INDONESIA

Sagging Oil Prices & Fund Raising Problems

By Keiji Omura

Economic development as national mission

President Suharto was elected to a fourth term at the People's Congress (MPR) held in March. He was also given the title of "Father of Development" (Bapak Pembangunan) in tribute to his success in leading Indonesia in achieving an annual average economic growth rate of 7.6% during the 1970s and raising per-capita national income in 1981 to US$520. Under his helm, Indonesia has gained the status of a middle income nation by IBRD (World Bank) standards.

Photo: Asahi Shimbun

President Suharto, Indonesia's "Father of Development"

In accepting the title, President Suharto also accepted the mission of continuing his policy emphasis on economic development. He must try to help the Indonesian economy "take off" during the 1990s, laying the foundation for the development of an industrial nation. As the head of the newly-formed "Fourth Development Cabinet," he will seek to overcome a slump in exports caused by the current international recession, and balance of payments uncertainties and a fiscal crisis deriving from a decline in the export price of crude oil.

Devaluation of the rupiah

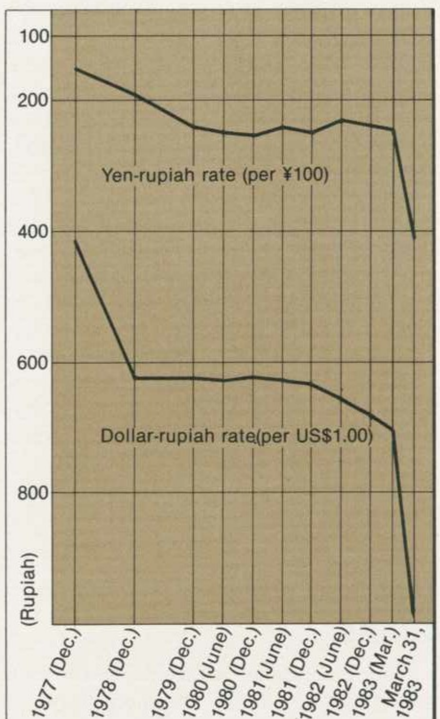
The first step taken by the new cabinet was to devalue the rupiah on April 30. The value of the rupiah had recently fallen to 625 rupiah to the dollar from 415 rupiah in November 1978, after drifting to 702.5 rupiah between December 1981 and March 1983. The recent devaluation dropped it another 27.6% to 970 rupiah to the dollar. The step had been widely anticipated in economic circles, unlike the devaluation in 1978 which threw the Indonesian economy into chaos.

The devaluation was intended, firstly, to end a slump in Indonesian exports that began in 1981, strengthening the competitiveness of Indonesian goods against imports and saving foreign exchange by curbing imports and, secondly, to cover the fiscal deficit caused by plunging oil exports with the exchange profits from the devaluation.

Judging from the outcome of the 1978 devaluation, not much can be expected in the way of promoting exports. Indonesia's principal export items other than oil are mainly primary products such as rubber and tin, and cannot compete in quality or price with comparable exports from Malaysia and Thailand. The problem is further aggravated by the slow recovery in international demand for primary products. Surplus inventory of some manufactured goods, including fertilizers and textiles, could be sold overseas, but would bring in minimal export earnings.

Nor can there be much hope for product substitution, except in the case of a few consumer goods. Most of the raw materials required for domestic production activities are imported, while domestic consumer goods still leave something to be desired in quality and supply. Devaluation will inevitably boost prices of imported raw materials, and an increase in domestic production of raw materials can be expected. Domestic production of processed foodstuffs, textiles, batteries, plywood, paper, tires and others increased after the 1978 devaluation. However, it will still be necessary to curb increases in wages and the prices of daily necessities to bring about a repeat performance.

Free Market Exchange Rate (Jakarta)



Pertamina oil base, Indonesia's oil monopoly

The second objective of the devaluation was short term. By acquiring exchange profit, the Indonesian government hopes to raise the nominal value of its national budget for fiscal 1983/1984 and meet its target for the final year of its Third Five-Year Program. As drawn up, the fiscal 1983/1984 national budget relied on oil revenues for about 70% of total domestic revenues of 8,800 billion rupiah, based on an assumption of exports of 900,000 barrels a day at US$34 a barrel. However, Indonesia was forced to lower the export price of its oil to US$29 a barrel April 1, leaving a revenue shortfall of some 1,500 billion rupiah. The increase in fiscal 1983/1984 revenue is a one-shot affair, however, while the effect of substantial cutbacks in fiscal subsidies has been canceled out as a result of increases in oil products prices in January 1983. The 1978 devaluation was followed by a fortuitous leap in revenues as crude oil export prices rose steeply in 1979. This time, however, there is little chance of a price increase, and the overall outlook is quite uncertain. This is true not only for fiscal 1983, but for the Fourth Five-Year Program itself, due to start in fiscal 1984.

The Indonesian government may thus be compelled for the first time since President Suharto came to power to switch from its policy of economic development led by public spending. In May it was announced that four large government projects would be shelved, with total investment in these projects to be reduced to US$1 billion from the original US$5 billion. The projects concerned are the Musi oil refinery, the Aceh olefine project, the Plaju aromatic center project, and the Bintan Island alumina project.

Raising development funds

The new cabinet is faced with the task of trying to maintain the momentum of the average 7.6% increase in annual growth rates realized in the 1970s throughout the pending Fourth Five-Year Program. Other goals are self-sufficiency in food and the promotion of domestic production of heavy machinery for processing agro-products. The attainment of these objectives will require that foreign currency funds be obtained by increasing exports and encouraging private capital investment and official foreign assistance.

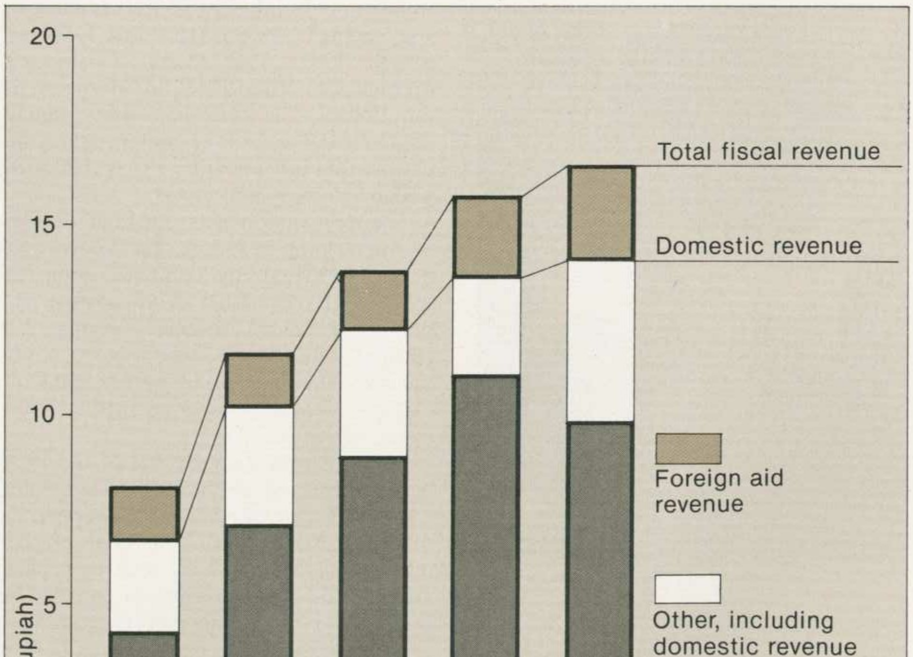
Indonesia's most important source of foreign currency revenue will continue to be earnings from exports of oil and other primary products. The two oil crises in the 1970s served to sharply raise Indonesia's export revenue. However, a subsequent plunge in oil consumption by the advanced industrial countries sent Indonesian oil exports in 1982 skidding 18.3% (US$1,769 million) to US$12,410 million. This was partly balanced by a 5.1% increase in 1982 exports of LNG to US$2,640 million, bringing total oil and LNG export earnings to US$15,050 million. Total export value in 1982 also declined to US$18,790 million from US$21,980 million in 1981. It is estimated that the US$5 reduction in oil prices this April will reduce Indonesia's oil export earnings by US$1,500 million in 1983. Clearly, future oil price trends are a serious concern. Should oil prices decline to around US$20 a barrel as some predict, panic would strike the Indonesian economy.

Indonesia's foreign exchange reserves fell from US$7,300 million at the end of March 1981 to US$3,300 million at the end of March 1983. Even without further declines in the export price of oil, the nation's foreign exchange reserves will inevitably continue to contract unless strong measures are taken to rectify the balance of payments. Moreover, exports of non-oil primary products also declined 12.3% in 1982 to US$3,750 million, while imports in the same year increased 27% to US$16,900 million. During the first quarter of 1983, Indonesia's oil exports fell sharply—production declined to 1,144,000 barrels per day, which was far below the 1.3 million bpd quota allotted by the Organization of Petroleum Exporting Countries (OPEC)—with the result that the fiscal 1982 trade balance was in the red for the first time since 1967. Imports of rice, only 300,000 tons in 1982, are expected to top 1.5 million tons in 1983 because of a lean crop, further affecting the balance of payments.

A second source of funds will be borrowings from other nations. These consist mainly of assistance from the Inter-Governmental Group on Indonesia (IGGI), suppliers' credits from export-import banks and similar organizations, and syndicated loans.

IGGI assistance is a stable source of low-interest funds for government development projects. It amounted to US$1,800 million in fiscal 1981 on a commitment basis. However, IGGI assistance has been reduced from a peak in fiscal 1980, on the

Fiscal Revenue Structure



grounds that Indonesia is an oil-producing country and therefore in less need of aid. To maintain a stable balance of payments position with reduced IGGI assistance, Indonesia has had to depend on syndicated loans from foreign private banks. Early this year the country succeeded in obtaining a massive loan of US$1,000 million. However, the nation's debt service ratio, which hovered around 10% through the 1970s, reached the International Monetary Fund's (IMF) maximum permissible ratio of 20% in March 1983. It will now be difficult to obtain additional loans. Indonesia will consequently need an increase in IGGI aid if it is not to scale down its government development projects. A regular IGGI conference, scheduled to convene in the Netherlands in June this year, was to consider increasing 1983 aid. Japanese Prime Minister Yasuhiro Nakasone, when he visited Indonesia early in May, pledged Japanese loans totaling ¥67,500 million in fiscal 1983, a 7% increase over the previous year.

Indonesia is also counting on luring private foreign capital into the country. Despite the export slump, rising debt service ratio and other signs of deterioration in its economic environment, foreign investment in Indonesia is continuing satisfactorily. New foreign and domestic investments approved in 1982 exceeded the original target by 60%, representing an 86.6% increase over the previous year. Of the total, there were 235 cases of domestic investments totaling 1,117,400 million rupiah, a year-on-year increase of 119%. However, approved foreign capital investment increased by only 10.5% to US$1,290.9 million. The Indonesian government's 1983 projections, announced in January, were quite optimistic, forecasting 4,500,000 million rupiah in domestic capital investment and US$2 billion in foreign capital investment. It is still too early to judge if these targets can be met.

One of the objectives of the 1978 devaluation of the rupiah was to encourage the recovery of then-stagnant foreign investment. Foreign investment did increase sharply with the economic boom triggered by higher oil export prices following the devaluation, and it was thus a matter of serious concern to the Indonesian government when approved foreign investments in 1982 increased by only 10%, insufficient to cover an increase in remittances of profits on previous foreign investments. Last March's devaluation was also intended in part to encourage foreign investment in the country, but account must be taken of the fact that the main reason for the previous sharp rise in foreign investment was Indonesia's success as an oil-producing nation. It is unclear whether devaluation will have the same effect this time, given the recent decline in oil prices.

As in the case of the present economic development program, the Fourth Five-Year Program will consider foreign capital investment a necessary ancillary factor for economic development and will seek to use it to the greatest degree possible without damaging the activities of indigenous capital. Despite this policy, the outstanding balance of foreign investment in Indonesia at the end of 1982 was US$10,390 million (6,500 billion rupiah at an exchange rate of 625 rupiah to the dollar), compared with an outstanding balance of domestic capital investment of about 12,400 billion rupiah, of which more than 50% depended on borrowings from overseas. Foreign capital investment thus continues to play an important role in the Indonesian economy. Further preferential treatment for foreign capital investment will be needed to overcome the difficult last year of the present program and to move successfully to the Fourth Five-Year Plan.

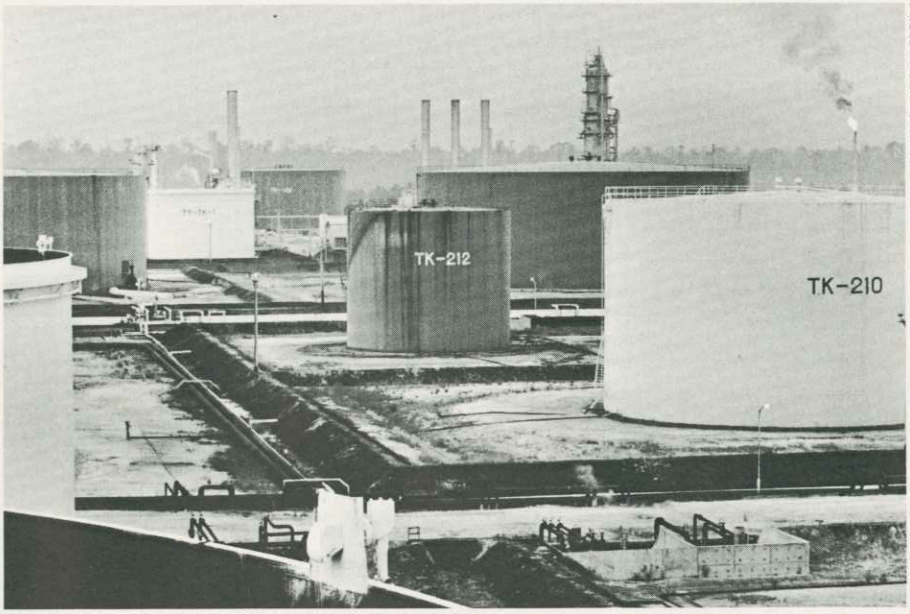


Photo: Asahi Shimbun

Pertamina is Indonesia's principal foreign exchange earner.

Will the economic environment improve?

Indonesia's economic environment is not bright. Exports will likely decline owing to a fall in the export price of oil and lower oil export volume, while stagnant exports of other primary products will further contribute to balance of payments uncertainties and the fiscal deficit. To this can now be added a poor showing in the agricultural sector owing to an anticipated drought in 1983. The nation's gross domestic product growth declined to 4.5% in 1982 from 7.6% in 1981, according to an estimate by the Asian Development Bank, and a high growth rate cannot be expected this year, either.

It must be pointed out, however, that 4.5% growth is not low compared with other LDCs, and that Indonesia's growth potential is still considered to be high among Asian nations. Overcoming of present short-term adversities under the "reverse oil shock" could be achieved through syndicated loans, an increase in IGGI assistance and export promotion measures, including a counter-purchasing system.

From the long-term perspective of development efforts, even more important for helping Indonesia realize its potential power is to improve the present loose performance of public finances and the character of business management, which up until now have depended too much on large revenues from oil exports. This will not be achieved by resorting to such measures as repeated devaluations of the rupiah. Although the world recession has begun to show signs of recovery, Indonesia is not yet at the stage where it can take it easy. According to a May 5 announcement by the U.S. Energy Department, oil prices are expected to reach US$25 a barrel in 1985 before starting to rise again. Indonesia must endure its present difficulties if its economy is to rebound after 1985. ●

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