Dutch colonial rule had a stifling effect on autochthonous Indonesian entrepreneurs, it had fostered the entrepreneurial activity of the Dutch and other foreigners, particularly the Chinese."

22. In the preface to their book, Panglaykim and Palmer (1969) advanced the proposition that state corporations could be used to provide a counterweight to Chinese domination of the private trade sector. (*Zaibatsus* were large holding companies that dominated the Japanese economy until the end of World War II.)

23. Liddle (1987) labels the two groups economists and engineers, respectively.

24. An account of IGGI's role in the 1966–70 period is given in Posthumus (1971).

25. Because of their influential foreign constituency, their lack of ideological aversion toward foreign investment, and the fact that several of them received doctorates from the University of California, the technocrats were called the "Berkeley Mafia" by their detractors.

26. Two earlier attempts to check Pertamina's influence had failed. When the minister of mining attempted to assert his control over Pertamina in 1969, Soeharto transferred the company out of the minister's jurisdiction. In 1971 Soeharto ignored the recommendation by a presidential commission on corruption that Pertamina be placed under the supervision of the Ministry of Finance.

27. The term "technician" is used because of the increasingly prominent role of Minister of Technology Habibie, who is an outstanding aerospace engineer.

28. This belief is evident in the following editorial in a magazine identified with the military advisors to the president:

> One [path of economic development] leads via the BAPPENAS technocrats to a free-flight and laissez faire pattern of development in the Western and American fashion. Another [path] takes the form of cooperation with Japan on the basis of one's own strength without loans from the IGGI, the IMF and the World Bank with Pertamina as guarantee. (*Ekpres,* 18 January 1974, quoted in *Far Eastern Economic Review,* 4 February 1974)

Chapter 4

1. The Indonesian government made this change beginning with 1984/85 but did not revise the figures of earlier years, so our revision merely makes the official categories consistent across time.

2. Real import tax revenue, measured in 1980 prices, fell by Rp 62 billion in the 1969–83 period.

3. The rise in oil tax revenues in 1983/84 is illusory because the 1983 devaluation increases the rupiah value of this revenue, which is paid in U.S. dollars.

4. Nonmining RGDP is used instead of RGDP because while the presence of oil and LNG industries increases a region's production tremendously, their impact on the region's income is small. This is because almost the entire revenue is taken by the central government and, being extremely capital-intensive industries, their local wage bills are small.

5. Jakarta is excluded here because its high figure "reflects the substantial level of spending on the apparatus of the Central Government rather than on the development of Jakarta" (World Bank 1984, 133).

Chapter 5

1. More detailed descriptions of the Indonesian financial markets from 1970 to 1979 are found in Nasution (1983) and Suwidjana (1984).

2. A fuller discussion of the new monetary instruments is in Nasution (1986).

3. This liquidity squeeze has been immortalized in the Indonesian press as the Sumarlin shock treatment, *Gebrakan Sumarlin*.

Chapter 6

1. See Corden and Mackie (1962) and Kanesa-Thasan (1966) for analyses of the Indonesian exchange rate system prior to the Soeharto years.

2. Glassburner (1970) and Pitt (1971) describe the pricing of foreign exchange during the transition to the unified exchange rate.

3. The low figure of 6.4 weeks for 1975 shown in table 6.2 was not because of a sharp drop in exports or a big increase in imports; it was because of the transitional financing of Pertamina's debts while negotiations were underway to convert the company's short-term debts to long-term debts.

4. On the eve of the devaluation, Arndt (1978, 10) wrote:

> The overall picture for Indonesia's balance of payments in the current fiscal year is thus still reasonably reassuring. On a longer view, it is difficult to resist the traditional balance of payments pessimism of economists everywhere, official and unofficial alike.

5. See stories in *Warta Berita*, April 6; *Sinar Harapan*, April 13; and *Merdeka*, May 5 and May 24.

6. An exponent of this view is Kincaid (1984, 88), who wrote that the 1978 "exchange rate adjustment" was prompted by "the balance of payments constraint."

7. Notable supporters of the Dutch disease interpretation of the 1978 devaluation are Malcolm Gillis, Dwight Perkins, Michael Roemer, and Donald Snodgrass (1987, 539) who wrote:

> [In 1978] the country had ample foreign exchange reserves to defend the vale of the rupiah, and the business community viewed devaluation as unthinkable.
>
> Nevertheless, the Indonesian rupiah was devalued by 50 percent in November 1978, not to protect a precarious foreign exchange reserve situation but primarily to encourage labor-intensive manufactured and agricultural exports.

8. These normalizations were suggested by Peter Warr (1986).

9. This statement is true as long as international prices do not rise above the domestic prices of the quota-protected goods. Tariff-protected goods are still considered tradables because their domestic prices are higher than international prices only by the amount of the tariff and they move in tandem with international prices.

10. The OPEC-1 price increase occurred in October 1973.

11. Pangestu (1986) constructed several price indices for tradables and nontradables by decomposing the gross domestic product, the CPI, and the WPI. Her results are qualitatively the same as those reported in table 6.5.

12. The Morgan Guaranty measure of competitiveness is the inverse of the real exchange rate reported in *World Financial Markets* published by Morgan Guaranty. The unit of measurement of competitiveness here is rupiahs per basket of foreign currencies.

13. Kincaid (1984) and Pangestu (1986) provide formal econometric explorations of the devaluation.

14. We have, as Gillis (1984) did in his table 4, identified the "miscellaneous" category in the World Bank list of nonoil exports as manufactured goods.

15. These disaggregated nonoil export data are available only in fiscal year intervals. Fiscal year 1979 goes from April 1979 to March 1980 and is henceforth represented by 1979/80.

16. McCawley (1980) discusses the need for other economic policy changes in order for the beneficial structural effects of the devaluation to be viable.

17. Debt here refers to medium- and long-term external public debt.

18. *International Financial Statistics*, June 1987.

19. *International Financial Statistics*, June 1987. The IMF, at the beginning of 1987, further lowered its prediction of the 1987 growth rate to 2.3 percent (IMF 1987).

20. Even after taking into account the fall in import prices, the real price of oil measured in terms of foreign purchasing power fell a whopping 40 percent in one year.

21. In this section, we confine our attention to the consequences of quotas on the supply of exportables within a static setting. For an excellent discussion of the impact of protection on growth, see Corden (1972).

22. Pitt (1971) and World Bank (1981) are two comprehensive studies of effective rates of protection in 1970 and 1975, respectively.

23. As pointed out in section 6.4, goods with QR protection are effectively sheltered from international price trends and are hence regarded as nontradables from an analytical viewpoint.

24. This is not the total level of protection as this figure does not take into account activities protected by quotas and tariffs.

25. See *Wall Street Journal*, 24 November 1986 for a longer list of vital inputs with a small number of approved traders.

26. Figures are from *The Asian Wall Street Journal Weekly*, 1 December 1986.

27. This assumes that the rent-seeker is rational enough not to demand too high a price and obliterate the industry.

28. We are abstracting from natural growth considerations here to make this point within a static context.

29. Current account expressed as a percentage of GDP.

Chapter 7

1. The conversion to rupiah was done using the average BE Market rate of October to December, 99.5 rupiahs/dollar. The average curb market rate was 130 rupiahs/dollar. Data are from the World Bank (1968), Basic Data section and pp. 39, 50, and 54.

2. Lipsky (1978), Glassburner (1976), and McCawley (1978) are excellent sources about and analyses of the Pertamina crisis.

3. According to Glassburner (1976), the power installation at the Krakatau Steel Mill cost three times more than the same installation in Taiwan.

4. These figures are only guesses because the same item from three official sources—balance of payments, the government debt record, and the government budget—sometimes shows gaping discrepancies. See also the note in table 7.4 on how the 1973/74 through 1977/78 data were constructed.

5. The rate of change in the CPI was 31 percent in 1973, 41 percent in 1974, and 19 percent in 1975; and real GDP growth was 7 percent in 1976, 9 percent in 1977 and 8 percent in 1978.

6. This paragraph draws upon the article by Haryono (1985).

Chapter 8

1. A textbook exposition of this fiscal cause of external debt crisis is Rivera-Batiz and Rivera-Batiz (1985).

2. For example, see table 17.5 of Rivera-Batiz and Rivera-Batiz (1985, 557).

3. For example, Dornbusch (1987), Lever and Huhne (1986), and Cline (1984).

4. Cuddington (1986), Dooley (1986), Khan and Haque (1987), and Morgan Guaranty (1986).

5. This is calculated assuming that Indonesia would pay the same effective interest rate as Mexico.

6. Quote is from the *Far Eastern Economic Review*, 25 July 1985. The *Asian Wall Street Journal Weekly*, 12 May 1986, put the cash injection at U.S. $360 million.

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