INDONESIAN INDUSTRIAL FINANCING

by

Jack Bennett

and

Edward A. Tenenbaum

THE CONTINENTAL - ALLIED COMPANY, INC.
1333 G STREET, N.W.
WASHINGTON 5, D. C.

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CABLE: "MONEY"

CONTINENTAL-ALLIED COMPANY, INC.
SECOND NATIONAL BANK BUILDING
1333 G STREET, N. W.
WASHINGTON 5, D. C., U.S.A.

JACK BENNETT
PRESIDENT
EDWARD A. TENENBAUM
EXECUTIVE VICE PRESIDENT

RAY C. BURRUS
VICE PRESIDENT-ENGINEERING

30 January 1959

International Cooperation Administration
Washington 25, D. C.

Gentlemen:

We have the honor to submit our final report on Indonesian Industrial Financing, under the terms of our contract with the International Cooperation Administration (ICA-W-583, dated 29 May 1958).

From July to November 1958, Mr. Edward A. Tenenbaum, Executive Vice-President of our company, spent a total of fourteen weeks in Indonesia. He interviewed approximately 175 government officials, businessmen, and bankers, including President Sukarno, Prime Minister Djuanda, the Ministers of Finance, Industry, Commerce, Foreign Affairs, and Veterans' Affairs, and the Director-General of the State Planning Bureau. While much of his time was spent in Djakarta, many other cities also were visited, including Bandung, Semarang, Djogjakarta, Solo, Surabaya, Madium, Singaradja, and Denpasar.

In addition, Mr. Jack Bennett (President of our company) and Mr. Tenenbaum have spent approximately 19 weeks in the Washington, D.C. home office, and other places authorized by I.C.A., in preliminary briefing, research, discussion of the feasibility of attracting private foreign capital, and the preparation of the various reports required by I.C.A. and the Government of the Republic of Indonesia.

It is not possible to thank properly the many persons in Indonesia and the United States who helped us in our work. This includes all the people who were interviewed in the course of our study, listed in Appendix A; it would be difficult to single out any small number for special thanks without neglecting others who deserve as much. However, particular appreciation is due to the officials of the Indonesian and U.S. Governments who planned and guided the project. The sponsoring agency within the Indonesian Government was the State Planning Bureau (Biro Perantjang Negara). The Director, Dr. Ali Budiardjo, was exceptionally cooperative and patient and deserves much credit for any beneficial results of our work.

We are also grateful for the generous help and advice of the American Ambassador in Indonesia, Mr. Howard P. Jones, the Chief and the Deputy Chief of the U.S. Operations Mission, Mr. James C. Baird, Jr. and Mr. George Gurow, and the following members of their staffs:

Mr. Herman Barger, Economic Counselor, U.S. Embassy
Mr. James D. Bell, Counselor, U.S. Embassy
Mr. Robert Grant, Chief, Industry Division, USOM
Mr. Martin Mulholland, Program Officer, USOM

In Washington we have had the benefit of briefing and encouragement from many members of the ICA, and in particular from the following:

Dr. Raymond Moyer, Director, Office of Far Eastern Operations
Miss Helene Granby, Chief, Far East Program Staff
Mr. Eric Hagberg, Chief, Indonesia-Japan Division
Mr. Walter Furst, Indonesia Officer
Mr. Nathaniel Raffler, Chief, Planning Branch, Far East Area Operations Division, Office of Industrial Resources
Mr. Kenneth Levick, Assistant Chief, Planning Branch, Far East Area Operations Division, Office of Industrial Resources

Special thanks are due to Mr. James Gill, who guided and supervised our performance under the contract.

Our assignment in Indonesia was one of the most challenging in our entire experience. It is almost impossible to realize the extraordinary difficulty of Indonesia's problems, until one studies them on the spot. One can only admire the perseverance, good will, and ability with which Indonesia's government and business leaders face their thorny problems. Indonesia's leaders have earned the right to succeed in their uphill struggle to develop a sound economy and society. It is essential that they succeed, not only for the benefit of Indonesia's own 85 million people, but also for the sake of peace and stability in all Southeast Asia.

We hope that our report will make some contribution to their ultimate success. We hope in particular that the report will help many Indonesians to realize how much they have been able to accomplish already and how much more they can hope to accomplish in the near future. During their many years of isolation under foreign domination most Indonesians acquired a great but unjustified sense of inferiority to the outside world. This feeling was fostered under colonial rule by theories of "white supremacy", that provided a convenient official justification for the existence of colonial rule, as well as a personal justification for the perquisites enjoyed by many individual "colonists" as members of the ruling class.

Many of the bad features of colonial rule can be explained, and to some extent may even be justified, by historical circumstances. For example, it is possible to explain why many Dutch "colonists" required Indonesian servants to enter a room on their knees: the Dutch took over this custom from native feudal rulers. It is also possible to explain why the Dutch refused to let Indonesians advance into many skilled trades and higher professional posts, even reserving streetcar motormen's jobs for white men: particularly during the 1930's, unemployment was rife in The Netherlands. But the time for explanation, justification or recrimination is past. There remain, as objective if unpleasant heritages, a widespread inferiority complex, and a widespread mistrust and dislike of white men.

These emotional heritages do not leave room for fine distinctions between the way some "colonists" behaved and the way that white men in general might be expected to behave once they have given up the unwarranted privileges of cononial rule. Sometimes, indeed, Indonesians fail to make distinctions between "private enterprise" as an economic ideal and the colonial exploitation that they once knew in the name of private enterprise. (In Indonesia's history, "liberalism" and free enterprise are synonymous with the removal of governmental restraints on European enterprise,that once provided some protection for native society -- as well as for a privileged group of Dutch monopolies.)

Thus, irrational and unjustifiable feelings of inferiority are closely associated with feelings of unfriendliness and even fear of private enterprise. Many Indonesians, afraid that they are inferior, are afraid to let non-Indonesians compete freely within Indonesia. This fear applies not only to white non-Indonesians, but also to foreign and native-born Chinese.

Economic and political difficulties since independence have tended to reinforce the widespread feeling of inferiority. Discouraged by their slow progress, Indonesians are afraid that everything they try to do will turn out wrong. Inflation, corruption, waste of resources, scarcity of capital, lack of trained technicians, lack of political maturity (to name only some examples) seem to confirm fears that Indonesia is unable to solve her own problems. This feeling is particularly prevalent among those who have studied abroad in advanced countries and who judge Indonesia's conditions by the standards of such advanced countries. Few Indonesians -- President Sukarno is one of the few -- realize that their problems are about the same as the problems of other underdeveloped countries throughout the world. Lacking the information and self-confidence needed to make fair comparisons, Indonesians are often their own worst critics.

Dissatisfaction and lack of confidence is not merely caused by a lack of opportunity for comparison. It is also caused by the fact that many Indonesians expected too much when they won their independence. There were many who hoped that winning freedom from Dutch rule would quickly lead to freedom from poverty. This hope may have been due to their national characteristic of optimism[1/].

The disappointment of unduly optimistic hopes has had a sobering effect on some Indonesians, and a dangerously frustrating impact on others. While many Indonesians now recognize the need for more patience, some have heeded totalitarian promises to perform the miracles that independence did not produce. To limit totalitarian influence, as Indonesia's responsible leaders know, democratic government must show greater progress in improving the economic situation of the average man.

So far, economic progress has been defeated by the rise in population. As more is produced, there are more people waiting to consume it, and the average man's lot does not improve. As is pointed out in Chapter 1 of the Report, population pressure is an important cause of Indonesia's difficulties. The Island of Djawa, with the world's heaviest population density (417 per square kilometer, or 1,080 per square mile in 1956), no longer offers much room for agricultural expansion. Opportunities for moving surplus population to other areas of Indonesia are limited, since heavy investments are needed to make transmigration practical. Therefore Indonesia needs industrialization. In particular, she needs small and medium industries that provide a rapid increase in employment at a relatively low cost for capital investment.

Inflation (examined in Chapter 2) adds to the difficulty of solving Indonesia's economic problems. Inflation is the cause of growing discontent and increasingly severe disorganization of the economy. By now, inflation is beginning to be self-defeating, reducing rather than increasing the resources available to finance development and the government's current deficit. Inflation makes the development of small and medium

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1/ Optimism is so much a part of the Indonesian character that it even appears in the structure of the language. For example, Indonesians rarely use the Indonesian word for "no" (tidak) if circumstances will allow them to use the word for "not yet" (belum).

industry particularly difficult by interfering with the supply of imported raw materials and spare parts. This discourages potential investors and sources of financing.

Despite this and other difficulties, Indonesian private industry has made impressive progress. It is particularly impressive when compared (as in Chapter 3) with some of the government's industrial ventures, and particularly, the "Induk" plants.

Existing financial institutions are not adequate to meet the need for industrial development. As is pointed out in Chapters 3 and 4, neither commercial banks, providing mainly short-term working capital, nor the long-term financing institutions, particularly government agencies like the Bank Industri Negara and the Lembaga Djaminan Kredit, have enough trained people, resources or experience to do the job. Commercial banks have concentrated their limited resources on the financing of trade. The government financing agencies have tried to lend to small and medium industry, particularly private industry, but have not been very successful. Defaults and arrears in payment have been experienced in up to 90% of the loans.

Industrial development could be speeded up by attracting more foreign investment. However, Indonesia's present attitude towards foreign investors is not very encouraging. The colonial period's legacy of suspicion and fear makes it difficult for Indonesia to offer attractive terms to foreign investors (see Chapter 6).

Our recommendation to meet this complex of problems (given in Chapter 7) is the establishment of an "Indonesian Development Finance Company, Inc.," to be owned 50% by Indonesian private investors (the Council of Industries, the Association of Private National Banks, and P.T. Escomptobank), and 50% by foreign private investors. This new organization would make long-term loans to private -- and cooperative -- industry through the existing Indonesian commercial banks. We recommend the approval of its application to the Development Loan Fund for a credit of $10 million; a copy of the application is attached to our report.

Respectfully yours,

Jack Bennett

Jack Bennett

Edward A. Tenenbaum

Edward A. Tenenbaum

Note on Geographical Names

In this report place names are given in their Indonesian form. Frequently used English equivalents, some of which are associated with the period of Dutch rule, are as follows:

Indonesian	English
Djawa (pronounced as in English "Java")	Java
Sumatera	Sumatra
Kalimantan	Borneo
Sulawesi	Celebes
Nusa Tenggara	Island group, including Bali and Lombok
Maluku	Molucca
Irian	New Guinea

Indonesia's capital city, Djakarta, was called Batavia during the period of Dutch rule.

Chapter 1

Population Pressure, Regionalism and Industrialization

Industrialization represents Indonesia's economic hope for the future. Indonesia's population is growing faster than her agriculture can expand (and the possibility of expanding services such as tourism is limited). Today, around 75% of Indonesia's workers live by farming, 10% by manufacturing and handicrafts, and 15% by services and miscellaneous activities. It is estimated that some 20% of Indonesia's labor force does not have regular work1/.

Indonesia's living standards are among the lowest in the world, and if anything are falling rather than rising as population continues to increase. Population is rising by around 1.5 million people, or roughly 2% a year, and has more than doubled since 1900; it will double again by the year 2,000 if present birth and death rates continue.

If the growth of population were spread evenly over Indonesia's entire area, it might not be as serious a problem. There are unused resources, both agricultural and mineral, in many parts of the country. If and when these can be brought into employment, Indonesia will be able to support a much larger population at much higher standards of living. Even now, the average population density for Indonesia as a whole is a mere 44.6 per square kilometer, or 115.5 per square mile (1956 data). However, population is concentrated on the Island of Djawa. With a mere 7% of the total land area, Djawa contains almost two-thirds of Indonesia's people. Djawa's population density, 417 per square kilometer or 1,080 per square mile, is the highest in the world for areas of its size.

There no longer is room for Djawa's growing population in agriculture. In Central Djawa, one of the most heavily populated areas, the average agricultural landholding has fallen to the incredibly low level of one-fourth hectare (six-tenths of an acre)! Intensive cropping of available land has been pushed beyond its economic limits, leading to soil erosion, flooding, and falling yields per acre. Use of chemical fertilizers and other modern practices may give a temporary boost to yields, but in the long run Indonesia will be lucky if Djawa's agricultural output can be maintained at present levels.

1/ U.S. Department of Commerce, "Investment in Indonesia, Basic Information for United States Businessmen," Washington, 1956, page 97.

There are two possible answers to the problem of Djawa's overpopulation: transmigration -- movement of people from Djawa to the less populated outer islands -- and industrialization. Both are essential and inevitable for the long-term development of Indonesia. However, the problem of overpopulation has hardly been touched by past transmigration programs, and is unlikely to be solved directly by conceivable future efforts. Official records show an almost insignificant transmigration at present. The number of families moved in 1956 was 5,763, with an estimated 24,350 members[1]. This is 0.4% of the estimated population increase in that year.

To move a much larger number of people from Djawa to the outer islands will be very difficult and very expensive. Comparatively large capital investments will be needed, in housing, and in transportation facilities, schools, and other public institutions. In addition, something will have to be done to change the thought patterns of the people who are to move. Most Djawanese today are unwilling to leave their ancestral homes for the perils -- real and imaginary -- of the outer islands. For example, there are fertile prairies along the coast of Kalimantan that are very suitable for agricultural settlement. However, it is virtually impossible to settle them because of the widespread belief in rural Djawa that Kalimantan is haunted. Better educated Djawanese who are not affected by such superstitions are understandably unwilling to accept the primitive frontier conditions, such as the extreme difficulty of travel, lack of potable water, and absence of educational facilities, even if they are offered many times what they can earn at home. (For example, a chinaware factory on the Island of Billiton offers three times the wages that are paid to skilled workers on Djawa. However, technicians refuse to accept work there because once in Billiton they may be unable to get an airplane passage out for several months.)

It is perhaps significant that the large-scale movement of Europeans to other continents only took place after the habits and social practices of feudalism had been radically changed by the industrial revolution (even then convicts and others who were transported by force made up a large proportion of the early settlers of the U.S. and Australia). Similarly, the possibility of large-scale transmigration from Djawa may depend on a change in attitudes which perhaps can only come about through the spread of industry within Djawa.

1/ Biro Pusat Statistik, "Statistical Pocketbook of Indonesia, 1957," Djakarta, 1957, page 16.

At best, therefore, transmigration may help directly to take care of a fraction of the annual increase in population, and may contribute indirectly, by helping to increase the production of exportable products or raw materials for industry. Most of Djawa's increasing population, however, may have to seek industrial work at home.

As Djawa's cultivable areas filled up, there began a rapid influx of surplus population to the cities. This has been accelerated by the physical insecurity in some areas. Since the war, banditry has been prevalent in parts of Djawa (no more than 60 miles from Djakarta) at least partly because of the impoverishment of the growing population. The population of Djakarta and eleven other urban centers increased from 1,843,200 in 1930 to 5,018,500 in 1952, and 5,703,300 in 1956 1/.

The growth of urban population has been much faster than the increase in opportunities for productive employment and decent life.

Before the war it was usually possible for an Indonesian who lost his city job to return to the family farm. As a result, the Indonesian economy turned out to be surprisingly resilient during the great depression. However, the growing population pressure is gradually closing this avenue of retreat from urban economy. Indonesia's hundreds of thousands of pedicab (betjak) boys are living evidence that the countryside can no longer re-absorb those who fail to find gainful employment in the cities.

Unemployment and social disorganization in the cities are at the root of some of Indonesia's most baffling political and economic problems. In particular, Indonesia's government is under almost irresistible pressure to devote an increasing share of the country's resources to palliatives for the distress of the urban population. Palliative measures include sale of rice at subsidized or controlled prices, and continued employment of redundant civil servants (many are veterans of the struggle for independence).

Heavy relief expenditures for the large cities of Djawa have dissipated on consumption much of the limited resources that might have been devoted to productive investment. (According to estimates of the State Planning Bureau, from 1951 to 1955 the share of national income going into capital goods (gross fixed investment) declined, from 7% to 5%. 2/)

1/ Biro Pusat Statistik, "Statistical Pocketbook of Indonesia 1957," Djakarta, 1957, page 11.
2/ Ekonomi dan Keuangan Indonesia, Vol. 9 No. 11, November 1956, page 677.

The relief expenditures and policies also aroused resentment in other areas of Indonesia. Protests against the favoritism shown to the cities -- and particularly to Djakarta -- have become entwined with the traditional jealousies between the population of Djawa and the outer islands. Often the problem is put in terms of interisland discrimination. Sumaterans, for example, argue that "their" island earns 70% of Indonesia's foreign exchange, and therefore should be entitled to spend at least 30% of the total on its own needs. However, the problem is by no means confined to interisland frictions. Even within Djawa, there are complaints against the concentration of government resources on the problems of the capital. No further away than Semarang, the military authorities have followed the precedent of the outer islands, by instituting a special tax (on automobiles) earmarked for local economic development. Similarly, the Island of Bali, less than ten miles from Djawa, has a special provincial tax of Rp 100 per quintal[1/] on shipments of coffee to Djawa (soon to be raised to Rp 200 per quintal); proceeds are to be used for development of roads, schools, Hindu temples, and a literary university. In Bali, as in many other areas, the local government intends to set up a regional planning bureau to encourage industrialization by providing ideas and experts.

The demand for industrial development is even stronger in more distant "outer islands." The Government has already begun to move in the direction of satisfying this demand, and sooner or later any new program for industrial development will face it. Therefore it is necessary to consider not only whether and how industry should be promoted, but also where, and how locational factors should be taken into account.

At the present time, almost all of Indonesia's manufacturing industry is located on Djawa. According to Table 1, Djawa has around 87% of the total purely industrial employment (not associated with mining, petroleum, or agricultural estates). Sumatera has a mere 8% of the total, while Kalimantan, Sulawesi, Nusa Tenggara, and Maluku together account for only 5%. Djawa's industrial leadership is indicated by the number of industrial employees per thousand of population. On Djawa this averages 7.3. For Sumatera, the figure is only 2.7, and for the other regions of Indonesia it is even lower. Djawa not only has more industry, but also has the larger and more developed industrial enterprises. In Djawa the average number of employees per reporting enterprise is 44.6. In Sumatera it is only 30.5, and in the other areas it is even less.

1/ A metric quintal is 100 kilograms, or 220.4 pounds.

Table 1

Industrial Establishments, Employment and Population by Area, 1956

	Number of Establishments	Number of Workers	Percent of Workers	Workers per Establishment	Population '000	Percent of Population	Industrial Workers per 1000 Population
West Djawa	3,399	147,343	31.9	43.4	17,230	20.3	8.6
Central Djawa	3,384	137,197	29.7	44.7	18,622	21.9	7.4
East Djawa	2,224	117,763	25.5	53.0	19,279	22.7	6.1
Total Djawa	9,007	402,303	87.2	44.3	55,131	64.9	7.3
Sumatera	1,232	37,601	8.2	30.5	13,987	16.5	2.7
Kalimantan	331	8,516	1.9	25.7	3,676	4.3	2.4
Sulawesi	283	7,198	1.6	25.5	6,206	7.3	1.2
Nusa Tenggara	98	5,264	1.1	53.7	5,205	6.1	1.0
Maluku	21	292	0.1	13.9	777	0.9	0.4
Total	10,972	461,174	100.0	42.0	84,982	100.0	5.4

NOTE: Does not include all handicraft establishments, or any industrial plants associated with agricultural estates, such as sugar mills and rubber crepe mills.

Source: Biro Pusat Statistik, "Perusahaan-Perusahaan Industri, 1956", Djakarta, 1958, and "Statistical Pocketbook of Indonesia, 1957", Djakarta, 1957.

Most light consumer-goods and capital-goods industries are concentrated on Djawa. As Table 2 shows, Indonesia's two largest industries -- tobacco and textiles -- have over 94% of their workers on Djawa. Food manufacture, non-metallic mineral manufactures (e.g. roofing tiles), and beverage industries tend to spread out more in accordance with the distribution of population, having "only" 81 to 85 per cent of their workers on Djawa. A few industries that rely heavily on domestic raw materials, such as rubber and wood manufactures (40 and 35% Djawanese workers) have a substantial proportion of their employment outside Djawa.

Whatever the political implications may be, there are good economic reasons for the concentration of many types of industry on Djawa, as well as some reasons that are not so sound. Industry is centered on Djawa because markets, government controls, and labor supply are concentrated there.

Concentration of markets. Djawa is Indonesia's largest market for industrial products, containing the bulk of Indonesia's population and a relatively large share of her national income. A disproportionately large part of Indonesia's small middle and upper class is in Djawa, partly because of the establishment in Djakarta of the capital and centralized institutions. Djakarta is also the center of the foreign population, small in number but each equal to literally hundreds of average Indonesians as consumers of many manufactured goods. Industries which benefit from large-scale production, requiring only a few factories to satisfy Indonesia's entire requirements, naturally may locate on Djawa to get close to their main market.

If interisland transportation were more reliable and less expensive, this advantage of location on Djawa might become less important. In the long run the policy of decentralization of government and other institutions will help to spread the market for manufactured consumer goods, by increasing the opportunities to earn higher incomes outside Djakarta.

Concentration of government control. Djakarta, as the center of government controls, attracts many factories that depend on the granting of import licenses or other government actions. To the extent that the government decentralizes its control functions, and to the extent that interisland transportation improves, this attraction may become less compelling. Recently, a step was taken in this direction by decentralizing the Foreign Exchange Bureau (Biro Devisen Perdagangan). Provinces now are allowed to spend 30% of their export earnings without reference to the central government. (Of this, 5% must be spent on essentials, 5% on foodstuffs and groceries, 5% on "reconstruction" or investment, and 15% is available for anything the provincial authorities may wish to license.) In addition, provinces are to receive 10% of the Rupiah revenue from the 20% exchange tax on export proceeds.

Table 2

Industrial Employment by Area and Industry, 1956

Industry	Djawa Total	Djawa West	Djawa Central	Djawa East	Sumatera	Kali-man-	Sula-wesi	Nusa Teng-	Malu-ku	Total Number	Percent of Total
	(in percent of total)										
Wearing apparel	100	31	61	8	-	0	-	0	0	52,572	11
Electrical mach'y and apparatus (incl. repair)	100	60	13	27	-	0	0	0	0	2,582	1
Leather and products	95	69	10	16	3	2	1	-	0	10,966	2
Tobacco	94	4	47	43	2	0	-	3	0	87,419	19
Textiles	94	41	33	20	4	-	1	1	0	71,149	15
Metal products (except mach'y and transport)	94	50	20	24	5	-	-	0	0	13,194	3
Paper and products	94	55	6	33	1	0	-	0	0	3,520	1
Miscellaneous	90	18	51	21	5	2	2	1	-	14,382	3
Machinery (except electr.)	89	39	10	40	9	2	-	0	0	7,803	2
Printing	88	55	16	17	8	2	2	-	-	25,197	5
Furniture and fixtures	87	40	23	24	9	-	2	-	-	8,521	2
Food manufacture	85	30	20	35	8	1	3	2	-	52,771	11
Chemical products	85	42	11	32	7	1	4	2	-	30,203	7
Transport equipment	85	49	11	25	7	1	6	-	-	20,887	5
Non-metal mineral products	81	42	15	24	17	1	1	1	0	17,423	4
Beverages	81	45	10	26	14	2	2	1	1	7,069	1
Rubber and products	40	29	4	7	43	17	-	0	0	21,410	5
Wood	35	14	9	12	44	16	3	1	-	14,106	3
Total number	402,303	147,343	137,197	117,763	37,601	8,516	7,198	5,264	292	461,174	
Percent of total	87	32	30	25	8	2	2	1	-		100

Note: Does not include all handicraft establishments, or any industrial plants associated with agricultural estates, such as sugar mills and rubber crepe mills

Source: Biro Pusat Statistik, "Perusahaan-Perusahaan Industri, 1956," Djakarta, 1958

However, as long as the capital remains in Djakarta and as long as government controls persist there will continue to be suspicion that somehow they are used to favor Djawa at the expense of the outer areas. The only solution to the problem -- and the only conclusive answer to accusations of corruption, favoritism, and discrimination -- is the substantial liberalization of government controls (e.g. by open general licensing of certain types of imports). For example, if licenses were automatically issued for most industrial raw materials, there would be no need to locate in Djawa in order to facilitate the acquisition of imports. Unfortunately, such relaxation of controls will only be feasible when inflation is overcome.

Concentration of labor supply. As the area of greatest population density, Djawa not only contains the bulk of Indonesia's skilled labor, but also has much lower wage rates than other areas. Wages of skilled workers in Djakarta are around one-half of the wages for similar skils in Palembang (Sumatera). The difference is even greater for professional salaries. Graduates of Gadjah Mahda University (Djakarta) can earn Rp 1,500 a month (plus housing) in Djawanese industrial enterprises, but are offered Rp 5-10,000 a month for similar positions in Medan (Sumatera).

In General, labor-intensive industries tend to locate in Djawa, and those which locate elsewhere may not be able to compete. Exceptions to this rule include some industries whose selling costs involve a heavy element of freight, such as furniture and soft drinks. There are also some labor-intensive industries which survive on outlying islands by catering to local tastes. For example, Makassar has a textile industry that supplies traditional Sulawesi designs. In the long run, however, differences in taste will probably lose their importance as transportation and communications improve.

Other advantages of Djakarta as a location for industry are the availability of public utilities, central location for interisland trade, ease of communications with foreign countries, and availability of feeder industries and ancillary services such as repair shops.

Djawa as a whole may continue to have a comparative advantage as a center for labor-intensive industry, but concentration of new development around Djakarta no longer seems to be fully justified by economic factors.

In recent years, Djakarta's rapid growth has resulted in some decline in its comparative advantage. For example, centrally located real estate has become scarce and has shot up in value. It is now almost impossible to find suitable industrial sites within the city. When factories move out to the suburban area, they run up against almost the same transportation difficulties as if they had moved to another city.

Within Djawa, wages tend to be higher around Djakarta than towards the Eastern end of the island. The minimum wage in the Djogjakarta area for certain skills is Rp 7 a day, or around half the minimum in the Djakarta area. Bali, lying off the Eastern end of Djawa, has even lower wage rates -- and an even more serious population problem. To some extent the lower wage rates in other areas are accompanied by lower productivity than that which is found among the more experienced industrial workers in Djakarta. However, this difference will decline in time, since workers in other areas have shown their ability to learn fast.

Although Djawa is likely to remain the center of mechanized industry, the other islands are and probably will continue to be the center of mining, rubber production, and other extractive activities that earn most of Indonesia's foreign exchange. Djawa now supplies a small part of the other islands' need for industrial products and services, and sometimes charges unduly high prices. Outer islands therefore are tempted to bypass the central government's economic controls, and to spend their foreign exchange earnings for things that Djawa cannot provide, or only provides at very high prices. If Djawa could offer more manufactured goods at lower prices, and could provide central government services at a lower cost, the economic reasons for feeling against Djawa would be diminished. To provide herself with more manufactured goods at reasonable prices, Indonesia needs to expand industry on Djawa, where labor is cheap. This is also necessary to obtain more efficient central government; only by increasing industrial employment in Djawa can Indonesia's government overcome the political pressure to employ unnecessary civil servants.

Industrial development on Djawa is thus of crucial importance to the future political stability of Indonesia. However, development of Djawa alone is not enough, either economically or politically: the outer islands also need industrial development. Since their economic needs have been neglected to some extent, by now development in the outer islands could be more profitable than alternative developments in Djawa. Development on the outer islands may also be less risky; it is often based on the use or processing of locally available raw materials, and is less subject to difficulties during periods of import restriction. Finally, development on the outer islands often results in a direct improvement of Indonesia's ability to earn foreign exchange, and thus may help to keep existing and new industries going in Djawa itself.

Even if there were not sufficient economic reasons for devoting part of any development program to the outer islands, by now there are compelling political motives. Whether or not the resentment against Djawa is justified, it exists. To ensure Indonesia's long-run survival as a nation, the demand for some development in the outer islands must be met, along with the demand for industrial employment on Djawa. This means that Indonesia must spend more, at a time when ugly signs of inflation seem to show that Indonesia is already spending too much.

Chapter 2

Inflation and Industrial Development

The most important financial fact about Indonesia today, the key to many of her most perplexing problems, is the growth of inflation. Many Indonesians tolerate inflation in the hope that somehow it will help to raise capital for investment. In fact, however, inflation is an important cause of the low rate of productive investment. By causing the real value of savings to go down, it is destroying the instinct to save. By rewarding unproductive speculation with high profits, and by undermining confidence in the future, it is diverting remaining savings into hoarded goods, capital flight, and other socially harmful ends.

At the same time, inflation makes it necessary for the government to divert available foreign aid from constructive investment purposes into imports of consumer goods (such as rice and textiles). Having preempted the community's financial resources for non-productive uses, the government is even afraid to use the local currency counterpart of aid for productive investment; any further expenditure, whether productive or non-productive, might make inflation assume catastrophic proportions.

Inflation causes social and political difficulties in the cities, where much of the population is at the mercy of rising prices. At the same time, it is responsible for persistent balance of payments difficulties (including the diversion of export products into black market channels or hoarding). Efforts to control the symptoms of inflation without curbing the cause have led to a proliferation of government controls, and to temptations for arbitrariness and corruption in the government civil service. In these and many other ways, inflation contributes to the friction between the Djawanese cities and the outer islands.

In her difficulties with inflation, Indonesia is like many other underdeveloped countries. Insecurity and low per capita income have led to a very low rate of savings. Annual net savings in normal years -- all that is available for productive investment -- have been estimated at a mere 5% of national income1/. This has been barely enough to keep up with the growth of population. Under conditions of inflation, even this small amount no longer is available to the government

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1/ U.S. Department of Commerce, "Investment in Indonesia, Basic Information for United States Businessmen," Washington, 1956, page 79.

to meet its socially and politically pressing requirements. To meet these needs, the government is sorely tempted to take the seemingly easy way out: deficit financing with newly printed money. Government deficit financing has been the cause of almost all Indonesia's inflation. During the years 1950-1958, Indonesia's money supply increased by an estimated Rp 21.2 billion to around Rp 24.4 billion[1]. This net increase was less than the loans of newly issued money to the Indonesian Government (see Table 3). Loans of newly issued money to private business were a relatively minor inflationary factor, increasing by 3.5 billion during the during the period. The combined inflationary effect of these two factors, almost Rp 30 billion, was offset in part by disinflationary factors totaling Rp 8.7 billion (e.g., the sale of imports to the public, at the expense of foreign exchange reserves, and miscellaneous factors, largely the increase in the capital and reserves of banks).

During the last few years a feeling of fatalism has permeated Indonesian discussions of inflation. The government deficit during 1957 and 1958 is said to result from extraordinary expenditures connected with suppression of the rebellion in the outer islands. Serious as this was, however, it was only part of the problem. As Table 4 shows, the proportion of the government's total expenditure devoted to military and police requirements was not much greater in 1957 than in previous years. Security expenditures increased, to be sure. However, other expenditures not directly attributable to security also increased, at more or less the same pace. The increase in security expenditures in 1957 by Rp 2,573 million (from Rp 8,343 in 1956 to Rp 10,916 million in 1957) was only half of the increase in total expenditures of Rp 5,121 million (from Rp 20,749 million to Rp 25,870 million). The rest of the increase was in expenditures related to normal governmental functions, particularly in the "economic sector" of the budget.

Whatever the reason, however, it is clear that the increase in money supply has been determined largely by the government's deficit. To some extent, an increase in money supply was justified, or at least could have been absorbed by Indonesia's economy without serious ill effects. (Whether a better use could have been found than the financing of unproductive government deficits is another matter, that can be decided only by the Indonesian people.) To determine the extent to which the increase has been seriously inflationary, we must look not only at the supply but also at the demand. The demand depends largely on the public's willingness to hold purchasing power in the form of money. This demand can increase or decrease. If the demand for money goes

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1/ 1958 figure partially estimated.

Table 3

Causes of Increase in Money Supply, 1950-1958
In Millions of Rupiah

	Credit to Government	Private Sector 1/	Foreign Sector 2/	Miscel-laneous	Total Increase (+) or Decrease (-) in Money Supply
1950	430	379	654	-381	1,082
1951	-1,355	1,470	561	62	740
1952	3,322	293	-275	-1,753	1,587
1953	2,452	-50	-1,560	80	922
1954	3,342	433	-269	-32	3,474
1955	1,755	-1,287	1,034	-385	1,117
1956	2,267	989	-1,815	-282	1,159
1957	5,833	2,337	-1,023	-1,527	5,520
1958 Est. 3/	8,254	-1,034	-1,804	+50	5,466
Total	26,300	3,530	-4,497	-4,168	21,165
Percent of Total	124.3	16.6	-21.2	-19.7	100.0

1/ Credit to private sector, less prepayments by importers, etc.
2/ Decrease (-) or increase (+) in foreign exchange reserves.
3/ First six months x 2.

Sources: Bank Indonesia, Annual Reports, "Bulletin No. 14, Fourth Quarter, 1957", Djakarta, February 1958, page 9, and "Berita No. 15, Triwulan Kesatu Dan Kedua 1958", Djakarta, August 1958, page 11.

Table 4

Gross Government Expenditure by General Purpose, 1951-1957 in Percent of Total and in Millions of Rupiah

	1951	1952	1953	1954	1955	1956	1957
			PERCENT OF TOTAL				
Security	51	39	44	43	44	40	42
Defense	31	24	27	22	24	21	23
Home Affairs	18	14	15	19	18	18	17
General Sector	14	15	14	15	15	15	13
Economic Sector	19	34	29	29	27	31	30
Cultural Sector	7	8	8	8	9	8	8
Social Sector	5	3	3	3	4	4	4
Foreign Sector	4	1	1	1	1	2	3
Total	100	100	100	100	100	100	100
			MILLIONS OF RUPIAH				
General Sector							
High College of State	54	1,136	1,131	1,250	1,329	1,537	1,809
Finance	1,485	1,297	855	1,028	1,184	1,612	1,451
Subtotal	1,539	2,433	2,016	2,277	2,513	3,149	3,260
Security Sector							
Defense	3,269	3,817	3,876	3,327	3,938	4,379	6,052
Justice	133	178	190	243	323	305	363
Home Affairs	1,922	2,158	2,178	2,912	2,941	3,659	4,501
Inter-territorial Relations	-	-	-	-	-	-	1
Subtotal	5,324	6,153	6,244	6,483	7,202	8,343	10,916

Table 4 (Continued)

	1951	1952	1953	1954	1955	1956	1957
		(MILLIONS OF RUPIAH)					
Economic Sector							
Agriculture	(386	(669	461	499	519	676	793
Economic Affairs	(	(1,292	1,143	1,345	964	193	159
Commerce	-	-	-	-	-	-	85
Industry	-	-	-	-	-	-	85
Financing Service	924	2,254	1,424	1,413	1,855	4,456	5,264
Transportation & Communications	194	322	371	424	232	315	316
Navigation	55	141	156	138	114	169	327
Public Works & Power	449	700	581	571	683	602	777
Subtotal	2,008	5,377	4,135	4,391	4,368	6,411	7,805
Cultural Sector							
Information	150	170	152	173	155	222	260
Education & Cultural Affairs	530	986	857	856	975	1,138	1,409
Religious Affairs	96	153	178	209	223	298	366
Subtotal	776	1,310	1,188	1,238	1,353	1,657	2,036
Social Sector							
Health	357	277	225	314	315	472	533
Social Affairs	113	127	154	193	229	273	331
Labor	36	62	51	73	45	56	79
Mobilization of Peoples Potential for Reconstruction	-	-	-	-	-	-	3
Veterans Affairs	-	-	-	-	-	-	22
Subtotal	506	466	430	580	589	801	968
Foreign Sector	477	135	204	172	293	387	885
Grand Total	10,630	15,873	14,217	15,141	16,316	20,749	25,870

Sources: Bank Indonesia, "Report for the Year 1956-1957", Djakarta, 1957, Page 76.
Biro Pusat Statistik, Statistik Konjunktur (Monthly Survey), Djakarta, September 1958, Page 107.
U.S. Department of Commerce, "Investment in Indonesia, Basic Information for United States Businessmen," Washington, D.C., 1956, Page 78.

up, it is possible to increase the supply without inflation -- whether to finance a government deficit or for some productive purpose. If the demand does not change, any increase in the money supply (whether for productive purposes or not) will be inflationary, and will cause prices to rise. If the demand should somehow decline, inflation might result without any increase in the supply of money.

This last is rather unlikely, but some idea of how it might happen will help in understanding Indonesia's present difficulties. Conceivably, the people of a country might suddenly lose confidence in their government, and in the money issued by the government. Then the public would try to reduce the amount of purchasing power that it holds in the form of money. That is, the people as a whole would try to spend its money faster than they receive more money from their sources of income. Of course, the public as a whole could not reduce its money holdings since the money spent by one person is received by another person. However, in trying to spend its holdings of money, the public would bid up prices (if the supply of goods stays the same). Thus, although the same nominal amount of money might be in circulation, the purchasing power of this money supply would be less.

There are many complex influences on the public's demand for money. Three are of particular importance for Indonesia's present problems: (1) money's usefulness to the individual or business, (2) the amount of economic activity, and (3) the state of confidence in the monetary system.

The first, the convenience and usefulness of money, depends to some extent on the state of development of Indonesia's financial and economic institutions, particularly the commercial banks. In countries with a well-developed banking system, possessing the confidence of the public, people are willing to hold larger amounts of currency and bank deposits (the two major forms of money). Chapter 4 discusses Indonesia's commercial banking facilities. For present purposes we may summarize that discussion as follows: Indonesia's commercial banking facilities are not adequate. Although they could be improved, this will be a slow process. It cannot be counted on as a way to increase the demand for money within the near future.

The second influence on the demand for money is the amount of economic activity. As a country's income per capita or population increases, the total national income may rise. With more being bought and sold, a larger money supply usually will be needed by the public. Indonesia's per capita income is among the lowest in the world, and has not been increasing in recent years. Therefore the demand for money is quite small. The major element of Indonesian economic growth has been the increase in population, by around 1-3/4% per annum. This possible cause of an increase in the demand for money is relatively insignificant compared with the increase in money supply during recent years. In 1957, for example, money supply increased by 41% while population went up by less than 2%.

Table 5 compares Indonesia with other countries in regard to this second influence. Admittedly, international comparison of monetary and national income statistics is difficult. At best, comparisons can only show rough orders of magnitude or rank. However, if this is kept in mind, some interesting conclusions can be drawn.

Table 5 shows per capita national income and per capita money supply in terms of U.S. dollars for 63 countries. These countries are arranged in ascending order of money supply per capita (with the country having the lowest money supply per person coming first). As this table shows, the average money supply per capita goes up with the income per person[1]. Thus, the United States, with the highest per capita national income in the world, has the highest money supply per person. Indonesia, whose per capita national income is among the lowest in the world, has the lowest money supply per person.

As national income increases, the demand for money becomes relatively as well as absolutely larger. In the U.S., money supply amounts to 37% of the very high national income; in Indonesia, money supply amounts to only around 10% of the low national income.

Productive investments help to increase the national income, and therefore help to increase the demand for money. To this extent, productive investments may be "non-inflationary," even if they are financed by an increase in money supply. However, few, if any, productive investments result in a net increase in annual national income that is as big as their cost. And even if the increase in national income equaled the cost, the increase in demand for money, in the case of Indonesia, would be only around 10% of that figure. In Indonesia, therefore, productive investments financed with printed money probably would be just about as inflationary as any other expenditure that might be financed with printed money. It is therefore not possible for Indonesia to spend her way into a sound development program without worrying about the inflationary consequences.

1/ The correlation is particularly close if certain special cases are excluded. For example, countries such as Switzerland and Lebanon, important refuges for "hot money," have significantly larger money supplies than they use for their domestic requirements. On the other hand, certain Caribbean countries (such as the Dominican Republic and Guatemala) satisfy part of their demand for money by some use of U.S. dollars, and their national statistics show only a part of their actual money supply.

Table 5

Per Capita National Income and Money Supply for 63 Countries

No.	Country	Currency and Unit (Millions -M or Billions -B)	Year or Date	Money Supply[1]	National Income[2]	Population (millions)[3]	Exchange Rate for Dollar[1,3]	Money Supply as per-cent of national income	National Income per capita in dollars	Money Supply per capita in dollars
1.	Bolivia	Boliviano(B)	Apr.'58	188.94	n.a.	3,305	8,855	n.a.	n.a.	6
2.	Korea (So.)	Hwan (B)	1957	139.2	1,365.5[4]	22,303	1,012	10.2	60	6
3.	Indonesia	Rupiah (B)	May '58	21.22	n.a.	84,900	37.9	n.a.	n.a.	7
	"	"	1954	9.42	91.6	81,020	20.0[5]	10.3	57	6
4.	Haiti	Gourde (M)	1955	129.1[6]	1,381[4]	3,305	5.0	9.3	84	8
5.	China(Taiw.)	N.T. $ (M)	1956	2,862	26,041	9,240	32.28	11.0	87	10
6.	India	Rupee (B)	1956	22.15	114.1	387,350	4.792	19.4	61	12
7.	Pakistan	Rupee (M)	56/57[7]	4,810[7]	20,785[7,8]	83,670	4.802[7]	23.2	52	12
8.	Paraguay	Guarani (M)	1956	1,714	13,562	1,601	90.62	12.6	93	12
9.	Burma	Kyat (M)	1957	1,273	4,560	20,054	4.79	27.9	47	13
10.	Thailand	Baht (M)	1955	6,800	34,950	20,302	21.45	19.5	82	16
11.	Honduras	Lempira (M)	1957	66.93	595.5	1,769	2.0	11.2	168	19
12.	Ecuador	Sucre (M)	1957	1,318	9,733	3,890	17.31	13.5[9]	145	20
13.	Uruguay	Peso (M)	Jul.'58	1,036	n.a.	7,710	6.82	n.a.	n.a.	20
14.	Iran	Real (B)	Mar.'58	31.17	n.a.	19,606	75.0	n.a.	n.a.	21
15.	Peru	Sol (M)	1956	3,837	22,060	9,651	19.0	17.4	120	21
16.	Viet Nam	Piastre (B)	Dec.'57	12.1	n.a.	7,790	73.0	n.a.	n.a.	21
17.	Yugoslavia	Dinar (B)	Sep.'58	340	n.a.	18,500	632[10]	n.a.	n.a.	21
18.	Greece	Drachma (B)	1957	9.66	70.65	8,096	30.0	13.7	171	23
19.	Ceylon	Rupee (M)	1957	1,060	5,067	9,165	4.76	20.9	116	24
20.	Nicaragua	Córdoba (M)	Sep.'58	257.6	n.a.	1,385	7.05	n.a.	n.a.	26
	"	"	1950	124.9[11]	873.0[4]	1,060	7.05	14.3	117	17
21.	Mexico	Peso (M)	1957	11,971	92,000	31,426	12.49	13.0	235	30
22.	Domin.Rep.	Peso (M)	1957	88.2	557.6[4]	2,698	1.0	15.8	206	31
23.	Iraq	Dinar (M)	1956	69.9	303	6,400	0.357	23.1	132	31
24.	Guatemala	Quetzal (M)	1957	108.4	550.3[4]	3,451	1.0	19.7	160	32
25.	El Salvador	Colon (M)	Sep.'57	196.6	n.a.	2,371	2.5	n.a.	n.a.	33
	"	"	1950	116.5	719.1[4]	1,868	2.5	32.4	154	25
26.	Chile	Peso (B)	1957	171.2	1,789.6	7,121	714[9]	9.6	352	34
27.	Philippines	Peso (M)	1957	1,569	8,799	22,690	2.01	17.8	193	35
28.	Ethiopia	Dollar (M)	Sep.'58	188.5	n.a.	20,400	2.484	n.a.	n.a.	37
29.	Turkey	Lira (M)	1956	5,456[11]	21,701	24,797	5.75[10]	25.1	152	38

Table 5, continued

No.	Country	Currency and Unit (Millions -M or Billions -B)	Year or Date	Money Supply[1]	National Income[2]	Population (millions)[3]	Exchange Rate for Dollar[1,3]	Money Supply as per-cent of national income	National Income per capita in dollars	Money Supply per capita in dollars
30.	Jordan	Dinar (M)	Jun.'58	24.95	n.a.	1,572	0.357	n.a.	n.a.	45
31.	Egypt(UAR)	Pound (M)	1956	372	913	23,520	0.348	40.7	111	45
32.	Costa Rica	Colón (M)	1957	352.7	1,900	1,033	5.67	18.6	325	60
33.	Malaya	Dollar (M)	Sep.'58	1,191	n.a.	6,300	3.06	n.a.	n.a.	62
	"	"	1953	1,141[11]	4,836[4]	5,706	3.05[4]	23.6	277	65
34.	Brazil	Cruzeiro(B)	1957	250.0	873.3	61,262	67.0[12]	28.7	213	63
35.	Colombia	Peso (M)	1956	2,131	10,720	12,939	2.51	19.9	330	66
36.	Syria(UAR)	Pound (M)	Jun.'58	1,046	n.a.	4,197	3.58	n.a.	n.a.	71
37.	Finland	Markka (B)	1957	107.2	903.0	4,336	320[13]	11.9	647	77
38.	Japan	Yen (B)	1957	2,550	8,252	90,900	360	30.9	255	78
39.	U.of So.Afr.	Pound (M)	1957	422.9	1,702	14,167	0.359	25.2	335	83
40.	Portugal	Escudo (B)	1956	22.67	48.7	8,837	28.75	46.5	192	89
41.	Argentina	Peso (B)	1957	64.74	188.52	19,868	29.32[14]	34.3	324	111
42.	Spain	Peseta (B)	1957	152.2	391.4	29,431	44.31[12]	38.9	315	122
43.	Israel	Pound (M)	1957	69.03	2,503	1,937	2.65[12]	27.7	493	135
44.	W.Germany	Deutsche Mark(B)	1957	33.2	160.3	53,692[15]	4.202	20.7	708	147
45.	Ireland	Pound (M)	1957	159.0	465	2,885	0.358	34.2	450	154
46.	Venezuela	Bolivar (M)	1957	3,168	17,762	6,134	3.35	17.8	864	154
47.	Cuba	Peso (M)	1957	1,030	2,311	6,410	1.0	44.6	361	161
48.	Italy	Lira (B)	1957	4,904	12,231	48,483	625	40.1	404	162
49.	Lebanon	Pound (M)	1956	763	1,465	1,450	3.22	52.1	314	164
50.	Austria	Schilling (B)	1957	30.74	98.90	6,997	26.0	31.1	544	169
51.	Iceland	Kronor (M)	1957	800	3,657	165	25.3[16]	21.7	880	192
52.	Netherlands	Guilder (M)	1957	9,081	28,220	11,021	3.842	32.2	668	216
53.	Sweden	Kronor (B)	1957	9.34	44.45[4]	7,367	5.173	21.0	1,166	245
54.	Norway	Kroner (M)	1957	6,784	22,880	3,494	7.857[17]	29.7	834	248
55.	Denmark	Kroner (M)	1957	7,713	27,020	4,466	6.91	28.5	874	250
56.	U.K.	Pound Sterling(M)	57	5,560	17,604	51,455	0.358	31.5	957	301
57.	Canada	Dollar (M)	1957	5,175	23,820	16,589	0.965	21.7	1,490	323
58.	France	Franc (B)	1957	6,823	15,680	44,071	420[18]	43.6	846	368
59.	Australia	Pound (M)	1957	1,624	4,687	9,643	0.446	34.7	1,082	376
60.	New Zealand	Pound (M)	1957	312.1	928	2,229	0.358	33.7	1,166	392
61.	Belgium	Franc (B)	1957	198.2	413.5	8,989	50.18	47.9	915	439
62.	Switzerland	Franc (B)	1957	14.45	26.90	5,117	4.284	53.6	1,228	660
63.	U.S.A.	Dollar (B)	1957	134.5	364.0	171,196	...	37.0	2,126	785

Table 5, continued

Footnotes:

1. Average of quarterly data where full year is covered, unless otherwise noted.
2. Estimate for middle of year, or for month specified
3. Official rate, official selling rate, or official major import rate, unless otherwise noted
4. Estimated as 85 percent of gross national product
5. Roughly estimated purchasing power parity; official major import rate was 11.48 and other import rates ranged from 15.3 to 22.9; average black market rate was 28.56
6. Average of June September and December; March figure not available.
7. Year beginning 21 April 1956; averages of June, September and December 1956 with March 1957. Population estimate for October 1956.
8. At 1949/1952 prices.
9. Free rate or free rate for invisibles
10. Toursit selling rate or other highest official rate
11. Average of December with December of previous year
12. Highest official minor export rate
13. Rate officially introduced on 15 September 1958
14. Average of official and free rates.
15. Including West Berlin
16. Rate officially introduced on 15 May 1958
17. Estimated as 10 percent more than official rate, to allow for overvaluation of Norwegian Kroner

Sources:

International Monetary Fund, "International Financial Statistics," Washington, D.C., December 1958 and earlier issues

United Nations, "Economic Survey of Asia and the Far East, 1956," Bangkok, February, 1957; Department of Economic and Social Affairs, Statistical Office of the United Nations, "Statistical Papers, Series H, No. 10, Statistics of National Income and Expenditure," New York, 1957, "Monthly Bulletin of Statistics," Vol. XII, No. 12, New York, December 1958, and "Yearbook of National Accounts Statistics," New York, 1958

République de Viet-Nam, Institut National de la Statistique, "Annuaire Statistique du Viet-Nam, 1954-1955," Saigon, 1957

The third factor is the state of confidence in the currency: people hold more money if they think it has a stable value than if they think it will depreciate. Confidence depends on many imponderables, and is not easily measured. What actually happens to a currency may on occasion be less important than what people think is happening. However, experience shows that sooner or later public opinion catches on to any serious disturbance of their currency, and sooner or later people react by holding less money.

An interesting illustration may be developed by comparing Asian countries. Indonesia and Korea, for example, have about the same per capita national income (roughly $57-60 per person per year), and have about the same money supply per person ($6-7). India, Pakistan and Burma, although per capita incomes are similar (ranging from $47 to $61), have almost twice as much money supply per person ($12-13). Asian countries in the second group have experienced relatively stable monetary conditions; they show significantly more demand for money than the otherwise similar countries in the first group, that have a recent history of severe inflation.

A similar conclusion may be drawn from the contrast between Ethiopia, a country with a very low per capita income (possibly around $60 per annum), and Greece and Chile, underdeveloped countries with the relatively high per capita incomes of $171 and $352 respectively. Ethiopia has the relatively high per capita money supply of $37, while Greece and Chile have smaller money supplies, $23 and $34 per person, respectively. Ethiopia has followed a policy of monetary stability ever since it introduced a predominantly paper money supply less than a decade ago; Greece and Chile have undergone repeated ruinous inflations.

Today Indonesia is somewhere between the countries whose paper money has the full confidence of the public, and those whose paper money obtains very little trust. Like most countries in the beginning stages of inflation, Indonesia at first benefited from a form of "beginner's luck." During recent years, she has been able to absorb a large increase in money supply without big inflationary effects. This gave rise to undue optimism, or at least caused less attention to be given to the dangers of inflation than they deserved. In particular, it lent support to a widespread belief that newly issued money is hoarded by the Chinese merchant community, almost as fast as it is printed.

It was comforting to think that inflation was merely a trick played at the expense of the wealthy and unpopular Chinese minority. Since money supply at first went up faster than prices, it was clear somebody must have been hoarding money. The assumption was made that only the Chinese would be wealthy enough to do this. Chinese merchants in fact were seen to have large amounts of cash (or bank deposits), and that seemed to lend credence to the conclusion.

Increasingly frequent and severe efforts to control the business activities of the Chinese made it unlikely that the Chinese would invest this cash in real estate or other property that might be hard to conceal. For security reasons, the military authorities undertook a number of raids on Chinese business establishments, hoping to discover ill-gotten wealth, excessive hoards of goods, or irregularities in payment of taxes. While relatively little was actually discovered, it was assumed (probably correctly) that the Chinese would be frightened into reducing their holdings of tangible property, and in the process of selling off stocks of goods would take in large amounts of cash.

It is, of course, difficult to be certain just what did happen within the Chinese business community, a closely-knit group not given to communicating its affairs to outsiders. However, available information suggests that the Chinese -- who invented paper money and have been familiar with inflation for thousands of years -- probably have not been hoarding Indonesian currency. To be sure, the general uncertainty in Indonesia, reinforced by military razzias (raids) on warehouse, safe deposit boxes, banks, business premises, and circulating vehicles, has caused many Chinese businessmen to sell off their inventories of goods. However, it would be contrary to ancient traditions and modern practices if Chinese businessmen had kept the proceeds of panicky sales in the form of Indonesian paper money.

Instead, they have sent their liquid wealth out of the country through illegal channels, by buying Singapore, Hong Kong, or American dollars on the black market. The razzias brought temporary relief to the Indonesian economy by driving hoarded goods onto the market, but at the same time they drove foreign exchange out of the country. In their eagerness to get resources out of the country, the Chinese have bid up the black market rate to around Rp 90 per dollar, or 2.4 times the official "Bukti Ekspor" (B.E.) rate of Rp 37 to the dollar. The difference between the Indonesian official and black rates is one of the most extreme in the world today, in view of the fact that the B.E. rate is a fairly good reflection of the Rupiah's actual purchasing power.

Some of the effects of this great discrepancy are amusing. For example, a clever Indonesian merchant recently took advantage of the rice shortage by smuggling Indonesian rice out of Djawa. After the rice was safely in Singapore he approached the Indonesian Government with an offer to bring in rice if the government would give him import licenses for certain luxuries that sell at high prices within Indonesia. When the government agreed to this, the merchant "imported" the Djawanese rice back into Djawa. His profit consisted of the earnings on the imports of luxury goods. Instead of paying freight for the shipment of rice to Singapore and back, the merchant arranged for the foreign vessel to fill its fuel tanks with Indonesian oil, bought at the low official price and paid for with Rupiah acquired on the black market. The saving to the foreign shipowner was more than enough to pay for the back-and-forth movement of the rice.

Although the present high black market rate is caused largely by political factors, such as the uncertainty of the Chinese community, it is leading to an acceleration of inflationary disorganization of the economy. The high black market rate is a constant source of temptation for large-scale diversion of export earnings away from legal channels. This reduces the ability of the government to provide for imports through legal channels, and thus contributes to the upward pressure on prices.

The above analysis leaves two questions unanswered: (1) if the Chinese did not hoard Indonesian Rupiah, who did? and (2) are those who hoarded in the past still hoarding? To the extent that hoarding of money did take place, it was probably among the farm population. Hoarding of cash is the normal response of peasant communities to the first stages of inflation. Only after an appreciable time lag do peasants, inexpert in monetary matters, begin to lose their initial trust in an inflating currency. Sooner or later, however, they join the more sophisticated members of the community in spending their money as fast as possible.

The records of the Indonesian Postal Savings Bank (Bank Tabungan Pos) indicate that this is what probably is happening in Indonesia. Savings deposits in the special savings offices located in metropolitan areas have declined sharply during the last year or so. Deposits continue to increase at ordinary postal offices, which draw savings to a greater extent from rural areas and small towns. (See Table 6.) In Djakarta, for example, net withdrawals amounted to Rp 4.1 million in January-April 1957, and to Rp 8.3 million, or twice as much, in January-April 1958. It is probable that the increase in the prices of rice and other necessities helped to force account holders in metropolitan areas to draw down their savings. In ordinary post offices, on the other hand, savings increased by Rp 20.8 million in January-April 1957, and by even more, Rp 23.3 million, in January-April 1958.

It is difficult to say when the dissaving of money, that now seems to prevail among city-dwellers, will spread to the country population. However, there are some signs that this already is beginning. In particular, despite one of the best rice crops in years, there is growing difficulty in obtaining delivery of rice for official distribution. Farmers probably already have begun to hoard crops instead of cash[1]. Similarly,

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1/ Even government agencies are now beginning to hoard commodities. The Industrial Service of one Province has decided to buy up stocks of galvanized iron and wire, using funds budgeted for an information program. The stocks will be sold later to smaller enterprises, which are experiencing serious difficulties as a result of the continuing rise in raw material prices.

Table 6

Net Postal Savings Deposits (+) or Withdrawals (-)
Through Ordinary Post Offices and City Savings Offices, 1957-1958

In Thousands of Rupiah

	Ordinary Post Offices	City Savings Offices						Total
		Bandung	Djakarta	Djogja-karta	Makassar	Medan	Sura-baya	
1957								
January	6,518	6	-326	-99	42	-248	-104	5,789
February	6,033	63	-325	-26	160	-68	-65	5,772
March	4,708	-2	-1,622	-222	-368	-385	-353	1,755
April	3,498	13	-1,863	-172	-304	-331	-304	537
May	8,088	20	-1,769	318	-67	-375	-336	5,879
June	6,588	11	-1,320	-107	5	54	-108	5,124
July	6,185	-84	-2,161	-315	563	-204	-558	3,425
August	8,883	-376	-1,647	-165	183	73	-414	6,536
September	8,977	-299	-1,516	-238	31	-4	-137	6,813
October	10,555	-432	-1,900	-121	406	215	220	8,944
November	11,359	-470	-1,507	-74	615	58	-322	9,660
December	7,156	-583	-2,987	-356	360	-270	-755	2,566
Total	88,548	-2,133	-18,943	-1,577	1,626	-1,485	-3,236	62,800
1958								
January	7,807	-579	-2,376	-86	298	-78	-103	4,882
February	5,863	-350	-2,192	31	-8	-461	-662	2,220
March	5,154	-815	-2,438	-353	-181	-446	-559	362
April	4,434	-685	-1,292	-57	-50	-74	-304	+1,971
Jan.-Apr. 1957	20,757	80	-4,136	-519	-470	-1,032	-826	+13,853
Jan.-Apr. 1958	23,258	-2,429	-8,299	-465	59	-1,059	-1,628	+9,436

Source: Bank Tabungan Pos, "Daftar Djumlah Penabungan Dan Pembajaran Kembali Dalam Bulan ... (month)", mimeographed statistical report for months January 1957 - April 1958, Djakarta, 1957 and 1958.

the Goodyear Tire Factory in Bogor (Djawa) no longer can obtain sufficient rubber from surrounding private growers, and must import supplies from its own plantations on Sumatera.

Apart from such indirect indications as those furnished by Postal Savings Bank records, it is impossible to show statistically the extent to which various groups are hoarding or dishoarding their cash. However, it is possible to show this for the country as a whole, by calculating the per capita money supply in terms of constant prices. According to such a calculation, Indonesia reached a definite and dangerous turning point around June 1957, when her "beginner's luck" ran out. Prices are now going up faster than the continuing increase in money supply. In other words, taken as a whole the public is losing confidence in the currency, and is spending off some of its "hoarded" paper money. Thus, serious inflation has begun in Indonesia.

To demonstrate this, we must first choose an appropriate price index. Indonesia has a number of price indices; some are shown in Table 7, with the single base year of 1952. (See also Appendix B, Table 1.) None is completely satisfactory as an indicator of the Indonesian currency's purchasing power. The weighted index of 19 foodstuffs in the Djakarta free market is often used for this purpose (it is shown as the "cost of living index" in the International Monetary Fund's "International Financial Statistics"). However, this index is heavily influenced by the price of rice, which fluctuates erratically in response to government import policies, transportation problems, and other specific developments. The price index for imported goods also has been influenced by government import policy, particularly by changes in quotas for textile imports2/. At the present time, however, it seems to be the best available indication of the general price level.

In Table 8, the price index for imported goods is used to indicate the effect of inflation on the public's willingness to hold purchasing power in the form of money. Some of the increase in money supply is related to the growth in population. To allow for this, the money supply (Column A of Table 2, Appendix B) is first divided by the estimated population (Column B)

1/ For example, from March to June of 1956 it dropped by 13%, in response to large imports of rice and flour. See H.O. Schmitt, "Monetary Policy in the Political Economy of Indonesia" (manuscript), University of California - University of Indonesia Economics Project, Djakarta, 1957.

2/ From September 1955 to July 1956 this index dropped by 16%, largely as a result of the liberalization of textile imports.

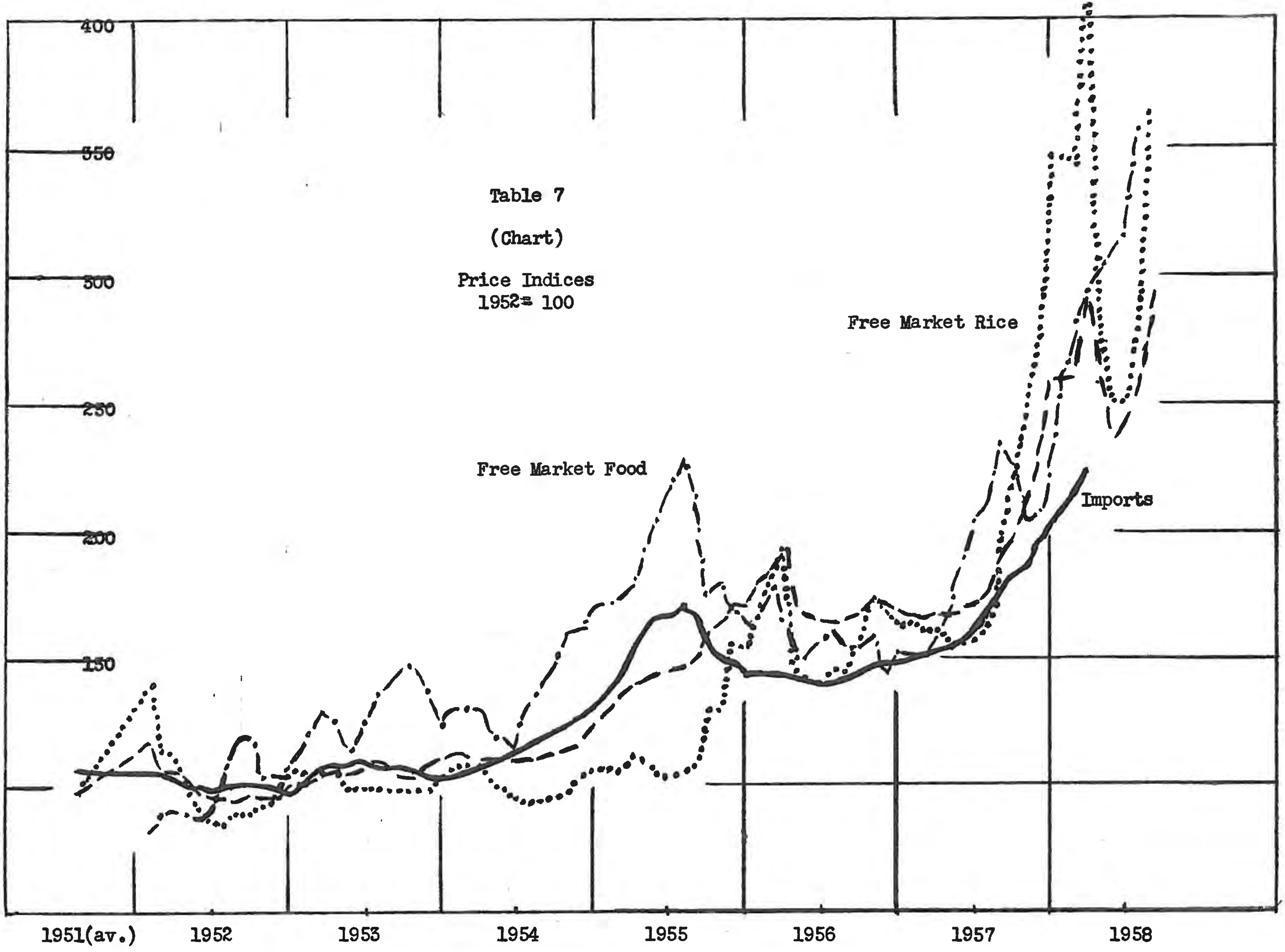

Table 7

(Chart)

Price Indices
1952= 100

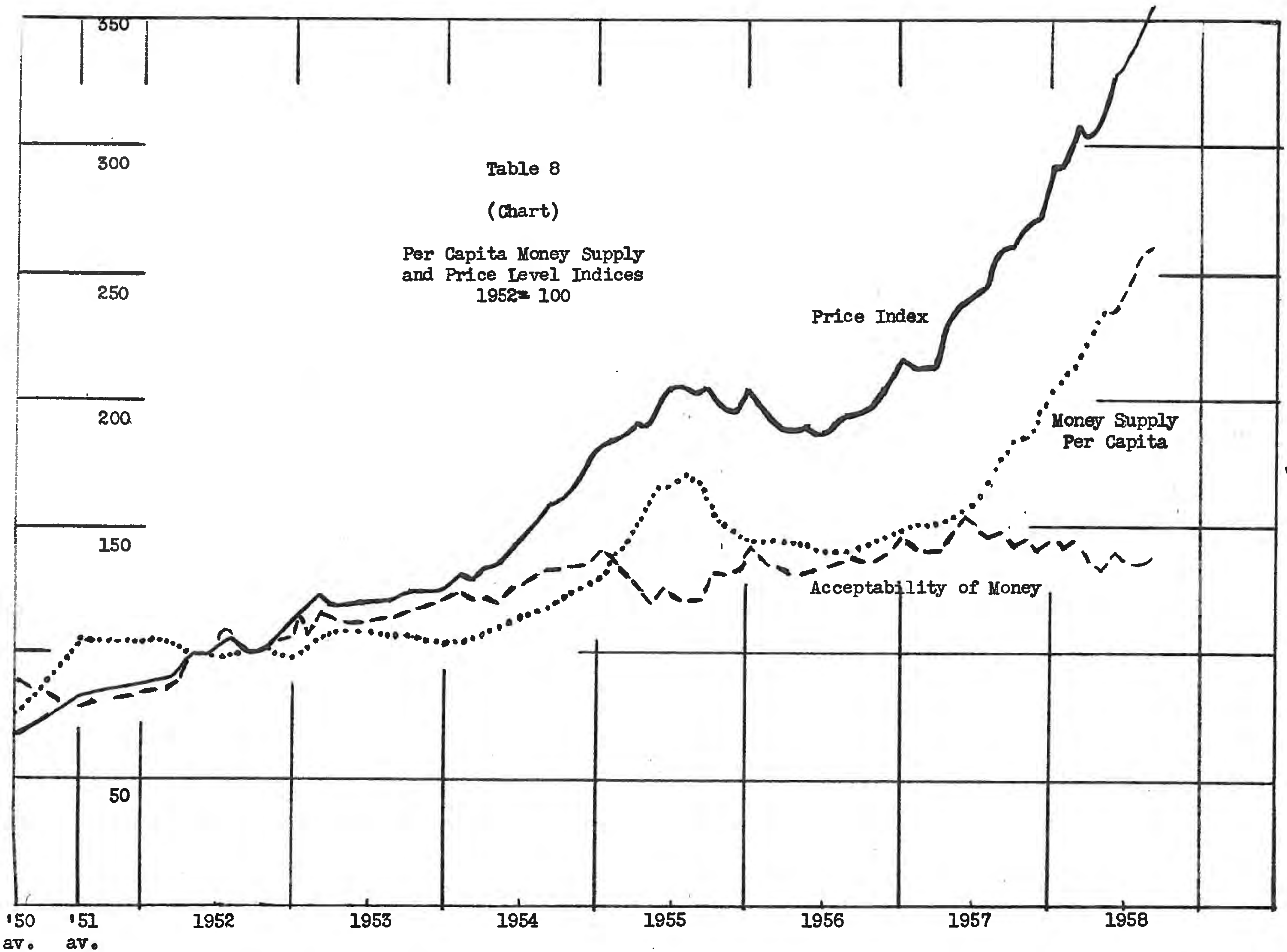
Table 8
(Chart)
Per Capita Money Supply
and Price Level Indices
1952= 100
Price Index
Money Supply
Per Capita
Acceptability of Money
350
300
250
200
150
50
'50
av.
'51
av.
1952
1953
1954
1955
1956
1957
1958

to show money supply per capita in Rupiah (Column C). The per capita money supply is shown as an index number, with the 1952 average as 100 (Column D). By August 1958 (latest date for which an estimate is feasible) money supply per capita had risen from around 75 Rupiah to roughly 347% of this amount, or to 259 Rupiah.

Some of the increase resulted in an increase in prices (Column E) while the remainder was absorbed by the Indonesian people without immediate inflationary consequences. The average amount of purchasing power held by the public in the form of money rose to 137% of its 1952 level (Column F). In other words, the average Indonesian now holds, more or less voluntarily, enough money to buy one-third more at present prices than he could buy with the money he held in 1952, at the prices of that year. Although the government tried to increase the money supply beyond this point, the average Indonesian refused to hold the additional amount. He used it to buy something, and thereby bid up the general price level.

During the period covered by this analysis, the willingness to hold money has changed significantly from time to time. From April 1952 to June 1955, money supply increased rather steadily, from 5.86 to 12.55 billion, or ~~to~~ 214%. However, there were no serious inflationary repercussions until some time in 1954. By the end of 1954, inflationary difficulties clearly had begun, and prices began to rise faster than money supply.

In 1955 the government adopted effective anti-inflationary policies (particularly steps to reduce the government deficit, and a requirement of advance deposits from importers. From June 1955 to June 1956 the money supply went down. Combined with liberalization of imports, this reduction in money supply quickly caused a fall in prices. Prices then remained stable until around the middle of 1957, even though a rapid increase in money supply began again around the middle of 1956. Since June 1957, however, the amount of real purchasing power in the hands of the average Indonesian has been doing down. While the nominal amount of money in circulation increased from 15.35 billion Rupiah in May 1957 to 22.70 in August 1958, or by 48%, the price index increased from 157 to 255, or by 62%. Per capita, allowing for an estimated 2.3% increase in the population, real purchasing power held in the form of money declined by 13%.

Apparently, Indonesia has now lost the confidence which was restored around June 1955, and is again in a period wherein inflation is self-defeating, as it was in early 1955. The more money the public is forced to accept, the more it spends, raising prices so that it keeps less purchasing power on hand. This, as the experience of other countries has shown, represents a danger point, the precursor of runaway inflation and the harbinger of serious political difficulties. From now on, inflation can be expected to get progressively worse, unless and until it is decisively halted.

Since the public as a whole is reducing its holdings of money (in real terms) the continuation of government-deficit financing can only be at the expense of some particular class or group of people. This group not only must bear the entire real cost of the government deficit, but also must give to the rest of the public, <u>in real goods</u>, the amount by which the public as a whole reduces its holdings of monetary purchasing power. Almost invariably, the group that bears the cost of inflation at this stage is the poorest, least well informed, and least solidly situated part of the community. The brunt of inflation now falls on those who are least able to pay the cost, who depend most on the daily purchase of rice, receive the lowest wages, have the smallest resources of real property. In the case of Indonesia this means the urban working class, and the salaried middle class (including civil servants).

Paradoxically, the government -- chief beneficiary of inflation so far -- is also beginning to be among the victims of the paper money flood. The government continues to squeeze some additional real goods out of the poorer Indonesians who bear the burden of continued inflation. At the same time, however, the government is losing some of its own resources, since inflation now erodes the value of its regular tax revenues. A vicious circle seems to be developing, as deficit financing reduces the government's real revenues, causes bigger deficits, and makes necessary more deficit financing.

As Table 9 shows, much of the increase in government expenditures so far has been illusory. Adjusted for price changes, net expenditures probably have not increased much in real terms from 1956 to 1957. They are about the same as -- or less than -- expenditures in the early years of the Republic, from 1951 to 1953. The government is spending more money, but primarily to pay higher prices rather than to acquire more goods and services.

Revenues have also increased, but have lagged even further than expenditures behind the rise in prices. The Indonesian Government's efforts to find more tax revenue have been by no means negligible in the past few years. Special taxes on imports and exports (T.P.I. and B.E.) shown under "sundries" have risen rapidly. Even though much of the tax structure rests on imports and exports, and the volume of foreign trade through legal channels has declined precipitously, revenues were higher in 1957 than in 1956 (see Table 9). Despite these commendable efforts, however, in real terms revenues have been falling off (that is, prices have been increasing faster than revenues). Even the very sharp increase in 1956, resulting from the introduction of the B.E. system, is beginning to lose its effectiveness. The total of indirect taxes and "sundries", Rp 12,701 million in 1957, is less than the 1956 equivalent in terms of 1957 prices (Rp 15,178 million) and also is less than the equivalent figure

Table 9

Government Revenues and Expenditures, 1951-1957
Actual Figures, and in Terms of 1957 Prices

In Millions of Rupiah

	1951	1952	1953	1954	1955	1956	1957
	A C T U A L	F I G U R E S					
Direct Taxes	1,571	1,823	2,027	2,439	3,131	3,115	4,368
Indirect Taxes	4,275	5,132	4,474	3,957	4,436	5,350	5,822
"Sundries"	4,326	2,436	3,001	2,010	2,642	6,792	6,879
Net Revenue of Government Enterprises	131	293	205	61	98	476	355
Net Revenues	10,303	9,684	9,707	8,467	10,307	15,733	17,424
Net Expenditures	9,108	13,192	11,947	12,069	12,397	17,273	22,724 1/
Net Deficit	+1,195	-3,508	-2,240	-3,602	-2,090	-1,540	-5,300 1/
Import Price Index 1957 = 100	43	41	50	61	80	80	100
	E Q U I V A L E N T	I N	1 9 5 7	P R I C E S			
Direct Taxes	3,653	4,446	4,054	3,998	3,914	3,894	4,368
Indirect Taxes	9,942	12,517	8,948	6,487	5,545	6,688	5,822
"Sundries"	10,060	5,941	6,002	3,295	3,302	8,490	6,879
Net Revenue of Gov't Enterprises	305	715	410	100	123	595	355
Net Revenues	23,960	23,620	19,414	13,880	12,884	19,666	17,424
Net Expenditures	21,181	32,176	23,894	19,785	15,496	21,591	22,724 1/
Net Deficit	+2,779	-8,556	-4,480	-5,905	-2,612	-1,925	-5,300 1/

Source: Bank Indonesia, Annual Reports

1/ Preliminary Estimate

for 1953 (Rp 14,953 million). Only in 1955, when a sudden rise in the price level drove down the real value of government revenues, were they smaller than in 1957.

To some extent this analysis exaggerates the effects of inflation on the real value of government expenditures. Much of the government's outgo is for things and services whose prices have not kept pace with the rise in the general price level. This is particularly the case for the salaries of government servants. In real terms, inflation has helped the government's budget by reducing the real incomes of civil servants, army officers, and others who receive fixed salaries from the treasury. This may have important social and political consequences in the future, and at present may be a cause of the spread of corruption and inefficiency that tend to increase the cost of government functions.

Thus, inflation has become a treadmill, on which the government must constantly run faster to stay in place. As it continues, there are three probable consequences for the industrial development of Indonesia:

1. The supply of voluntary savings, very small to start with, will probably get even smaller. More and more, available savings will be diverted away from normal financial channels (such as banks) which make them available for socially desirable uses. Therefore it will be less and less easy to find capital for industrial development.

2. The shortage of foreign exchange will probably become even more severe. There will be even more difficulty in ensuring a regular supply of raw materials and spare parts and new equipment for industry.

3. It will become more and more difficult to avoid corruption and other abuses in the government. Therefore it will be less possible to rely on government agencies to foster healthy economic development, whether in industry or in other fields.

Chapter 3

Indonesian Industry

The problems caused by inflation might not be very big if Indonesia's industry were strong. In fact, however, it is not. Industry is new and weak. Its most remarkable feature is the fact that so much has developed, despite very great difficulties. Except for a short period just before World War II, Dutch authorities did not encourage the development of industry in Indonesia, even by Dutch interests. For the most part, they looked on the Indonesian economy as a source of raw materials and as a market for European manufactured goods. Though some industries were started despite official discouragement, this was done mostly by foreign investors. Very few Indonesians were able to acquire the experience and capital needed to establish industrial undertakings1/.

After Indonesia gained her independence, industrialization had to start from scratch. Nevertheless, during less than a decade, Indonesians developed a surprising variety of enterprises, often out of literally nothing and with little or no outside help. Today Indonesians own and successfully operate manufacturing plants in such fields -- to name only some examples -- as food, cigarette, textile, clothing, printing, sawmill, furniture, rubber, soap, pharmaceutical, building material, foundry, shipyard, radio, electrical equipment, automobile body and assembly, plastic, houseware, and medical instrument. Even so, however, the total number of industrial workers in all establishments covered by financial statistics is a mere 461,174 or 5.4% of the total population.

Some idea of the variety and scope of industrialization can be obtained from Table 10, showing employment in a number of important industries in the years 1954-1956.

In general, employment is expanding in most branches of industry. The few exceptions are largely industries whose employment is being reduced by mechanization. Examples include the wood furniture industry (whose employment fell from 9,218 to 6,882 while output increased), lime kilns (with a drop in employment from 1,605 to 1,220), and the cigarette industry. In 1956

1/ During the late 1930's the increasingly difficult population problem forced a relaxation of Dutch opposition to industrialization. See: Dr. A.M. de Neuman, "Industrial Development in Indonesia," Djakarta, 1955, page 16.

Table 10

Employment in Some Important Industries1/, 1954-1956

End of:	1954	1955	1956
Food Processing			
Rice Milling	21,026	23,900	21,257
Tapioca Flour & "Sohun"	6,111	5,077	5,891
Confectioneries	4,646	4,658	4,814
Biscuit Baking	4,713	4,026	4,321
Ice Manufacture	3,705	3,968	3,870
Non-alcoholic Beverages	2,681	3,452	3,609
Tea Sorting & Packing	2,990	2,684	3,110
Bread & Cake Bakeries	3,397	2,387	2,875
Chinese Noodle ("mi" & "bihun")	1,725	1,454	1,581
Beer	1,339	1,470	1,499
Alcohol & Wine	1,338	1,493	1,472
Peanuts (salted & dried) and Melon Seeds	901	914	1,429
Meat, Vegetable & Fruit Preserving	936	1,027	1,086
"Krupuk" (Indonesian Shrimp-Cassava Chips)	1,492	1,007	1,077
Soy Sauce	694	810	1,065
Chocolate	883	778	844
Coffee Roasting & Grinding	594	514	844
Total	59,171	59,619	60,644
Tobacco			
"Kretek" (Indonesian) Cigarette	57,836	61,360	63,142
Tobacco Leaf Processing	4,294	3,927	12,400
Western Cigarette	10,254	9,908	9,993
Cigar	1,127	1,183	1,173
Total	73,511	76,378	86,708
Textile & Leather			
Weaving	49,032	52,221	52,303
Batik (Indonesian printing)	76,841	73,460	46,694
Shoe, Trunk & Other Leather Mfrs.	7,744	7,001	7,387
Spinning & Thread Winding (large scale)	4,742	6,168	6,586
Garment Knitting (large scale)	3,268	4,929	6,556
Ready-made Clothing	5,765	6,099	5,021
Leather Tanning	3,695	3,579	3,579
Hosiery Knitting	2,502	1,911	1,854
Gunny Bag	679	1,226	1,255
Total	154,268	156,594	131,235
Paper & Wood			
Printing	23,870	25,084	25,197
Sawmill	12,611	11,090	12,375
Wooden Furniture	9,218	7,733	6,982
Paper & Cardboard Products	1,743	2,072	1,869
Paper & Cardboard Mills	1,381	1,573	1,575
Wooden Box	835	778	1,014
Total	49,658	48,330	49,912

Table 10 (continued)

	End of: 1954	1955	1956
Rubber, etc.			
Rubber Remilling	7,914	9,769	10,193
Hard Rubber Mfrs.	8,004	8,110	7,646
Kapok Cleaning	4,132	4,800	6,299
Total	20,050	22,679	24,138
Fats & Oils			
Cocoanut & Vegetable Oil Mills	8,743	9,226	9,477
Chemical & Pharmaceutical			
Soap Factories	5,267	5,852	6,221
Medicine & Pharmaceutical	2,154	2,096	3,009
Matches	1,354	2,338	2,860
Cosmetics & Toothpaste	1,726	1,585	1,768
Total	10,501	11,871	13,858
Building Materials, etc.			
Tile & Concrete Products	4,576	4,652	4,890
Brick & Roofing Tile	5,889	5,504	4,738
Glassware (large scale)	3,970	3,654	3,718
Cement	1,448	1,443	1,452
Lime Kilns	1,605	1,446	1,220
Total	17,488	16,699	16,018
Metal Manufactures			
Machinery & Metal Products	10,022	10,172	10,933
Motor Vehicle Service Stations	6,739	6,264	7,921
Oriental Frying Pans	6,859	9,125	7,758
Iron Ship Dockyards	6,849	7,076	6,886
Electrical & Radio Equipment	1,496	2,310	2,572
Tinplate & Aluminum Ware	1,318	1,626	2,461
Enamelware	225	1,202	1,411
Motor Vehicle Assembly Plants		Confidential	
Motor Vehicle Body Works	891	929	1,064
Total	34,399	38,704	41,006
Miscellaneous			
Wooden Ship Dockyards	3,227	3,089	2,389
Plastic Ware & Toothbrush	431	601	1,163
Sporting Goods & Toy Mfr.	1,317	938	1,077
Total	4,975	4,628	4,629

Source: Biro Pusat Statistik, "Perusahaan-Perusahaan Industri 1956", Djakarta, 1957.

1/ Not a complete listing. Excludes smaller categories, all petroleum and mineral enterprises, and industries associated with plantations, such as sugar mills and tea factories.

Western-type cigarette factories employed 9,993 workers to process 19,234 metric tons of tobacco, or 1.9 tons per worker; in 1954, 10,254 workers processed 16,255 tons, or 1.6 tons per worker[1].

The most striking decline in employment is in the batik (hand-printed cloth) industry. The number of workers fell from 76,841 in 1954 to 46,694 in 1956. This seems to be due to a change in styles and standards of living rather than to the effects of mechanization. The trend away from hand-made batik to machine-printed cloth has been accelerated by the fall in real wages in the cities, and by the effect of the rising exchange rate on the cost of imported grey goods.

Similarly, the handloom industry has been seriously hurt by the effects of inflation on average living standards. In Denpasar, Bali, for example, 48 out of 50 handloom plants have been forced to close. Difficulties of the handloom industry also are attributed to the increasing cost of imported raw materials and to the shrinkage of real purchasing power of the public.

In this and in other ways, inflation has harmed rather than helped small manufacturing. Industry has turned out to be far less profitable than speculative trade, and much capital and talent has been diverted from the former to the latter. Smaller industries, with relatively high overhead, have been particularly tempted into speculation in raw material supplies and even into resale of equipment in order to profit by inflationary conditions.

Import restrictions, needed because of inflation's effects on the balance of payments, have both encouraged and discouraged industrial development. The cutting off of imports has encouraged -- and perhaps even forced -- some importers to go into productive industry. It has thus brought into industry some of the windfall profits accumulated since 1950 by importers who were able to obtain licenses from the government. The restriction of imports is also forcing some industries which started as assemblers of imported parts to manufacture a greater proportion of their product.

On the other hand, the uncertainty caused by import restrictions has made investment in industry extremely risky, and discourages almost all new investment at the present time. Difficulties have resulted not only from the recent cutting off

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1/ To meet this development, the Indonesian Government has prohibited the further mechanization of the "kretek" (Indonesian-type cigarette) factories.

of imports, but from sudden relaxation of barriers in the past. In 1955, for example, controls were suddenly liberalized in order to combat inflation. There was a very big increase in imports, particularly of textiles. Domestic prices dropped precipitously and the struggling young textile industry experienced very great difficulties. In 1956 new restrictions were put on to curtain the flood of imports, but in the meantime speculative stocks of finished goods had been built up in the country. Therefore, the most immediate effect of new import restrictions has been to reduce the access of local industry to raw materials and machinery that must be obtained abroad. Thus changes in import regulations have hurt local industry both coming and going.

Even in more or less "normal times," the delays and uncertainties caused by import controls are a heavy burden on new industries. A textile plant in Bali ordered power looms in 1954, paying for them in Rupiah at the time the order was placed. It financed this purchase by borrowing from Chinese merchants on the strength of its handloom business, at 2% interest per month. Changes in the government's import policies made it impossible to obtain delivery of the looms until 1957. By the time the new machinery went into operation the owners had paid out as interest more than its cost. (As a result, the enterprise is very short of working capital. An application for a loan from the appropriate government institution has been pending for over a year.)

In one form or another, the extra expense and difficulty caused by import restrictions is passed on to the Indonesian consumer. Some entrepreneurs have been clever enough to foresee difficulties, and to take them into account in their calculations. A toothbrush factory, for example, made sure that it had on hand a two-year supply of raw materials before beginning operations. The price of the toothbrush is set to return the entire cost of the plant within two years, so that the owners will not lose money even if they are unable to obtain any raw materials after the initial supply is used.

Since 1 June 1958, applications for imports of machinery or supplies for new enterprises have not been accepted at all1/.

Today many existing factories are running out of materials and spare parts. Some have cut back production by one-half or more. Others have closed down. Still others are cutting into normal working stocks, and will be forced to close before replacements can possibly arrive. As stocks have been reduced

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1/ Foreign Exchange Bureau Announcement to Banks B. No. 888, dated 1 June 1958.

below the levels that permit direct procurement from regular producers, it has become necessary to rely on intermediaries in Hong Kong or Singapore, who provide immediate delivery at a substantial increase in cost.

At current low levels of output very few factories are able to operate at a profit. Many are kept going only by drawing on the profits of associated trading enterprises. Chinese entrepreneurs, usually more closely associated with trade than their "asli" ("genuine") Indonesian counterparts, are better able to survive under such conditions, whether or not they are better managers of productive activity.

As a result of this kind of difficulty, banks and Indonesians with capital are very much afraid of lending or investing in industry.As a prominent stockbroker put it, "Indonesian industry depends on imported raw materials. Imports depend on the volume of exports through legal channels, and that is just too uncertain." Chinese investors also are worried by their difficulties with the military authorities, and by the growing xenophobia among the population, and are no longer anxious to invest in long-term industrial projects.

Indonesian industry faces a number of other difficulties, not dissimilar from those found in other underdeveloped countries. One is the prejudice of Indonesian consumers -- including Indonesian government agencies -- against the products of their own manufacturers. Indonesians are willing to pay a substantial premium for foreign products, because they do not trust local producers.

A sock-knitting factory was almost forced into bankruptcy (and did have to suspend payments on a loan from a government agency) when imports were liberalized. Although the quality of its product is not much different from that of imports, it can sell only at a substantially lower price. When imports came in freely the local product sold for Rp 60-80 per dozen, while imports brought Rp 150-180. With the restriction of imports, the price of the local product rose to Rp 150 per dozen, but imports continued to sell at a premium, for Rp 200-300 per dozen.

Most consumer goods are marketed under foreign-sounding names, and without any marks of their Indonesian origin. (Only one factory in the entire country goes out of its way to advertise that its products are "Made in Indonesia.") Government agencies have been "advised" to buy from local producers, but in many cases get around this advice by specifying types of merchandise that cannot be produced locally. The army, for example, demands sanforized uniform cloth, made with mercerized thread.

The main difficulties, however, are the shortage of capital for industrial development purposes, and the shortage of experienced management. The Indonesian government has tried to deal with these two problems by helping private enterprise to obtain capital and training, and by setting up government enterprises with government capital and government managers.

One of the important programs for the establishment of government-owned industries is the "Institute for Establishing Industrial Enterprises" (Lembaga Penjelenggaraan Perusahaan Perusahaan Industri) or LP3I. The original purpose of the program was to set up a number of new industrial centers (Induks) around which small handicraft industries would cluster. The "Induks" were supposed to act as "mother hens" for small industry, disseminating technical information and providing centralized services such as preparation of raw materials, finishing, and selling.

During the course of time, however, the function has been changed somewhat. At present there is little to distinguish the LP3I program from other programs for the establishment of government-owned industries. Indeed, "Induks" sometimes compete with the small handicraft industries they were supposed to assist, cutting prices by as much as 50% on similar products. In at least one case, the "Induk" is not a new factory, but is a privately owned plant that was purchased by the LP3I organization. This is the Sumber Mas metalworking plant in Malang. If there are any small-scale metalware producers in the neighborhood, they are not known to the management, and there is no intention to try to use the plant as a "mother hen." On the contrary, the main concern at present is to get orders in competition with private producers in the Surabaya area, so that the plant may quickly be put into operation. So far, the main orders have been obtained from the Gresik cement mill (for such metal products as grinding balls). These orders have been obtained without competitive bidding, "as one government plant doing a favor for another."

While the LP3I has done useful pioneering work in the past, the beginnings of a tendency to copy the successes of others may now be seen. For example, the LP3I now has a cement block plant under construction in the vicinity of Djakarta, and plans to set up other plants in other cities if this one succeeds. Cement block manufacture was introduced into Indonesia some time ago by a private entrepreneur in Bandung, who for some months has been shipping his product to the Djakarta market. It is therefore difficult to see the connection between the LP3I's interest in cement block manufacture and its educational function.

The change in emphasis may be due to the difficulty of combining the functions of education and industrial production. For example, the textile-dyeing-and-finishing "Induk" at Madjalaya was intended to demonstrate better techniques to the surrounding village dyeing and weaving industry. According to the manager of this Induk, "The village people are not willing to be educated." It might be more accurate to say that they cannot learn from the Induk as it is now built. The plant is so highly mechanized and represents such a heavy investment (its present value being perhaps $1 million) that it is completely foreign to the experience and potentialities of village industry.

The educational aspects of the LP3I program sometimes make it difficult to obtain a clear view of its status as an economic enterprise. Although the manager of the Madjalaya plant professed to know nothing about the financial status of the enterprise, and did not even know how much the plant had cost, he did admit that it loses money. This, he explained, was because "the purpose of the Induk is social rather than economic."

Difficulties and losses sometimes are blamed on marketing problems. The LP3I's textile dyeing and finishing plant at Madjalaya, for example, has not used its elaborate yarn-dyeing equipment for several years, and does not use its cloth-finishing installation continuously. Two explanations are given for the lack of sufficient orders to keep busy:

1. There is no longer a demand for dyed yarn, since sarongs woven with dyed threads in a plaid pattern are going out of style.

2. The small-scale weavers around Madjalaya, lacking capital, are forced to work with raw materials supplied by the Chinese merchants, who require the weavers to use the Chinese-owned dyeing and finishing plants in nearby Bandung.

However, a private textile mill owner in Madjalaya has a somewhat different explanation. He says that the LP3I does not seem to be able to obtain the proper chemicals to do good finishing and dyeing, possibly because of some lack of management skill. He is therefore installing his own finishing and dyeing plant (although he would have been glad to buy the facilities of the LP3I if they had been for sale).

So far the LP3I organization has spent around Rp 200-250 million. Approximately 70 projects have been started, but only a few are in operation. In some cases delays are attributed to the difficulty of importing raw materials and machinery. In addition, Induks are subject to the usual difficulties of government-sponsored industry, including excessive red tape and delays. One Induk, started some years ago, was officially opened at a ceremony attended by the responsible Minister in May 1957. However, installation of the machinery was not actually completed until a year later, and production for sale had not begun when the plant was visited in August 1958. Nevertheless a full working force was on hand, their salaries paid by the government.

The LP3I receives an annual directive from the Ministry of Industry, listing the projects to be started. For the current year, 15 factories are to be begun, mostly outside Djawa, including woodworking plants, sawmills, brick factories, and ceramics plants.

Each factory is supposed to become self-supporting after one year of operation, but in practice the LP3I makes up any deficit for an indefinite period of time.

New Induks charge all expenses to the LP3I, according to an annual budget, and deposit all revenues to a special account. This special account is supposed to provide working capital for the enterprise in the future. Charges for the use of invested capital do not begin unless and until the enterprise is transferred to local government or other ownership. Then the cost is supposed to be paid back over 20 years. However, the manager of one Induk believed that it would be unrealistic to expect repayment of the heavy capital investment in less than 40 years. One Induk, whose management seems to be above average, writes off machinery over 10 years and buildings over 20 years, and allows for interest of 5% per annum on its capital. Even when such an allowance is made, however, Induks have a great advantage over private competitors (whether small-scale or large-scale), which at best must pay at least 10% per annum, and in many cases must pay 30% or more, for borrowed money. Private industry expects to write off machinery in three to five years under the conditions that prevail in Indonesia.

The LP3I is supposed to sell its factories after they become established. Some five projects have been turned over to cooperatives or local government authorities. In theory, enterprises could be sold to private enterprises, but this is not encouraged, although Indonesian private buyers are available. Terms of sale are fairly generous. In general, LP3I only requires 20% cash payment, and the remainder may be paid over 5-10 years without interest. Most of the projects are several years old, and are on the government's books at much lower Rupiah prices than would now have to be paid to duplicate them.

Other government industrial programs sometimes have similar problems. These may be illustrated by the case of the Perbedija Metal Works in Djogjakarta, which is owned by the Government's Bank Industri Negara. Perbedija is a heavy machinery factory that was built under the Dutch to make equipment for sugar mills. During World War II the Japanese used it to mass-produce lathes, boring machines, and 115 horsepower diesel engines. The plant's heavy machinery now is operated with great inefficiency to turn out consumer goods and hand tools (such as mattocks, gas hotplates, and clothes irons). Twenty-foot lathes produce parts that are less than one foot long. Grinding wheels three feet in diameter sharpen the edges of mattocks. Orders come from the sales subsidiary of the Bank (USINDO) and the factory manager has nothing to do with the marketing of his production.

The number of workers admittedly is far in excess of requirements, but the management is not allowed to dismiss any for fear of unfavorable political consequences. Lacking markets suited to its machinery and unable to enforce labor discipline, the factory has operated at a loss for many years. This is covered by periodic additional "working capital loans" from the Bank Industri Negara. The present manager cannot think of any profitable use for his factory's existing equipment. He would like to scrap most of it, and obtain at least Rp 20 million of new machinery to produce small Diesel engines for motorized pedicabs (betjaks). The Bank Industri Negara seems to hope to solve its problem by selling the plant as soon as possible to the local government of Djogjakarta.

Not far from "Perbedija" is the privately owned "Gamstow" metalworking plant. The latter does not seem to have difficulty in finding a market for its products. "Gamstow" started in 1950, with literally nothing. The first order, obtained from a friendly employee of the local electric power company, was for cast metal cable clamps. The castings were made in sand in the back yard of the President of the Company. The profit made on this order was the initial capital of the company.

Profits on subsequent business were plowed back into expansion, and today the company has 140 workers and a net worth of over 3.5 million Rupiah. Although the firm has borrowed moderate amounts at times, from Bank Negara Indonesia and other sources, it is now completely out of debt. Products include cast-iron frying pans, water-closet tanks, parts for platform scales, and electric-wiring boxes. Machinery is now being installed to mass-produce water pumps, and plans for the future include the manufacture of Diesel engines for pumping.

Although there is no lack of business for the factory, the company continues to look for more through newspaper advertisements, correspondence, and personal salesmanship. Costs and prices of this company are the lowest in Indonesia in its field. In recent bidding on a government requirement for castings the "Gamstow" firm quoted a price of 7 Rupiah per kilogram, while the nearest competitor asked for 20 Rupiah per kilogram for the same work. Reasons for this difference include the relatively low cost of labor in the Djogjakarta area (outside the Perbedija plant), the location in a rural area, and high labor morale. The factory's owners all work alongside the ordinary laborers whenever necessary, and there are no foremen. Other reasons for the low cost of production are the use of more modern techniques (such as wet casting) and very low overhead. Office facilities are extremely modest. All office work is done by three people, who only work in the office part-time.

Much of the impressive enterprise is equipped indigenously with locally available resources. Scrap-melting furnaces have been made from parts of a wrecked sugar refinery. Electric power is produced by a second-hand diesel engine. Factory buildings are low-cost. The tile roof is held up by bamboo rafters (an almost infallible sign of a well-run plant in Indonesia).

The President of the Company, a young Indonesian, is a graduate of the Djogjakarta technical high school. During the war he worked as a machinist for the Perbedija metalworking factory. Much of his technical knowledge comes from omnivorous reading of foreign engineering books. He and the other owners have trained their foundry workers themselves, and are now giving some of them training as machinists in preparation for the production of pumps. They also plan to hire graduates of the Technical High School. Asked if he would hire people from the government's Perbedija factory, the President replied, "No, they're too spoiled."

There are many examples of private and cooperative industrial development similar to the "Gamstow" company. These show what Indonesian private entrepreneurs can do with little or no help. They suggest that it might be possible to achieve much more, if adequate and appropriate help can be given to small and medium private industry. However, it must be admitted that efforts to encourage private enterprise in the past have not all been successful. This is particularly true of efforts to supply capital to trading enterprises without adequate consideration of the need to ensure availability of necessary skills. The results have been disappointing to many of Indonesia's leaders, and have raised doubts among them on the advisability of providing any more encouragement for private enterprise.

Dr. Loekman Hakim, Governor of Bank Indonesia, expresses such doubts in the latest annual report of the Bank:

> ". . . The fact has been overlooked that the Indonesian people are poor and lack experience. In fact, it is doubtful whether national development can cope with a great many obstacles if it is entrusted to individual enterprise which lacks capital and skill. . .Supplying capital to individual entrepreneurs implies that any loss will come to the charge of the public as a whole, while any profit will be to the advantage of the entrepreneur concerned. . .Such a policy. . .actually

leads to the growth of a national capitalist group, which does not come into being through its own efforts and through carrying its own risks, but thanks to Government aid.

"I doubt whether our revolution had as an object the creation of a group of individual entrepreneurs living on the money of the people -- the creation of a small, though national, group growing prosperous by the sweat of the people. I also doubt whether the system of bringing our country to development through individual energy and effort is in keeping with our condition."1/

Whether or not such words sound pleasant to American ears, they do represent a serious and important opinion, for which there is much justification in the history of programs to help private Indonesian enterprise. This will become apparent in our discussion of government long-term lending agencies, in Chapter 5 below.

One of the most important reasons for these difficulties has been the failure to provide a well-rounded program of help. An article in Indonesia's leading economic journal, discussing the government's "Mechanization Credit Program," states:

". . .the process of adaptation on the part of the workers who have to face the conditions of machine production clearly does not take much time and special difficulties do not arise. The basic difficulties are those which confront the entrepreneur, because of lack of skill in managing mechanized firms and because of the shortage of technical skill in running machines. . .it is evident that the efforts to mechanize small-scale industry will not bring about the expected results if they are pressed forwards independent of other activities also directed towards assisting developments in the field of small industry. . . which should cover aspects of finance (fixed and working capital), of marketing technique, the connection between small and large-scale industry, and so on."2/

The government has tried to meet the problem of shortage of technicians through scholarship programs and special courses.

1/ A more complete extract of Dr. Hakim's important statement is given in Appendix C.

2/ Ekonomi dan Keuangan Indonesia, February 1957, page 129.

Unfortunately but understandably, there has been a tendency to use all available resources to meet the government's own very pressing needs, leaving little or nothing for private industry. This is perhaps most marked in the very popular programs for study abroad; virtually all available places are absorbed by employees of government agencies. This also happens in some programs for study within the country. For example, the Institute of Industrial Technology, with help from a foreign aid program, recently began to offer a much-needed management training course. In order to obtain government support, the Institute had to agree to fill the first course with government employees.

Chapter 4

Banks and Savings Institutions

In advanced countries, the well-rounded assistance that new industry needs is provided to a large extent by the banking system. Banks not only provide money, but also advice, information, and business connections. Unfortunately, in Indonesia banks are not yet able to fill these functions for industry.

Indonesia's banking system today is comparatively weak, and has relatively little influence on the country's economic development. During the period of Dutch rule, a few foreign-run banks had an important role in the development of large enterprises (notably the large plantations, trading companies, and a few important manufacturing plants). Little effort was made to provide banking facilities for the Indonesian population. The vast majority of the population remained outside the orbit of the banking system (and, indeed, to a large extent lived in a barter economy without using money of any kind).

Since independence the Indonesian Government has sought to foster the development of new banks under Indonesian control. A number of government-owned institutions have been created or expanded, and many privately owned banks have been encouraged to open, in many cases with heavy financial support from the government.

Nevertheless, Indonesia still does not have an effective banking system. For lack of banking facilities, Indonesia continues to rely almost entirely on paper currency for her money supply, and only a small part of her demand for means of payment is satisfied by bank deposits. Table 11 shows how money supply is divided between cash and bank deposits in 62 countries. Indonesia stands almost at the top of the list of countries that rely heavily on cash, and accordingly may be said to have one of the least-well-developed banking systems in the world.

As Table 12 shows, the share of currency in total money supply has been increasing in Indonesia, and the share of bank deposits has been decreasing. In part this may be due to a tendency towards accumulation of money in rural areas, where banks are largely lacking. However, whatever the explanation these facts show that banks have not improved their standing as a part of the monetary system. Indonesia has not yet begun to benefit from the expansion in the use of money which goes along with a well-developed banking system.

Table 11

Cash as Percent of Money Supply in 62 Countries
Latest Available Data

No.	Country	Currency and Unit, Billion (B) or Million (M)	Date	Cash	Total Money Supply	Cash as % of Total
1.	Bolivia	Boliviano (B)	Apr.'58	188.9	239.7	79.2
2.	Ethiopia	Dollar (M)	Sep. "	139.9	188.5	74.2
3.	Malaya	Dollar (M)	" "	862	1,191	72.4
4.	Indonesia	Rupiah (B)	May "	15.0	21.2	70.6
5.	Thailand	Baht (M)	Apr. "	5,611	8,332	67.4
6.	Viet-Nam	Piastre (B)	Dec.'57	8.1	12.1	66.6
7.	Pakistan	Rupee (M)	Oct.'58	3,566	5,389	66.1
8.	India	Rupee (B)	Sep. "	15.3	23.2	65.9
9.	Greece	Drachma (B)	Dec.'57	7.1	11.0	64.6
10.	Iraq	Dinar (M)	Sep. "	49.0	76.3	64.2
11.	Jordan	Dinar (M)	June'58	15.7	24.9	63.0
12.	Haiti	Gourde (M)	Aug. "	67.5	107.5	62.8
13.	Sweden	Krona (B)	Sep. "	5.5	9.2	59.8
14.	Honduras	Lempira (M)	" "	37.3	62.6	59.6
15.	Argentina	Peso (B)	Aug. "	44.7	75.4	59.2
16.	Colombia	Peso (M)	Sep. "	3,086	5,269	58.5
17.	Belgium-Lux.	Franc (B)	Aug. "	119.3	205.5	58.0
18.	Guatemala	Quetzal (M)	" "	60.4	106.7	56.6
19.	Syria (UAR)	Pound (M)	June "	581	1,046	55.5
20.	Uruguay	Peso (M)	July "	564	1,036	54.4
21.	Iran	Rial (B)	Mar. "	31.2	59.1	52.8
22.	Ecuador	Sucre (M)	Sep. "	719	1,426	50.4
23.	Peru	Sole (M)	June "	2,289	4,542	50.3
24.	Egypt (UAR)	Pound (M)	Sep. "	193.2	386.4	50.0
25.	Domin. Republic	Peso (M)	Aug. "	47.6	96.3	49.4
26.	Korea	Hwan (B)	Sep. "	88.4	182.4	48.5
27.	Netherlands	Guilder (M)	Dec.'57	4,349	9,026	48.2
28.	Nicaragua	Cordoba (M)	Sep.'58	120.5	257.6	46.8
29.	Portugal	Escudo (B)	July "	11.7	24.9	47.0
30.	Austria	Schilling (B)	Sep. "	16.0	34.5	46.4
31.	Philippines	Peso (M)	Aug. "	764	1,646	46.4
32.	Ceylon	Rupee (M)	Oct. "	506	1,090	46.4
33.	Germany	Deutsche Mark (B)	Sep. "	17.6	38.0	46.3
34.	France	Franc (B)	" "	3,507	7,639	45.9
35.	China (Taiwan)	N.T. Dollar (M)	Aug. "	1,990	4,363	45.6
36.	Finland	Markka (B)	Sep. "	52.1	114.9	45.4
37.	El Salvador	Colon (M)	" "	88.7	196.6	45.1
38.	Norway	Krone (M)	" "	3,160	7,009	45.1
39.	Mexico	Peso (M)	July "	5,610	12,515	44.8
40.	Costa Rica	Colon (M)	Aug. "	154.5	361.2	42.7
41.	Paraguay	Guarani (M)	" "	921*	2,193*	42.0*
42.	Lebanon	Pound (M)	May "	384*	922*	41.7*
43.	Cuba	Peso (M)	June "	449	1,087	41.3
44.	Switzerland	Franc (B)	Aug. "	6.0	15.4	39.0
45.	Venezuela	Bolivar (M)	July "	1,136	3,600	37.8

Table 11 (continued)

No.	Country	Currency and Unit, Billion (B) or Million (M)	Date	Cash	Total Money Supply	Cash as % of Total
46.	Yugoslavia	Dinar (B)	Sep.'58	126	340	37.1
47.	Israel	Pound (M)	July "	254.4	659.0	36.9
48.	Spain	Peseta (B)	Aug. "	63.5	173.1	36.7
49.	Iceland	Krona (M)	Oct. "	402	1,112	36.2
50.	Chile	Peso (B)	Sep. "	80.5	224.6	35.8
51.	Ireland	Pound (M)	Oct. "	58.6	167.7	35.0
52.	United Kingdom	Pound Sterling(B)	Sep. "	1.9	5.5	34.7
53.	Italy	Lira (B)	June "	1,743	5,157	33.8
54.	Canada	Dollar (M)	Sep. "	1,731	6,021	28.7
55.	Japan	Yen (B)	June "	732*	2,555*	28.6*
56.	Union of South Africa	Pound (M)	Aug. "	114.2	407.5	28.0
57.	Brazil	Cruzeiro (B)	Sep. "	92.9	343.7	27.1
58.	Turkey	Lira (M)	Dec.'57	2,921	7,730	26.5
59.	Australia	Pound (M)	Sep.'58	380	1,554	24.5
60.	Denmark	Krone (M)	Sep. "	1,995	8,378	23.8
61.	New Zealand	Pound (M)	Aug. "	66.2	298.0	22.2
62.	United States	Dollar (B)	Sep. "	28.0	136.1	20.6

* Not strictly comparable with other data.

Source: International Monetary Fund, "International Financial Statistics", Washington, D.C., December 1958.

Table 12

Composition and Increase of
Indonesia's Money Supply, 1938-1958

In Millions of Rupiah

	Currency	Deposits	Total	% Currency
March 1938 (Est.)	240	180	420	57.1
December 1950	2,582	1,726	4,308	59.9
1951	3,328	1,706	5,034	66.1
1952	4,349	2,255	6,604	65.9
1953	5,218	2,269	7,486	69.7
1954	7,474	3,643	11,117	67.2
1955	8,647	3,587	12,234	70.7
1956	9,372	4,021	13,393	70.0
1957	14,091	4,822	18,913	74.5
March 1956	7,666	3,444	11,100	69.0
June	7,881	3,136	11,017	71.5
September	8,176	3,476	11,652	70.2
December	9,372	4,021	13,393	70.0
January 1957	9,261	3,967	13,229	70.0
February	9,160	4,018	13,179	69.5
March	9,333	4,028	13,361	70.0
April	10,195	4,222	14,417	70.7
May	10,391	4,604	14,996	69.2
June	10,852	4,280	15,131	71.7
July	11,635	4,672	16,307	71.4
August	12,200	4,513	16,713	73.0
September	12,545	4,336	16,880	74.3
October	12,684	4,644	17,318	73.2
November	13,100	4,526	17,626	74.3
December	14,091	4,822	18,913	74.5
January 1958	13,775	5,235	19,010	72.5
February	13,920	6,084	20,004	69.6
March	13,969	5,649	19,618	71.2
April	14,531	5,754	20,285	71.6
May	15,030	6,191	21,221	70.8
June	15,417	6,230	21,646	71.2
July	15,690	6,790	22,480	69.8
August	16,050	7,280	23,330	68.8

Source: Bank Indonesia: "Bulletin No. 14, Fourth Quarter 1957", Djakarta, February 1958, p. 9; "Report for the Year 1957-1958", Djakarta 1958, p. 76; "Berita No. 15, Triwulan Kesatu Dan Kedua 1958", Djakarta August 1958, p. 11. International Monetary Fund, "International Financial Statistics", Washington, D.C., January 1958.

As Chapter 2 explained, the total amount of money is quite low to start with. The lack of adequate banking facilities helps to cause this, and also results in much of the available money supply going to the government rather than to private borrowers. For institutional reasons, cash usually is put into circulation to meet government demands for credit, while the needs of private borrowers are largely met by the expansion of the part of the money supply which consists of bank deposits. The low share of the banks in Indonesia's money supply results in relatively little availability of credit to finance industry and trade. Recent efforts to control inflation, although weak, have intensified the shortage of credit. The central bank has not been allowed to curb the government's demand for money to cover deficits. On the other hand, from time to time the banks have been required to restrict credit for private business, in order to offset the government's continuing deficit financing.

Credit control policies have followed somewhat contradictory paths. In at least one instance, the efforts of the banking system to restrict credit for private business were negated by a wave of government lending--out of deficit financing--to private importers. From April 1953 to October 1955 foreign exchange banks had to limit credit to importers to the amount outstanding on 31 March 1953. In September 1955 credit conditions were made even tighter by a requirement that importers deposit the Rupiah cost of goods in advance when applying for import licenses. However, in order to ensure a continued flow of imports, the limit on bank lending to importers was removed. In addition, Bank Indonesia undertook to rediscount import credits to enterprises that earned or saved foreign exchange. Furthermore, foreign banks were permitted to borrow from Bank Indonesia up to 40% of the amount of advance deposits made on behalf of customers. (National banks were allowed to rediscount 75% of the value of imports financed for Indonesian importers.)

The resulting expansion of credit during 1956 helped to cause a renewal of inflationary pressure (see Table 13), and an effort was made to restrict credit again in July 1956. At this point the government stepped in to counteract the restriction. According to Bank Indonesia's annual report for 1956-1957

> "Credit granted by banks. . .showed a continuous fast rise during 1956 with the sole exception of end-September, notwithstanding the fact that Bank Indonesia as from July 1st, 1956 had endeavored directly as well as indirectly to reduce bank credits, in the first place credits to the import sector. Said efforts of Bank Indonesia were hampered, however, by the granting of credit facilities by the Ministry of Finance to private enterprises (including national private banks), either direct or via the intermediary of other banks. These credits totaled about Rp 540 million in the year under review." 1/

1/ Bank Indonesia, "Report for the Year 1956-1957", Djakarta 1957, page 87.

Table 13

Importers' Prepayments and Credits,
Bank Indonesia and Other Foreign Exchange Banks, 1954-1957

In Millions of Rupiah

December	Amount: Prepayments from Importers 1/	Amount: Credits Granted to Importers 2/	Annual Change: Prepayments from Importers 1/	Annual Change: Credits Granted to Importers 2/	Annual Change: Net Deflationary Change (Prepayments Minus Credits)
1954	1,216	482	-	-	-
1955	3,326	867	+2,110	+385	+1,725
1956	3,343	1,367	+ 17	+500	-483
1957	681	996	-2,662	-371	-2,291

1/ Includes Bank Rakjat Indonesia
2/ Excludes Bank Rakjat Indonesia

Source: Biro Pusat Statistik, "Statistical Pocketbook of Indonesia 1957", Djakarta 1958, p. 182-183, and Bank Indonesia, "Report for the Year 1957-1958", Djakarta 1958, p. 96-97.

Some further restrictive measures were taken in June, 1957. All banks with deposits of over Rp 75 million (that is, the foreign-owned banks) were required to keep minimum reserves of 30% of demand and time deposits. In addition, certain reserves must be invested in government treasury bills. In December 1957, when the West Irian crisis caused runs on the Dutch-owned banks, a ceiling was placed on total lending of private foreign exchange banks with over Rp 75 million of deposits. The purpose was to prevent the British-owned Chartered Bank, to which large sums had been transferred, from expanding its loans.

During 1957 current account credits of banks authorized to handle foreign exchange -- around three-quarters of all current account credits -- fell from 3.9 billion to 3.5 billion Rupiah, or by over 10%. Most of the decline resulted from a fall in credit to importers, due more to the severe restriction of imports than to the credit control measures. There was also some reduction of credit to agricultural estates, presumably connected with the departure of Dutch managers. (See Table 14.)

Credit to trading firms (mostly importers) accounts for almost half the total. Fluctuations in credit to importers are the main variable in total credit. This is shown by the rise in 1955 and 1956 as well as the drop in 1957. Credit to industry, increasing slowly, amounts to about 11% of the total.

Although the banking system is weak, there is a very large number of banks. Too many, however, are small, inexperienced and undercapitalized institutions, concentrated in the capital city of Djakarta. According to official statistics, at the end of 1957 there were no less than 108 commercial banks (with a total of 436 main and branch offices) and 18 savings banks. (See Table 15.) Of the 108 commercial banks, four are owned by the government (Bank Indonesia, Bank Negara Indonesia, Bank Rakjat, and Bank Industri Negara; this last is not a commercial bank in the ordinary sense of the term).

Of the 104 private institutions, 60 have complied with government requirements, and have received permanent licenses. Temporary licenses have been granted to 36 (usually unable to qualify for permanent licenses because they do not have a minimum capital of 2.5 million Rupiah, plus 0.5 million Rupiah for each branch). Eight are known to be operating without any license, and it is possible that there are other banks in existence without the formal knowledge of the government. The latest estimate of the number of savings banks is 24, of which only six are large enough and sufficiently well organized to make regular reports to Bank Indonesia.

Table 1[illegible]

Credits Granted by Bank Indonesia, Bank Negara Indonesia, and 11 Foreign Exchange Banks[1], 1952-1957

End of year, in Millions of Rupiah

	Amount						Percent					
	1952[2]	1953[2]	1954[2]	1955	1956	1957	1952[2]	1953[2]	1954[2]	1955	1956	1957
A. Government enterprises and foundations	435	161	378	581	407	426	23	6	16	17	10	12
B. Enterprises predominantly financed by Government	-	-	10	32	48	100	-	-	-	1	1	3
Subtotal	435	161	388	613	455	526	23	6	17	18	12	15
C. Private businesses and individuals	1,557	2,096	1,945	2,789	3,470	3,007	78	82	83	82	88	85
Total	1,992	2,557	2,333	3,402	3,925	3,533	100	100	100	100	100	100
Of C. Private business and individuals:												
Banks (excl. foreign exchange banks)	65	50	21	41	55	70	3	2	1	1	1	2
Insurance cos., savings institutions and pension funds	1	7	4	16	16	19	-	-	-	-	-	1
Subtotal, finance	66	57	25	57	71	89	3	2	1	2	2	3
Domestic produce trade	25	55	97	83	83	105	1	2	4	2	2	3
Exporters	161	257	373	390	375	434	8	10	16	11	10	12
Importers	392	517	482	867	1,367	996	20	20	21	25	35	28
Storage and transport companies	22	111	89	44	69	45	1	4	4	1	2	1
Subtotal, trade	600	1,040	1,041	1,384	1,894	1,580	30	41	45	41	48	45
Rice Mills	5	7	6	4	4	10	-	-	-	-	-	-
Sugar estates	487	490	279	364	318	218	24	19	12	11	8	6
Other agricultural estates	183	219	107	187	241	130	9	8	5	5	6	4
Subtotal, agriculture	675	716	392	555	563	348	7	9	8	9	9	11
Miscellaneous enterprises	60	130	265	419	460	472	3	5	11	12	12	13
Individuals	10	15	39	67	125	118	1	1	2	2	3	3
Subtotal	70	145	304	486	585	590	4	6	13	14	15	17

1. Excluding Bank Rakjat
2. Bank Indonesia, Bank Negara Indonesia, Bank Industri Negara and 7 other foreign exchange banks.

Sources: Biro Pusat Statistik, "Statistical Pocketbook of Indonesia 1957", Djakarta, 1957, page 16
Bank Indonesia, "Report for the Year 1957-1958," Djakarta, 1958, page 78

Table 15

Number of Banks and Bank Branches, By Area
End of 1956 and 1957

Region	Head Offices of Commercial Banks				Agencies & Sub-agencies of Commercial Banks				Total Commercial Banks	
	Private		State		Private		State		Private & State	
	1956	1957	1956	1957	1956	1957	1956	1957	1956	1957
Djakarta Raya	39	52	4	4	15	19	2	2	60	77
West Djawa	9	9	-	-	11	12	18	18	38	39
Central Djawa	17	15	-	-	35	38	31	32	83	85
East Djawa	7	8	-	-	41	43	33	33	81	84
Sumatera	10	10	-	-	34	40	32	31	76	81
Kalimantan	2	2	-	-	10	11	8	8	20	21
Sulawesi	5	7	-	-	9	9	12	13	26	29
Nusa Tenggara	2	1	-	-	8	7	6	9	16	17
Maluku + West Irian	-	-	-	-	-	-	4	3	4	3
	91	104	4	4	163	179	146	149	404	436
Private Savings Banks	17	18								

Source: Bank Indonesia, "Report for the Year 1957-1958", Djakarta, 1958, pages 92 and 94.

Indonesian banks may be divided into four categories: government banks, foreign commercial banks, private commercial banks, and savings banks. Table 16 compares certain asset and liability figures for various types of banks. It shows clearly that the bulk of the commercial banking business is conducted by Bank Indonesia and the 13 commercial banks which are authorized to handle foreign exchange transactions. These include the former Dutch banks, several English and Chinese banks, three of the government banks, and some Indonesian private banks. Most of the remaining commercial business is handled by 20 of the larger national private banks.

Rates of interest vary considerably. The commercial department of Bank Indonesia charges around 6½% per annum; rates charged by the foreign-owned exchange banks are somewhat higher. National private banks claim to charge 12% a year, but in fact -- by adding various commissions and fees -- charge around 18-24% or more. Although there is a law against usury, it is generally disregarded. No action can be taken until a borrower complains, and no borrower can afford to complain if he ever wants to borrow again.

a. Indonesian Government Banks

Bank Indonesia is the country's central bank, and also conducts an important commercial banking business, through numerous branches. Bank Indonesia is the successor to the Jav'sche Bank, established as a note-issue and commercial bank under the Dutch. Dutch employees have been eliminated, and the Bank suffers an acute shortage of trained personnel. Though free of day-to-day government intervention, the Bank is almost completely subservient to the government in its over-all monetary policies. Bank Indonesia is supposed to avoid active competition with other institutions for commercial business, by refusing to accept new accounts, and by opening new branches only where existing commercial banks close down.

Bank Negara Indonesia (Indonesian State Bank) is a commercial bank, originally established in 1946 as the central bank of the Republic of Indonesia, and relegated to a secondary role after the Jav'sche Bank was taken over from the Dutch. Bank Negara then was given the task of financing Indonesian newcomers to business, and particularly to import trade. Since its main lending is to finance imports, it has been unable to find uses for all its available funds after severe restrictions were placed on import trade. It has been trying to lend out a substantial proportion through the smaller private national banks. The personnel of Bank Negara is largely inexperienced. According to some observers, the bank suffers frequently from attempts to exercise political pressure on behalf of would-be borrowers. The bank now has over 60 branches.

Table 16

Selected Assets and Liabilities of Banks, December 1957

In Millions of Rupiah

	Total	Bank Indonesia and 13 Other Foreign Exchange Banks1/	Other Banks	
			20 Largest2/	Remaining 292/
ASSETS				
Cash on Hand	608	530	68	10
Interbank Deposits	2,174	1,9713/	177	26
Treasury Notes & Bills	673	669	4	-
Securities	137	131	5	1
Participations	35	32	1	1
Advances & Domestic Bills Discounted	5,277	4,443	683	151
Foreign Bills & Balances	1,114	1,114	-	-
Real Estate & Inventory	490	451	26	13
Sundry	170	-	146	24
Total Assets	10,678	9,341	1,111	226
LIABILITIES				
Capital, Reserves, Etc.	2,056	1,931	60	65
Loan Capital	51	-	17	34
Interbank Balances	n.a.	1,9713/	65	18
Demand Deposits and	(7,115	4,822	(434	(60
Government Accounts	(	1,799	(	(
Blocked (Rurni) Accounts	122	122	-	-
Time Deposits	380	170	182	28
Sundry	1,646	1,272	353	21

Source: Bank Indonesia, "Report for the Year 1957-1958", Djakarta, 1958, pages 96-97, 104.

1/ Including Bank Negara Indonesia and Bank Rakjat.
2/ Out of 49 reporting.
3/ Only with other foreign exchange banks.

Bank Rakjat (People's Bank) was established in 1934 as a rural credit agency, to centralize credit for village financial institutions (so-called "desa" banks). Since 1951, Bank Rakjat has expanded into the commercial banking field, particularly to provide credit to civil servants, other members of the middle class, and small commerce and industry in outlying areas not served by large commercial banks. The original function of providing rural village credit is supposed eventually to be shifted to the government's cooperative service (Djawatan Kooperasi). Table 17 shows how the share of agricultural credit has gone down, until it now amounts to a bare 9% of the bank's total lending. Recently the Bank was authorized to conduct foreign exchange transactions. Bank Rakjat has a number of experienced employees on its staff, and is able to maintain a certain amount of independence from political pressures. Its large number of branches in rural areas -- a total of 115 offices throughout the country -- give it access to substantial deposits. The Bank follows quite conservative lending policies, so that it has a surplus of funds. At present the Bank has around Rp 900 million outstanding in loans to almost 300,000 different borrowers. In rural areas, prospective borrowers are still fingerprinted -- in order to identify them.

Bank Industri Negara (State Industrial Bank) or "BIN" provides long-term financing, mostly for industries owned or managed by the government. The Bank is not supposed to make short-term loans. Some of the Bank's resources have been raised by sale of bonds to foreign enterprises, which were allowed to buy them with blocked profits. From 1953 to 1956 a tax amnesty was granted to persons who made money available to the Bank.

b. Foreign Commercial Banks

Until Indonesia obtained independence, almost all commercial banking was in the hands of Dutch and British banks. The foreign banks played a very active role in the development of Indonesia's economy, often by financing and managing subsidiary plantation or trading companies and industrial concerns.

Apart from the Jav'sche Bank (now Bank Indonesia), the Dutch banks were the Nederland'sche Handelsmaatschapy (also called "Factory"), the Nationale Handelsbank, and the Escomptobank (later taken over by Indonesian interests). All have a number of branches scattered throughout Indonesia.

The British banks in Indonesia are the Hong Kong & Shanghai Banking Corporation and the Chartered Bank of India, Australia and New Zealand. They are mainly interested in the financing of export trade; the former specialized in commerce with the China coast, and the latter mainly handles trade with England.

To many Indonesians, foreign commercial banks seem to be the center of imperialism. Even after independence, foreign

Table 10

Credits Granted by Bank Rakjat Indonesia, 1952-1957
(Millions of Rupiah)

End of	Agriculture Amount	Agriculture %	Persons With Fixed Income Amount	Persons With Fixed Income %	Middle Class and Business (Current Account) Amount	Middle Class and Business (Current Account) %	Total Amount
1952	88.0	35	21.4	8	146.3	57	255.7
1953	98.2	21	59.6	13	302.5	66	460.3
1954	92.6	19	66.6	14	321.1	67	480.4
1955	106.3	18	84.4	14	415.5	68	606.2
1956	94.1	12	108.4	14	574.4	74	776.9
1957	80.3	9	120.0	14	683.9	77	884.2

Source: Bank Indonesia, "Report for the Year 1957-1958", Djakarta, 1958, page 102.

commercial banks continued to predominate in the financial life of the country. Most of the bank deposits in Indonesia belonged to long-established Western- or Chinese-owned enterprises, which continued to deposit in the foreign commercial banks.

Foreign banks have been reluctant to extend credit to the Indonesian newcomers to business. In the opinion of the foreign banks, newcomers usually lack capital and experienced management. Newer firms tend to engage in highly speculative ventures in the hope of making quick profits. The owners sometimes draw down profits -- or even capital -- to support personal consumption, without adequate regard for the need to build up reserves.1/

In 1957 at the time of the West Irian crisis, the Indonesian Government placed the Dutch institutions under military control. The Escomptobank, originally chartered in Indonesia rather than in the Netherlands, has passed under the control of Indonesian shareholders. The others, some observers believe, sooner or later will be nationalized. In the meantime, they have been placed under increasingly severe restrictions.

The Overseas Chinese Bank, incorporated and largely owned in Singapore, and the Great Eastern Bank (owned mainly by Chinese on Taiwan) are also important foreign-owned banks. The Great Eastern Bank recently was placed under military supervision, like the Dutch banks, as part of the campaign against Kuomintang Chinese organizations.

Since Indonesia obtained independence several other foreign-owned commercial banks have attained prominence. One is the Bank of China, owned by the mainland (Communist) government. The Bank of China has expanded rapidly in recent years, and now occupies one of the largest and most impressive office buildings in all of Djakarta. The Bank does a large commercial banking business with the Chinese trading community. It also provides long-term financing for some industries. The publicly known interest rate of the Bank of China, 6½%, is comparatively low. Although seemingly generous in lending money, this Bank is said to be ruthless in taking over the businesses of borrowers who are not able to meet their obligations. Except within the Chinese community, the Bank is chary of conspicuous activity, to avoid irritating Indonesian sensibilities. However, occasionally it makes well-publicized offers of credit on favorable terms to government agencies (e.g. an offer to lend Rp 2.5 million to the National Printing Office to finance the purchase of paper).

1/ Hans. O. Schmitt, "Monetary Policy in the Political Economy of Indonesia," University of California - University of Indonesia Economics Project (manuscript), Djakarta, 1957, page 37.

Escomptobank, in transition from foreign to Indonesian status, is in a special position. It was the only one of the large Dutch-owned banks to be chartered in Indonesia with its main office in Djakarta rather than in the Netherlands. During the years since Indonesia won her independence, a majority of the Escomptobank's shares were sold by the original Dutch owners to Indonesians. Control of the Bank is believed to be in private hands, although the Bank Industri Negara is an important shareholder.

At the end of 1957, when the West Irian crisis brought anti-Netherlands feeling to a head, the Dutch managers of Escomptobank turned over control to a prominent Indonesian banker, and an Indonesian Board of Directors took over. In November, 1958, a shareholder's meeting made certain changes in the by-laws to facilitate conversion into a purely Indonesian institution. The most important were a requirement that the Managing Director and Board of Directors be Indonesian. Branches in the Netherlands were deprived of their special autonomous status, and were placed under the orders of the home office in Djakarta. The name has been changed from Escomptobank N.V. to P.T. Escomptobank.

In February, 1956, a joint Indonesian-Japanese bank was founded, under the name of Bank Perdana. Japanese stockholders are the Ishihara group, Shahyo Bank and Daiwa Bank. The President of the Bank is Jusuf Wibisono, a former Indonesian Minister of Finance in the Harahap cabinet (who fell from power almost immediately after he licensed the establishment of the Bank), and a member of the Masjumi party. The other Indonesian shareholders also come from parties which are in opposition to the present government.

The Indonesian shareholders own 51% of the stock, while the Japanese hold only 49%. The Board of Directors consists of three Indonesians and two Japanese. The equity capital of the Bank is largely nominal, and virtually all the capital resources come from the Japanese shareholders in the form of a loan, with an indefinite term for repayment. The Indonesian shareholders are supposed to pay in their 51% over a period of years out of profits, and ultimately are to have the right to buy out the Japanese interests. The ultimate capitalization is to be Rp 50 million, but so far the Japanese have advanced only Rp 10 million. Even this, however, gives Bank Perdana one of the largest capitalizations of any Indonesian private bank.

The Japanese have also provided ten experts to help in the management and in the training of Indonesian staff. At present the experts act as the Bank's department heads and sub-managers. At first, Bank Perdana was expected to devote its resources largely to long-term financing of industrial development. However, after finding out that the profit from industrial lending would be small and the risks would be large, the Bank has devoted

Table 18

Balance Sheet of P.T. Escomptobank, 1957-1958

In Thousands of Rupiah

	30 September, 1957	31 December, 1957	31 March, 1958	30 June, 1958
ASSETS				
Cash and Central Banks	315,376	154,244	233,377	300,212
Due from Other Banks	111,283	120,976	35,822	38,960
Foreign Bills Receivable	13,134	17,369	9,174	18,896
Treasury Notes	94,317	59,369	86,554	95,618
Inland Bills	16,302	9,018	4,857	15,130
Securities, Listed	1,011	1,042	815	1,922
Securities, Not Listed	74	39	251	251
Advances	305,138	300,078	165,546	230,652
Permanent Investments	10,619	9,812	9,812	9,815
Bank Premises and Other Real Estates	P.M.	P.M.	P.M.	P.M.
	867.254	671.947	546.208	711.456
LIABILITIES				
Capital, Issued and Fully Paid	18,500	18,500	18,500	18,500
Reserve Fund	18,000	18,000	18,000	18,000
Special Reserve	9,500	9,500	9,500	9,500
Deposits	22,099	16,490	13,389	11,866
Current Accounts	662,189	486,207	396,696	538,994
Bills Payable	60,374	7,942	9,122	16,051
Sundry Creditors	76,450	115,166	80,859	98,403
Undivided Profit	142	142	142	142
	867.254	671.947	546.208	711.456

Source: Escomptobank, "Statement of Condition", Djakarta, 1958.

most of its energies to the development of short-term commercial business. In recent months deposits have increased as Chinese merchants have sought shelter from the threats against the Great Eastern Bank and other Chinese institutions.

Bank Perdana is not looked upon with favor by Indonesia's present government. Among other objections is the feeling that this Bank represents a competitive threat to locally owned institutions.

c. Indonesian Private Commercial Banks

With the exception of Escomptobank (whose transition is described above) almost all Indonesian private banks are small, lack experienced management, and have very limited resources. Only a few are authorized by the government to handle foreign exchange transactions in their own name (although the others can serve their customers as agents for authorized foreign exchange banks).

Many of the private Indonesian banks were founded with the help of comparatively large credits from the government, and still draw most of their lendable funds directly or indirectly from government sources. Many that have not yet received government assistance were founded in the hopes that they would get such help eventually, and have languished while waiting for government support to become available. During 1956, national private banks received Rp 54 million in advances from the government, Rp 181 million of government "liquidity credits," to be passed on to designated private enterprises, and Rp 85 million of "open credits" from Bank Indonesia with a similar purpose. The total of Rp 320 million was one-third of the reported assets of private national banks at the end of the year (Rp 969 million reported by 41 banks).1/

During 1957 liquidity credits became less important, and in September, 1957, were stopped entirely because of the government's budgetary difficulties. However, government funds of one sort or another continue to be an important source of financing for some national private banks.

Figures for one small bank illustrate the often extreme dependence on government support. Total assets are around Rp 3.9 million. Of this, Rp 2 million or 51.3% is a loan from the government. Repayment, in five annual installments, begins in a few years. Paid-in capital and reserves amount to Rp 0.8 million (or 20.5%), less than the minimum required by government regulations. Current account deposits amount to only Rp 0.3 million, and time deposits are Rp 0.6 million. Thus, deposits amount to a mere 23% of total resources.

1/ Bank Indonesia, "Report for the Year 1956-1957," Djakarta, 1957, pages 93-94.

As a result of their reliance on help from the government, many of the national private banks are closely related to various political parties. At least one of these banks was started by a political party (not now part of the government) as a place to invest temporarily a Rp 3 million reserve for future campaign expenses. The bank has since made substantial profits as a result of its ability to get import licenses for its subsidiary trading companies.

Most of the private national banks are owned by "genuine" (asli) Indonesians, or at least seem to be. In fact a number of the "genuine" Indonesian banks have hidden Chinese owners. Around 35 of the larger and better "genuine" Indonesian banks belong to the Association of National Banks (Perhimpunan Bank 2 Nasional). Members of this Association generally are connected with pro-government political parties, or are politically neutral. The largest member is the Indonesian Banking Corporation (I.B.C.).

A rival association, the Indonesian Bank Federation (Federasi Bank di Indonesia) represents six banks that are known to be mainly owned by Chinese and Indonesian-Chinese interests. The most important member is Bank Siliwangi. Some of the banks which belong to Federasi Bank have close relations with the Masjumi, or other parties now outside the government, perhaps partly because Chinese interests are not welcomed by pro-government parties.

Chinese-owned banks usually have "genuine" Indonesian presidents or managers, partly in order to ease relations with the government. At the same time, some "genuine" Indonesian banks have managers of Chinese origin, in order to keep the confidence -- and deposits -- of the important Chinese business community.

Some banks have begun to accept anonymous deposits from Chinese and other customers. This is contrary to government policy, but cannot be stopped in all cases because of Bank Indonesia's lack of trained enforcement personnel. In many cases, anonymous deposits are made on condition that the money be loaned back openly to the secret depositor, who then is able to show the tax collector a legal source of his wealth.

Foreign firms and large domestic businesses are still reluctant to deal with the smaller private national banks. These banks usually do not have branches in the outer islands, and therefore are unable to provide convenient remittance facilities. Furthermore, they sometimes lack a full understanding of what is expected of a bank. For example, one large foreign firm with operations throughout Indonesia deposited Rp 300,000 in a branch of a private national bank located in Makassar. When the building burned down the bank tried to refuse to allow withdrawal of the funds, on the grounds that _force majeure_ had intervened.

The marginal nature of the smaller national private banks has had one effect which in the long run may turn out to be for the good: Some of the national private banks have begun to invest short-term funds in industry, for lack of more profitable alternatives. Loans are in the form of six months' credits, sometimes granted with the understanding that they will be renewed as they fall due for up to five years. Although intended for working capital purposes, the lending banks usually raise no objection to use by the borrower to buy capital equipment, if the investment is expected to pay for itself out of profits in one or two years. In general, the national private banks are increasingly interested in lending to industry, since many of them recognize that the concentration on lending to trade is risky. National private banks may have over 25% of their resources on loan to industry in some cases.

This is particularly the case for the few banks that have resisted the temptation to move their main office to Djakarta. For example, Bank Persatuan Tenaga Ekonomi in Djogjakarta devotes much of its resources to loans to small batik, silverware, and transport enterprises. Managers of the bank realize that they could earn more money by financing trade, and probably would prefer to do so if they could. However, they do not find enough opportunities for reasonably sound loans to commerce in the Djogjakarta area. Trading firms in Djogjakarta are newer and much more speculative than the traditional industrial establishments. Often the trading firms are run by Chinese newcomers who are not known in the Indonesian community.

Otherwise, private banks are very reluctant to accept long-term risks. A leading national private banker says that he would only make long-term loans if the government guarantees them, because "The regulation of imports is controlled by the government, not by me."

The few banks that have most of their activity outside of Djakarta often benefit by close political or financial relations with the local government. A number have become the depositary for surplus local government funds. In Bali, for example, the well-managed Bank Perniagaan Umum has had a very rapid increase in deposits recently: it keeps for the local government the proceeds of the special tax on coffee shipments (Rp 100-200 per quintal), levied to pay for a local development program. Another bank, which has good political connections in South Sumatera, doubled its deposits in a very short period of time by inducing the local governments and the Finance and Economic Department of the Military Administration to deposit their cash reserves. The bank successfully argued that if all payments were made by check it would be easier to prevent corruption, and to ensure compliance with budget estimates.

The concentration of banking in the capital city continues to be a problem. Some banks which originally started in provincial areas have transferred their main offices to Djakarta. Examples are Indonesian Banking Corporation (founded in 1950 in Djogjakarta) and Bank Timur (whose headquarters in theory are still in Semarang, but which in practice is increasingly managed from its Djakarta "branch").

The excessive concentration of banking facilities in Djakarta has caused increasing difficulties for the smaller or less well-managed institutions. The profits on investments in banking have gone down until it is difficult to raise money from shareholders to meet the Government's minimum capital requirement for a permanent banking license, except by taking in concealed Chinese owners. Some new banks are said to earn only 4% per annum on their share capital, while others probably lose money. More and more bankers are beginning to realize that as a result of inflation they have unknowingly been living off their share capital. On paper they have made profits by lending out available funds at relatively high interest rates. In fact, however, rates of 20 or more percent a year (charged by various subterfuges) have not even compensated for the decline in the value of money. Paper profits have really hidden a decline in the real value of the stockholders' investment.

Many of the smaller banks have already been forced to branch out into trading on their own account in order to keep alive; one "bank" is an active dealer in used automobiles. Other banks are beginning to go into trade as a way to avoid further losses from inflation. While trading activity is prohibited by government banking regulations, there are a number of ways to get around the law. This is a dangerous practice, since banks do not enforce against their own trading subsidiaries the high margin requirements that are demanded of regular clients. If anti-inflationary policies are ever introduced without careful and impressive warnings, a number of banks may get into very serious difficulties. So far the opposite policy seems to have been followed: to the extent that any anti-inflationary policies are contemplated, they have been kept quiet for fear of arousing political objections.

While some banks have been going into trade, traders and other businessmen have been going into banking. A number of prominent merchants have established their own "banks," which are little more than counting-houses to administer the funds of their businesses and family relations, so as to minimize the amount of cash that they require. Some trade associations, such as the Chamber of Industries and the Association of Small Retail Merchants, have established banks, hoping to centralize cash surpluses for the benefit of their own members.

In some cases the hope of obtaining some kind of government funds -- including I.C.A. counterpart deposits -- seems to have had more influence than any other factor in the decision to establish a bank.

Outside the banking system there is a flourishing "black market" in credit, largely in Chinese hands. Interest rates range from 2-6% per month. It is a common practice to add 20% to a bill for merchandise if credit is given for a month or so. This is known as "t.t.t." after the initials of the Dutch words meaning "twelve back for ten." Manufacturers sometimes sell at a substantial discount to merchants who pay in advance of delivery. A Chinese-owned flashlight battery factory, for example, sells a certain quantity of batteries for Rp 25, but charges only Rp 22.50 if payment is made three or four months in advance of delivery. This amounts to interest at a rate of 30-40% per annum. Chinese-owned factories, better able to obtain the confidence of the Chinese merchant community, have easier access to this sort of credit than their Indonesian competitors.

A few enterprising businessmen have managed to borrow the cash surpluses of former Dutch firms that are now under military control, for periods of up to 5 years, and at rates of around 9½% per annum.

Savings institutions are not very well developed, and have little or no desire to finance new industrial undertakings. Savings deposits are relatively unimportant in Indonesia. The total of savings collected by postal and private savings banks -- Rp 338 million at the end of 1957 -- is less than half of the amount loaned out by the government's pawnshop service (see Table 29).

The largest savings bank in Indonesia is the Postal Savings Bank (Bank Tabungan Pos) with around seven times as much savings deposits as the private savings banks. The Postal Savings Bank has expanded rapidly in recent years:

	Number of Offices Offering Savings	Number of Depositors	Total Savings (Millions of Rupiah)
1950	598	523,700	50
1955	785	1,010,400	192
1957	859	1,247,400	296

According to the head of the Postal Savings Bank, the recent expansion has been helped along by a publicity campaign, begun in August 1956, which drew on the patriotic

Table 19

Balances at Savings Banks and Outstanding Loans of Pawnshop Service 1940-1957

In Millions of Rupiah

End of	Postal Savings	Private Savings	Total	Outstanding Loans of Pawnshop Service
1940	51	16	67	33
1951	65	12	77	167
1952	91	13	104	250
1953	123	18	141	384
1954	159	21	180	377
1955	189	25	214	595
1956	225	34	259	752
1957	296	42	338	711

Source: Bank Indonesia, "Report for the Year 1957-1958", Djakarta 1958, pages 106-107.

support of organizations such as the political parties (especially the Nationalist and Communist Parties) and trade unions. However, during the early part of 1958 the rise in the prices of foodstuffs caused a slackening of savings. Much of the savings now come from government employees, doctors, and other professionals, and farmers. Some individual savings accounts are as large as Rp 200,000 ($6,600). Persons using the Postal Savings Bank do not seem to have the imagination or experience needed to invest their own money themselves. The main motives for savings seem to be to accumulate a dowry, set up a new household, or to make some specific purchase.

All resources of the postal savings system are invested at the government's direction, without any initiative or control by the Postal Savings Bank. Some 40% goes into treasury bills, while the remainder is loaned with the central government's guarantee to provinces and autonomous government-owned corporations (such as Bank Industri Negara).

The interest paid to postal savings depositors is quite low -- 2.64% per annum -- but deposits may be withdrawn without notice at any time. The Postal Savings Bank enjoys a certain amount of confidence as a government-guaranteed institution. Private savings banks offer higher interest rates, but usually require deposits to be made for a fixed period. One private bank offers 2.4% per annum on deposits for one month, 4½% per annum on deposits for 6 months, 6% on deposits for one year, and 7½% a year on deposits for three years. Some Chinese-owned banks offer 12% interest on deposits for periods of 5-10 years.

One of the largest private savings banks has found it difficult to make long-term investments. The bank would like to make 15-20 year mortgage loans, but finds that most borrowers only want credit for 2-3 years. Apparently the effect of inflation on long-term debt is not yet well understood. Borrowers, interested in quickly investing their current earnings in real property, overlook the possibility of profiting by the future fall in the value of borrowed funds. The savings bank therefore is increasingly driven into short-term commercial lending for imports and interisland trade.

One bank finds that most savings are for three year periods. Its savings accounts are divided as follows:

Period	Amount in Rupiah
15 year	115,000
10	389,400
5	562,000
3	5,971,135
1	1,275,650
1/2	760,900
1/4	20,000
	10,460,075
Monthly payment plans	1,365,960
Total	11,826,035

Indonesia's most important savings institution, by far is the cooperative movement. As Table 20 shows, total savings and reserves of the cooperative movement now amount to almost Rp 700 million (as of the end of 1957). Members of the co-operative movement save in three ways:

1. Voluntary savings, including special-purpose saving for pilgrimages, ceremonies, etc.

2. Compulsory savings, including initial capital participation on joining, and periodic additional savings.

3. Reserves accumulated out of profits, to which must go at least 25% of the cooperative's annual net earnings.

Figures for the end of 1956 show the following division between the various types of savings:

	in Millions of Rupiah		Percent
Voluntary	43.0		
Special Purpose	78.9		
Subtotal		121.9	26.0
Initial Capital	70.1		
Compulsory	217.1		
Subtotal		287.2	61.0
Reserves		60.4	13.0
Total		469.5	100.0

Table 20

Savings by Cooperatives, 1938-1957
In Thousands of Rupiah

Year	Number of Cooperatives	Number of Members	Savings1/	Reserves1/	Total
			F l o r i n s :		
1938	540	40,237	633	189	822
			or, in 1957 Rupiah, approximately:2/		
			37,980	11,340	49,320
			in Current Rupiah (Estimated)		
1950	1,155	85,000	4,500	incomplete	incomplete
1951	5,770	1,000,324	35,313	3,474	38,787
1952	7,667	1,179,422	56,389	3,262	59,651
1953	8,223	1,431,977	97,418	11,548	108,966
1954	9,664	1,652,369	157,533	27,782	185,315
1955	11,446	1,938,074	282,877	45,893	328,770
1956	11,901	1,990,373	409,101	60,421	469,522
1957	11,863	1,941,719	596,103	102,645	698,748

1/ Includes savings in the forms of rice (paddy weight) and Straits Dollars (cooperatives in the Rian Archipelago, where Straits Dollars continue to circulate), converted into Rupiah as follows:

	Rupiah	Paddy Weight (Metric Ton)	Pounded Weight (Paddy x 0.6)	Estimated Price Per Ton	Rupiah	Straits Dollar	Exchange Rate	Rupiah Equivalent
			S A	V I	N	G S		
1953	93,640	2,999	1,799	2,100	3,778	-	3.8	-
1954	148,196	4,419	2,651	2,100	9,280	15.0	3.8	57
1955	268,598	5,391	3,235	2,630	14,178	26.6	3.8	101
1956	394,077	4,651	2,791	3,130	14,558	97.0	4.5	436
1957	583,133	3,501	2,101	3,400	11,903	140.4	7.6	1,067
		R	E S	E R	V	E S		
1953	11,321	180	108	2,100	227	-	3.8	-
1954	27,452	262	157	2,100	330	-	3.8	-
1955	45,221	423	253	2,630	665	1.9	3.8	7
1956	59,521	468	281	3,130	880	4.4	4.5	20
1957	101,435	555	333	3,400	1,122	11.6	7.6	88

2/ Based on change in cost of living index, as given in "International Financial Statistics" by International Monetary Fund.

Source: Djawatan Kooperasi, "Data on the Indonesian Cooperative Movement", mimeographed, Djakarta, 1958.

Life insurance is a relatively new form of capital accumulation in Indonesia, and is only just beginning to assume importance. The spread of life insurance is assisted by the introduction of a number of new types, such as educational endowment policies, pension and annuity plans, and "popular" (postal) insurance polciies which do not require a medical examination. Some of these ideas have introduced by insurance company executives who have studied in the United States.

During recent months there has been a flow of "hot money" into insurance policies. A number of very large policies (Rp 1-2 million) were taken out, until the Ministry of Finance issued an order prohibiting the writing of policies over Rp 100,000.

A large part of the reserves of life insurance companies is invested in real estate, and particularly in apartment houses. A smaller part is invested in mortgages, sometimes as a service to the members of mutual companies. The remainder usually is invested in bonds of the Bank Industri Negara, or of the government. Mortgages and real estate have high rates of return -- normally around 18% -- and real estate investments usually go up in price as time goes by. Bonds have relatively low yields, and have been subject to serious price drops. Bank Industri Negara bonds, for example, fell to 40-50% not long after being issued at 100.

Usually mortgages are for a very short period of time, such as 20 months. The insurance companies do not like to tie up their funds for longer periods, since they fear depreciation of the currency. Banks and other sources of funds only lend money for even shorter periods, such as 3-6 months, and insurance companies are able to place their slightly longer-term funds without difficulty.

The exchange in Djakarta is a very small and thin market. The total number of listed securities is 33 (6 bonds and 27 stocks). From time to time Bank Industri Negara or other similar institutions offer large new issues of bonds. These usually are oversubscribed before they are issued and there is very little subsequent trading. Four banks and three brokerage houses maintain the market, meeting at the Bank Indonesia for around one-half hour a day.

There are few private Indonesians interested in the purchase of securities. Indonesians with money to spare turn largely to traditional hoarding media like gold (see Appendix B, Table 3), or to real estate. Most of the securities exchange activity in the past came from Dutch customers. At present, of the little that is left, much comes from Chinese. The Chinese now are afraid or legally unable to make traditional investments in real estate. The chief buyers of securities are a few institutional investors, such as insurance companies, banks, and pension funds. The government itself also is a buyer, picking up its own bonds from time to time at a substantial discount, rather than providing for regular amortization at par value.

Since the market is so narrow, it does not seem to respond to supply and demand in a normal way. At the prevailing low prices, there are said to be more would-be buyers than sellers. There appears to be some kind of "gentlemen's understanding" between the various important participants in the market, and the quoted prices are to some extent fictitious.

Chapter 5

Long-Term Credit for Industry

As the previous chapter pointed out, the commercial banking system provides very little credit of any kind, and only a small part goes to industry. Of this, practically none is directly available to finance long-term investment. Savings institutions are even less willing and able to provide industrial credit.

Even if banks were willing to finance long-term industrial investments, they would not be allowed to do so to any large extent. To overcome serious abuses the government's Monetary Board decreed (on 11 March 1957, Decree No. 25) that banks may not carry on commercial business themselves, or found other enterprises outside the field of banking. Banks may only participate in other enterprises or make long-term loans (for periods of over one year, including mortgage loans) to the extent that their capital and free reserves exceed the legal minimum of Rp 2.5 million (plus Rp 500,000 for each branch). Long-term loans may not be larger than 10% of the total of paid-up capital and reserves, unless guaranteed by the government.1/

Limited amounts of long-term credit have been made available from abroad, including some credits to Indonesian private industry from Soviet-bloc countries. The Bank of China, in particular, offers some long-term credit to favored firms. This credit may be used to finance imports of machinery, not necessarily from Soviet-bloc sources. Some of the enterprises established with Soviet-bloc credit are of impressive size. An ultra-modern enamelware plant (so highly mechanized and electrified that it probably cannot operate at a profit under Indonesian conditions) represents an investment of Rp 20 million, financed mostly with Bank of China credit. Credit is also available from other Soviet-bloc countries, including Czechoslovakia and the Soviet Union.

To the extent that industry obtains any long-term credit at all, it comes mostly from Indonesian government agencies.

1/ Bank Indonesia, "Report for the Year 1956-1957," Djakarta, 1957, Appendix G.

Government programs provide credit for small private enterprises through the Credit Guarantee Institute (Lembaga Djaminan Kredit) or LDK, the Small Industries Fund (Dana Industri Ketjil) or DIK, and the Mechanization Credit Program. A few medium-size cooperative enterprises are financed through the Cooperative Service (Djawatan Kooperasi). Government-owned industries, mostly large-scale, are financed through the Bank Industri Negara and the LP31.

All government credit programs have suffered from a lack of understanding on the part of the beneficiaries. Borrowers often seem to regard loans from government agencies as some sort of gift, or as a reward for good citizenship or political services. There is a belief on fht part of many borrowers that they do not really have to pay back the money received from the government. In some cases borrowers have lost respect for government credit institutions because of the shortage of competent personnel, and less reliable borrowers are tempted to try to fool the officials in charge.

In many if not most cases, borrowers probably would be able to pay their debts, but do not choose to do so. Credit is short in Indonesia, particularly at the reasonable interest rates charged by the government. As long as borrowers can avoid paying back the government, they have the use of the money for their other business needs. (One delinquent borrower admits that "if necessary" he could pay back his loan. However, much of his working capital is tied up in amounts due from slow-paying customers, and particularly from government purchasing agencies. In effect, he has extracted a loan from the government in order to finance the government.)

Government employees have been reluctant to apply pressure to borrowers. Court calendars are clogged with criminal cases, and the courts are reluctant to act on purely civil matters. Furthermore, the introduction of martial law has added a complication which seems to have paralyzed action. Only rarely has court action been initiated against borrowers who are in arrears, and only very seldom has it resulted in repayment. Sometimes an effort has been made to frighten delinquents by haling them before officers of the military administration. However, this has not been a very successful device, since the culprits seem to be able to out-talk military officers who lack business experience.

While it is difficult to generalize about the numerous government credit programs, in many cases it is apparent that over three-quarters by number and around one-half by value of all loans are in arrears. The government record is better in some provinces than in others. Repayments are particularly good in the Bali and Djogjakarta areas, where religion has a strong influence and where old family ties and traditions are still strong.

Faced with this record, government officials at all levels are becoming more cautious in making loans. They are now demanding higher security from borrowers, and are beginning to investigate more carefully such matters as the availability of markets for new products. The difficulty of establishing new enterprises in an unstable economic environment is increasingly recognized. Some officials, like Dr. Lookman Hakim, have concluded that small enterprises, lacking the capital to withstand such stresses, cannot be helped by the availability of government credit.

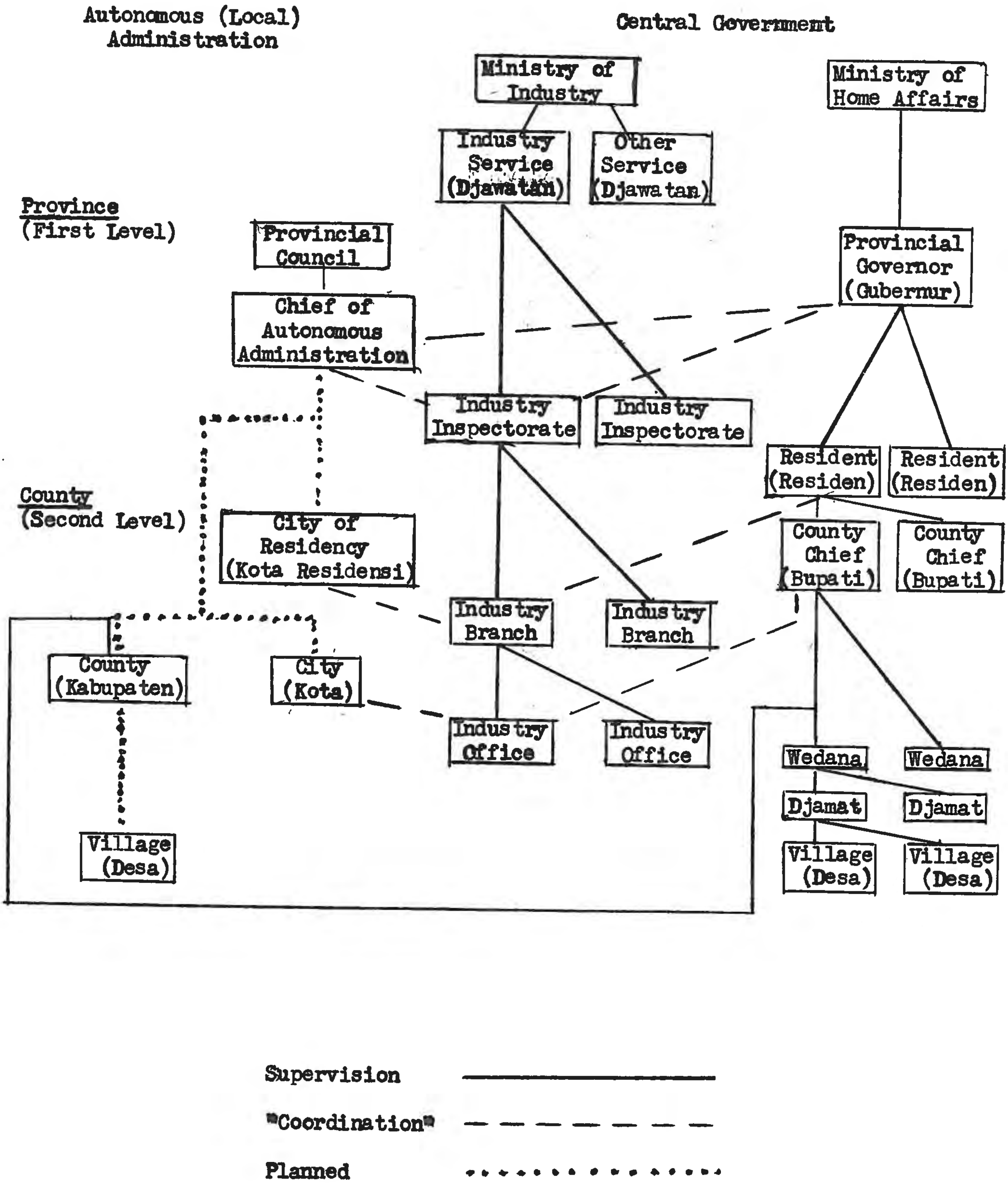
While the problems of the government's credit programs are fairly well recognized, it is difficult to do much about them at the present time. Indonesia's entire local government structure is undergoing a long-needed reform. The highly centralized system introduced by the Dutch for colonial purposes is to be changed into a federal and democratic system, somewhat similar to that in the United States. This change, which is to take place over a period of four years, has now reached the stage where the centralized and decentralized systems exist side by side. Almost inevitably, some temporary confusion and friction have resulted.

As Table 2B shows, the old Dutch system of central control persists in two respects. The first is a system of centrally appointed local officials under the Ministry of Home Affairs, starting with the Governor of each Province and going down through a chain of District Residents (Residen), County Chiefs (Bupati), and other local officials to the village (desa). This is being replaced by a system of elected "autonomous" provincial governments, with subordinate municipal and rural counties, which eventually will take over control of the villages. Planning for this transition seems to be good, even if the details are not always well understood by subordinate officials in the field.

However, there is a second chain of central control, inherited from the Dutch, whose future as yet is by no means clear. This is the system of "Inspectorates" representing the technical services (Djawatan) of the various ministries in the provinces. Although the chart shows only the Industry Inspectorate, there are similar organizations for agriculture, cooperatives, and a number of other specialized fields. Unlike the Ministry of Home Affairs, which has agreed to relinquish its network of provincial and local officials, the other Ministries seem to be trying to retain control of their existing personnel, while grudgingly sharing their services with the new "autonomous" local governments. Thus, officials of the Industry Inspectorate at all levels will remain under the central government's Industry Service "for administration." When "large projects" are under consideration, they will work as employees of the Ministry; when "smaller projects"

Table 2

(Chart)
Relations Between Central and Local Government



are under consideration, they will follow the policy guidance of the autonomous local governments.

One may doubt whether this division of labor will last very long. As the autonomous units of local government gain power, they are beginning to insist on a greater voice in the economic development of their areas. Sooner or later they will demand full control of the technical personnel stationed in their offices. If decentralization is to have real meaning, this demand is likely to be met. In the meantime, the unfortunate individuals who work as technical experts attached to local governments find themselves in a most difficult position.

The ultimate solution to some part of this problem may be found through the establishment of provincial development banks, now planned by the government. Little is known about this plan, which is still in its early stages. Even before the government had decided on this course, local military commanders and civilian authorities had begun to establish local banks (e.g. in Palembang and Semarang). Some of these are privately owned and some are owned by local government agencies. The bank in Semarang, for example, was established to finance a central wholesaling company, intended to help small producers and merchants to compete with Chinese traders.

The main existing programs for credit to small and medium private industry depend largely on the technical personnel of the provincial and local governments for their administration. They are the Mechanization Program, the Dana Industri Ketjil, and the Lembaga Djaminan Kredit.

The Plan to Mechanize Small Scale Industry (Mechanization Program) began in 1952 with aid from the U.S. Government. This has been one of the most important programs to foster the development of private industry, and one of the least successful.1/

Like most of the government's existing credit programs, the Mechanization Program began as an attempt to correct the defects of previous lending efforts. In the words of a U.N. Technical Assistance report,

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1/ A lengthy study, prepared by the Institute for Economic and Social Research, Djakarta School of Economics, University of Indonesia, appears in "Ekonomi dan Keuangan Indonesia," February 1957, pages 127-171 and March-April 1958, pages 158-217.

> "It was believed that the amount of loans being granted for small-scale industry development was far behind the absorption capacity of such loans. It was also thought that a larger proportion of the loans should be devoted to capital equipment rather than to operating capital."1/

Earlier lending programs gave assistance in the form of cash, without adequate supervision of the use of the loan. Sometimes the borrower used the loan to purchase a house or an automobile for himself, rather than for productive investment. One Indonesian entrepreneur defends this practice arguing that a newly established businessman has to buy an automobile before potential clients will take him seriously.

To avoid these abuses, under the Mechanization Program the government procured and delivered machinery -- rather than money -- to borrowers. The government tried to plan for "selective mechanization of key bottlenecks" in small-scale enterprises. This, it was hoped, would facilitate additional output without displacing hand labor. The labor-intensive character of small-scale industry was to be preserved, and if possible employment would be increased. In theory, assistance would be confined to enterprises with less than 50 workers, or with a maximum of 5 horsepower of mechanical power.

In practice, credits have gone to somewhat larger industries. The average loan under the program was Rp 221 thousand (the present value would be around Rp 500- 750 thousand). Around half the projects by number included electric power generating facilities, requiring around one-fifth of the total amount of credit. About 64% by number and 57% by value went to projects located in Djawa. (See Tables 22 and 23.)

By March 1958 Rp 34.4 million had been spent under the program. Only a very small fraction (2% according to one report) has been paid back, and there are serious doubts whether much of the remainder will ever be collected.

Shortcomings of the Mechanization Program seem to result from faulty execution rather than from a poor conception. In the early stages difficulties resulted from highly bureaucratic procedure. According to the U.N. report,

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1/ United Nations, Technical Assistance Program, Report No. TAA/INS/3, "Industrial Development in Indonesia, by J.E. Stepanek," New York, 4 October 1955, page 147.

Table 22

Mechanization Credits by Industry
As of 15 March 1958

In Thousands of Rupiah

	Cost of Machinery 1/	Percent of Total	Number of Plants	Percent of total	Average Amount per Plant
Printing & Publishing	10,033	29.2	18	11.6	557
Sawmills & Woodworking Plants	5,679	16.5	24	15.5	237
Bricks, Roof & Floor Tiles	5,496	16.0	26	16.8	211
Textile & Clothing	3,167	9.2	11	7.1	288
Metalworking	1,701	4.9	14	9.0	121
Automobile Service & Repair	1,533	4.5	7	4.5	219
Electric Power Station	1,288	3.7	2	1.3	644
Sulfur Refinery	1,206	3.5	2	1.3	603
School Slates & Chalk	682	2.0	3	1.9	227
Tapioca Starch	446	1.3	6	3.9	74
Coconut Oil Expressing	402	1.2	9	5.8	45
Sewing Needles	400	1.2	1	0.6	400
Rice Milling	305	0.9	1	0.6	305
Shoes & Leather Goods	290	0.8	9	5.8	32
Spoons & Forks	282	0.8	1	0.6	282
Rattan Furniture	274	0.8	2	1.3	137
Tannery	228	0.7	1	0.6	228
Ceramics & Pottery	222	0.6	2	1.3	111
Radio Assembly	206	0.6	1	0.6	206
Weighing Scales	149	0.4	1	0.6	149
Krupok (shrimp crackers)	92	0.3	1	0.6	92
Rope & String	74	0.2	6	3.9	12
Instrument Making	57	0.2	1	0.6	57
Bean Curd	54	0.2	3	1.9	18
Tobacco Cutting	48	0.1	1	0.6	48
Ice Cream	45	0.1	1	0.6	45
Soft Drinks	44	0.1	1	0.6	44
Total	34,403	100.0	155	100.0	222

Source: Ministry of Industry

1/ Cost of machinery is delivered cost, calculated at rate of exchange effective at time of delivery; cost under present conditions (calculated at "BE" rate) would be approximately 2½ times as great.

Table 23

Geographic Distribution of Mechanization Credits
As of 15 March 1958

Province	Number of Factories	Percent	Cost of Machinery[1/] (Thousand Rupiah)	Percent
West Java	45	29.0	11,143	32.9
Central Java	25	16.1	5,052	14.7
East Java & Madura	30	19.4	3,408	9.9
Total Java	100	64.5	19,602	57.0
South Sumatra	9	5.8	1,316	3.8
Central Sumatra	10	6.4	2,736	8.0
North Sumatra	10	6.5	5,200	15.1
Total Sumatra	29	18.7	9,252	26.9
North Sulawesi	4	2.6	903	2.6
South Sulawesi	4	2.6	627	1.8
Total Sulawesi	8	5.2	1,530	4.4
East Kalimantan	1	0.6	45	0.1
West Kalimantan	2	1.3	753	2.2
South Kalimantan	7	4.5	2,321	6.7
Total Kalimantan	10	6.4	3,119	9.1
Nusatenggara-Bali	4	2.6	185	0.5
Nusatenggara-Lombok	1	0.6	118	0.3
Nusatenggara-Maluku	3	1.9	597	1.7
Total Nusatenggara	8	5.2	899	2.6
Grand Total	155	100.0	34,403	100.0

Source: Ministry of Industry

1/ Delivered to factory, imported at fluctuating rate of exchange; present cost at BE rate would be about 2½ times this figure.

"The limiting factor in the implementation of this project was the necessity of perfecting the loan organization within the Department of Industry, rather than lack of funds. In spite of every attempt made to simplify loan procedures it was found that 14 complicated steps were absolutely essential. As reported by the consultant assisting this programme they are

"1. Announcement of the loan programme to the regional offices of the Department of Industry and in turn to all branch offices.

"2. Contact with and inspection by the branch industry offices of the private factories interested in receiving loans.

"3. Assistance to the private factory managers in answering the loan questionnaire. Official visit made and report written to assure the Department that the equipment will be properly used, that the loan can be repaid, and that adequate capital for operating supplies, land and buildings, if needed, is available. (It has often been found necessary for the local industry offices to request assistance from one of the institutes or the central office in making such recommendations.)

"4. Assembly of all loan applications at the central office and preparation of a draft plan and detailed budget.

"5. Review, screening and approval of the individual projects at the central office.

"6. Request for expenditure authorization from the Ministry of Finance.

"7. Writing of detailed specifications of all equipment required to fill the loan request.

"8. Submission of these specifications to the central purchasing office for quotations from import companies and local manufacturers.

"9. Consolidation and analysis of all equipment quotations and selection of a supplier.

"10. Submission of the specifications and recommendations to the private factory manager for approval.

"11. Authority given by the Ministry of Finance to the central purchasing office to place the equipment on order.

"12. Confirmation of the order with the importer, opening of a letter of credit, foreign exchange license, and confirmation by the prime manufacturer.

"13. Signing of hire-purchase agreement between the private manager and the Department of Industry.

"14. Consultation with the People's Bank (... Bank Rakjat...) regarding the loan repayment plan."1/

All important questions had to be referred to the Ministry in Djakarta for decision and local offices only were allowed to make recommendations.

It would have been difficult for a very experienced government agency, with ample trained staff, to administer such a complicated procedure. Under Indonesian conditions, it turned out to be almost impossible. Although some of the difficulties had been foreseen, there was an understandable urge to get quick results. Confident that they had corrected the faults of previous credit programs, the sponsors sometimes insisted on action before proper administrative arrangements could be made.

Some of the greatest difficulties reflected the usual ills of government procurement programs. Various machines, forming part of the same factory, arrived at different times (sometimes years apart). On arrival of the machines, it was sometimes found that one was not suitable for operation together with others that were part of the same factory. Machinery which was received often turned out to be substantially different from that which had once been ordered; for example, a brush factory asked for machinery to insert bristles, and received machinery to make wooden backs.2/ Often entrepreneurs were surprised by the elaborate and expensive equipment which they received. Some refused to accept it, realizing that they did not know how to operate it at a profit.

Delays in executing the program, caused at least partly by the elaborate procedure, added to the difficulty.

1/ ibid., pages 47-48.
2/ Ekonomi dan Keuangan Indonesia, March-April 1958, page 184.

Some firms went out of business while waiting for the arrival of their equipment. Of a total of 72 projects in the program as of 1952, only 48 had reached the procurement stage by 1954, and only 7 borrowers had received and installed machinery by that year. Of these, only 4 plants were actually in operation.1/ (See Table 24.)

By May 1956, orders had been placed to equip 82 firms. However, only 14 had their equipment installed in working order, and only 7 were in operation.2/

The widespread shortage of electric power caused many difficulties. Many enterprises were persuaded to accept machinery without realizing that they would not be able to get power from the public supply. Some were too small to provide their own electric power sources (as large industries usually must do). In many cases machines are still sitting idle on the borrower's premises, although in some cases the Mechanization Program has managed to get them back. Some machines are sitting idly in the importer's warehouses, with the government paying rent to store them.

While the program tried to overcome the lack of technical planning by centralizing procurement of machinery in the government's hands, it paid little or no attention to financial requirements, and particularly the provision of needed working capital. Often the installation of new machinery turned out to be insufficient to make industries more productive. In particular, if capacity increased, more working capital often was needed to keep the additional capacity at work.

Many of the borrowers were merchants with little or no experience as producers, although they were more or less experienced in financing and marketing. They usually lacked technical and managerial skills needed for manufacturing, and little or nothing was done to help or to persuade them to obtain help before their machinery arrived. Merchants often were encouraged by government officials to take up manufacturing, with the help of appeals to patriotism, or unrealistic predictions of profits.

Many merchants were dazzled by the ease with which they made profits as traders with borrowed money under inflationary conditions. They were so attracted by the

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1/ *ibid.*, February 1957, page 128.

2/ *ibid.*, March-April 1958, page 100.

Table 24

Progress of Mechanization Credit Program
By Number of Projects

	End of 1955	End of 1956
Number ordered	58	82
Number installed and operating	8	19
of which		
Operated experimentally	3	3
No longer used	1	3
Machines returned	-	2
Machines sold	-	1
In commercial use	4	10
of which		
Not satisfactory	1	1
Satisfactory but not continuous	-	3
Satisfactory and continuous	3	6
Satisfactory and Continuous Operations as % of number ordered	5.2	7.3

Source: Ekonomi dan Keuangan Indonesia, March-April 1958, page 200.

government's offer to lend that they almost overlooked the fact that capital would be in the specific form of machinery (good only for manufacturing goods, and not to finance speculation).

Another important government lending program is that of the Jajasan Lembaga Djaminan Kredit (Autonomous Institution for Guaranteeing Credit), or LDK. This was established in 1950 (under another name), in part to get around the very strict security and credit-worthiness requirements of the Bank Rakjat. New enterprises in particular were unable to meet the standards set by the Bank Rakjat, since they had no record of experience and reliability.

The L.D.K. also was intended to overcome some of the difficulties experienced in previous lending programs of various ministries of the government to promote development within their separate spheres of interest. The various ministries had not been able to get together staffs that were technically qualified to administer credit programs. After some unhappy experiences of its own the LDK was completely reorganized in 1956 and 1957. However, it continues to have a number of difficulties, and many government officials are discouraged by its record.

LDK loans are usually made with money provided by Bank Indonesia. At present LDK is authorized to draw on Bank Indonesia for a total of Rp 93 million. In return Bank Indonesia receives Treasury Bills from the Ministry of Finance. The Ministry of Finance decides how much LDK can lend in each province.

Loans usually are paid out and collected through local branches of the Bank Rakjat, although in a few cases Bank Negara, Bank Industri Negara, or one of around seven private banks may take over these functions. The borrower is charged 10% interest a year. Bank Rakjat (or the other administering bank) keeps 1%, Bank Indonesia receives 3% for supplying the money, and the remaining 3% goes to the LDK; all risks are borne by the LDK.

LDK is now trying to raise its compensation to 5%, bringing the total interest charged to 12% per annum. LDK argues that it should charge more than the normal rate (around 9½% per annum including commissions) because it makes more risky loans, and should not become a competitor of the regular banking system.

Loans are made only to "productive" enterprises, whether in the field of commerce, agriculture, or industry, and are not intended to finance luxury goods or services.

LDK will lend up to the full amount of the collateral of the borrower, or in some cases may waive all requirements for security; banks normally lend only up to two-thirds of the collateral available. LDK will lend up to three-fourths of the capital required for a project, whereas banks usually lend no more than one-half. LDK lends for as much as 5-6 years, while ordinary banks lend for no more than 2 years. LDK's main requirement is that the estimated profit from an enterprise be enough so that one-half of it will repay the loan in a reasonable period of time.

The LDK is run by a Board of Directors representing the Ministry of Finance (whose appointee is nominated by Bank Indonesia), the Ministry of Industry, the Ministry of Commerce, and the Ministry of Agriculture. There is a central staff, headed by a Secretary.

The branch in each Province has a Board of Directors composed of the Provincial Governor (or his representative), two representatives of Bank Indonesia, and representatives of the regional services of the Ministries of Agriculture, Industry, or Commerce, selected by the Governor (see Table 25). Before 1957 the provincial Board was substantially larger, and included permanent representatives of all the regional services. Decisions were made by a simple majority vote; the technical specialists on the Board tended to vote for each other's projects and to overrule the advice of the banking experts.

Each Provincial Branch has a full-time Secretary and a small staff, engaged mainly in accounting and record-keeping. The Provincial Board of Directors decides on applications for loans of up to Rp 100,000 ($2,700) and for no more than three years. Other applications are referred to the main office.

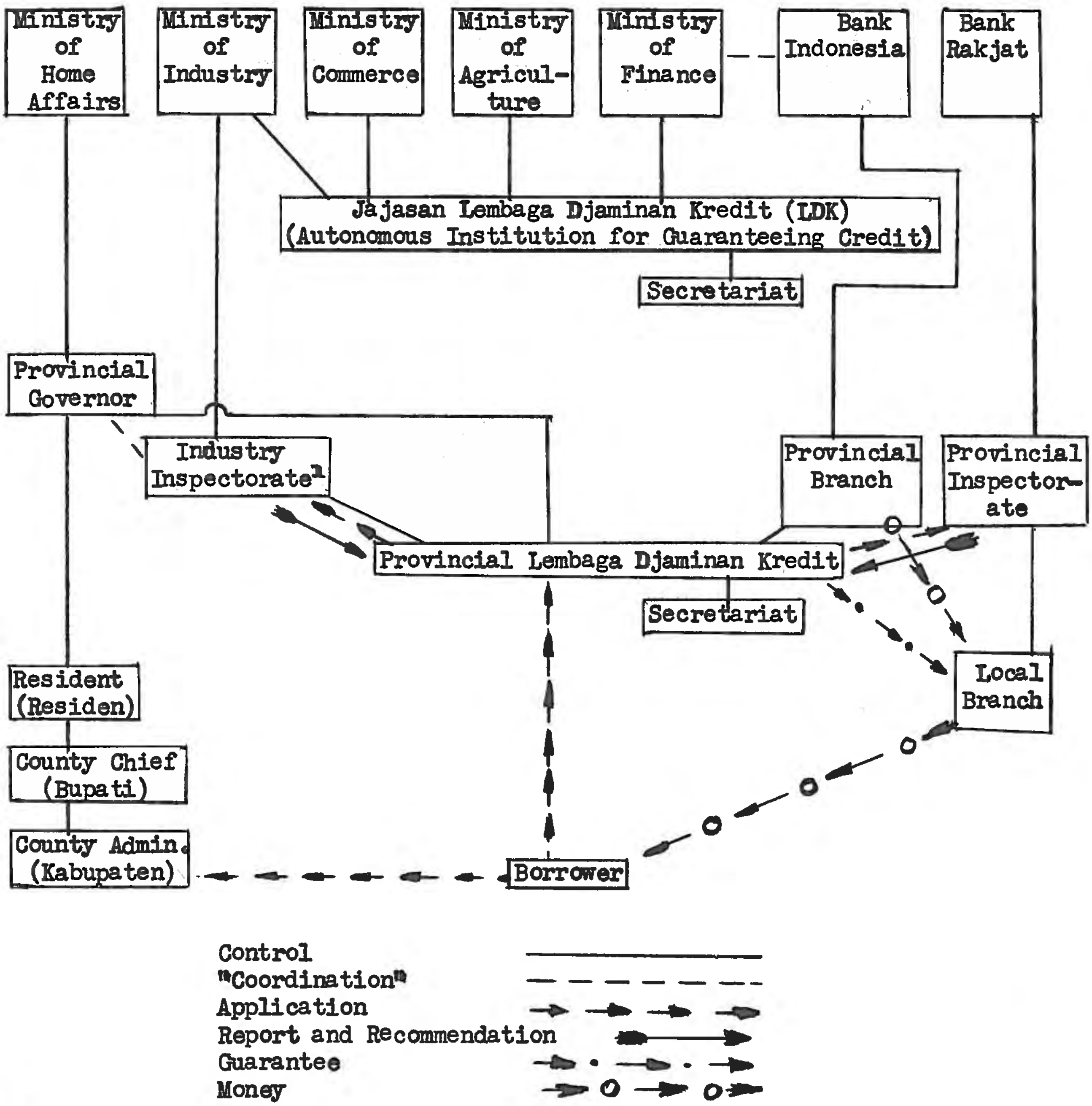
In the past, LDK had sub-branches at the county (Kabupaten) level, each with a local committee and access to the services of county government personnel to do the necessary work. Sub-branches were authorized to pass on applications for Rp 50,000 or less. The borrower submitted his application to the county office. This was forwarded, if necessary, to the Residency, and from the Residency to the Province. Further correspondence went through the same complex channel. Frequently, several years were required to process an application.

Under a recently simplified procedure, the borrower sends his application directly to the Provincial LDK, and at the same time sends a copy to the County. This makes it possible for the Provincial LDK to follow up on the application, and make sure that it is handled promptly by the various government agencies which are concerned.

Table 25

(Chart)

Organization of Lembaga Djaminan Kredit



[1] Or provincial technical service of another Ministry

Under both the old and the new procedures, one copy of the application is forwarded to the regional technical service concerned (for industry this is the Industry Inspectorate). Another copy goes to the Bank Rakjat. Both the Industry Service and the Bank Rakjat investigate the application, and each fills out an elaborate questionnaire. While the Industry Service examines the technical aspects of the proposal, Bank Rakjat looks into a number of financial factors:

1. The general reputation of the borrower, usually determined by consulting the borrower's village or neighborhood administrative office ("Lura").

2. The nature and value of the collateral offered by the borrower (Bank Rakjat prefers that the loan be limited to 60% of the estimated value of property pledged by the borrower; sometimes the endorsement of cosigners is accepted in the place of physical collateral).

3. The manner of operation of the borrower's enterprise, and particularly the state of its books (sometimes, if adequate books are not available, Bank Rakjat will try to make an estimate of the enterprise's profit by calculating the value of the products sold in one month, and subtracting the estimated cost).

Replies of the Industry Inspectorate and of Bank Rakjat are examined by the Secretary of the Provincial LDK, who may or may not make a recommendation of his own to the Board. Final decisions are completely up to the Board.

The process of examination has been extremely time-consuming, usually requiring about a year from the time an application is filed. Much if not most of the delay results from the slowness of the Industry Service and Bank Rakjat in beginning and in completing their investigations. Delays frequently are explained by the lack of personnel, automobiles, or other needed facilities.

In practice, processing of LDK applications seems to be considered as doing work for somebody else's benefit (particularly within the Bank Rakjat). There is also a tendency on the part of the technical services to turn in an unduly optimistic report. The Provincial Board of Directors has to act on the banking and technical reports without an opportunity to question the applicant directly. When defaults occur, the same officials that recommended the loan may be called upon for their opinion on whether the borrower should be taken to court. Often they try to delay court action, which would be a reflection on their own judgment.

As Table 26 shows, the LDK had at the end of 1957 a backlog of applications roughly equal to the number received during the preceding two years. Although the backlog had been declining during 1955 and 1956, it began to rise again in 1957 (although there was no great increase in the number of new applications filed in that year). Presumably, this was caused by the efforts to reorganize and to introduce a more cautious policy in the LDK.

The average size of applications has been increasing during the period covered by the table, at least partly as a reflection of inflation. Applications by non-industrial firms are somewhat larger than those from industrial firms, and the average size of loans granted to non-industrial firms is substantially larger than the average granted to industrial firms. In 1957 the average industrial loan granted by the LDK was Rp 180,000 (roughly $4,860), while the amount requested in applications received in that year averaged Rp 295,000 ($7,973). Thus most applications probably exceed the figure of Rp 100,000, and have to be referred to the central office.

The total of LDK loans outstanding at the end of 1957 was Rp 73 million (which is less than the authorized maximum of Rp 93 million). Of this, as Table 27 shows, around one-third has been loaned out to industry. Another third has financed trading enterprises, and the remainder went mostly to agriculture. In 1957 LDK ceased to lend to cooperatives, in order to avoid competition with the growing loan program of the government's Cooperative Service.

The LDK program has experienced a very high rate of default. Unfortunately, it is not possible to obtain complete information from LDK's present records, since administering banks do not provide LDK with sufficient information. As Table 28 shows, as of December, 1957, the LDK has received reports on only 51% by number and 49% by value of the credits disbursed. Of the credits covered by reports, 84% by number and 56% by value were in arrears. Industry, with arrears in 94% by number and 57% by total value, is the worst of the categories of borrowers. The percentage in arrears seems to be rising (see comparison between December, 1956, and December, 1957, in Table 28). This, however, may be due to some improvement in reporting, rather than to a change for the worse in the behavior of borrowers (presumably, the unreported credits are in worse condition than the reported ones, and as reporting improves the statistical record of LDK may get worse).

LDK's chief defect is the fact that no one person or agency has responsibility for its success or failure. Investigations are carried on mainly by the Bank Rakjat, money is supplied by the Bank Indonesia, losses are covered by the

Table 26

Disposition of Applications Received by Lembaga Djaminan Kredit, 1950-1957

Number and in Thousands of Rupiah

	1950-1953	1954	1955	1956	1957	Total
Industry						
Number Received	1,330	583	227	218	236	2,594
Number Rejected	430	372	311	233	125	1,471
Number Granted	365	142	102	58	49	716
Backlog	535	+69	-186	-73	+62	417
Amount Received	103,673	72,377	32,216	63,555	69,743	341,564
Amount Rejected	33,740	45,568	29,967	50,173	45,014	204,462
Amount Granted	15,364	5,783	3,758	3,497	8,844	37,246
Average of Received	78	124	142	292	295	132
Average of Rejected	80	123	96	216	362	139
Average of Granted	42	41	37	60	180	52
Total (Including Trade, Coops and Agriculture)						
Number Received	2,324	911	400	382	413	4,430
Number Rejected	753	619	473	340	245	2,430
Number Granted	647	262	163	120	91	1,283
Backlog	924	+30	-236	- 78	+77	717
Amount Received	246,363	134,243	54,692	71,908	118,158	625,364
Amount Rejected	76,761	81,179	55,275	74,901	79,296	367,412
Amount Granted	91,260	36,525	10,167	7,670	13,330	158,952
Average of Received	106	147	137	188	286	140
Average of Rejected	102	131	122	220	324	151
Average of Granted	141	139	62	64	146	124

Source: Bank Indonesia, "Report for the Year 1956-1957," Djakarta, 1957, Pages 98-99; "Report for the Year 1957-1958," Djakarta, 1958, Pages 108-109

Table 27

Outstanding Loans of Lembaga Djaminan Kredit, 1953-1957

End of	INDUSTRY Number				TRADE Number				COOPERATIVES Number				AGRICULTURE Number				TOTAL	
	Number	o/o of Total	Rupiah (000)	o/o of Total	Number	o/o of Total	Rupiah (000)	o/o of Total	Number	o/o of Total	Rupiah (000)	o/o of Total	Number	o/o of Total	Rupiah (000)	o/o of Total	Number	Rupiah (000)
1953	383	62.3	15,353	50.0	167	27.1	11,859	38.6	65	10.6	3,488	11.4	-	-	-	-	615	30,700
1954	521	61.1	19,956	49.2	226	26.4	14,752	36.3	107	12.5	5,881	14.5	-	-	-	-	854	40,589
1955	495	61.5	18,760	26.1	209	26.0	22,407	31.0	99	12.3	6,603	9.0	2	0.2	23,947	33.3	805	71,716
1956	464	61.9	18,737	24.8	195	26.0	23,367	30.8	89	11.8	6,449	8.5	2	0.3	27,150	35.9	750	75,703
1957	422	61.5	23,147	31.6	179	26.1	24,425	33.4	81	11.8	6,003	8.2	4	0.6	19,655	26.8	686	73,230

Source: Lembaga Djaminan Kredit

Table 28

Reported Arrears in Lembaga Djaminan Kredit Program
September 1952-December 1957

	Trade	Industry	Coops	Agriculture	Miscellaneous	Total
Credits Disbursed						
Number	353	680	162	2	2	1,199
Amount (Rp '000)	58,501	35,592	10,055	1,060	24,000	137,308
Credits Reported						
Number	166	362	74	2	2	606
Amount (Rp '000)1/	22,200	20,830	3,990	125	19,444	66,728
Percent Reported						
Number	47	54	46	100	100	51
Amount (Rp '000)	38	59	38	12	81	49
Arrears Reported						
Number	123	340	43	1	1	508
Amount (Rp '000)	11,987	11,873	2,156	8	11,344	37,368
Arrears as o/o of Credits Reported						
December 1957:						
Number	74	94	58	50	50	84
Amount (Rp '000)	54	57	54	1	58	56
December 1956:						
Number	71	87	54	-	-	78
Amount (Rp '000)	43	69	45	-	-	53

Source: Bank Indonesia, "Report for the Year 1956-1957," Djakarta, 1957, pages 98-99; "Report for the Year 1957-1958," Djakarta, 1958, Pages 108-109.

1/ Estimated from available data; not forced to add.

Ministry of Finance, technical advice comes from the Industry Service (or the other technical services) decisions are made by a committee drawn from several government agencies, while the only permanent staff is largely engaged in housekeeping functions and has little or nothing to say on decisions to lend money. Nobody seems to be really responsible for the onerous job of collecting the money that is overdue, and the agencies that recommend loans suffer no material penalty -- and very little blame -- if the loan goes sour.

One possible way to improve the LDK might be to give the national and provincial Secretaries more power to investigate applications, to make recommendations to the Board, and -- above -- to initiate and follow through on collection proceedings against delinquent borrowers. In some cases, an improvement in the staffing of the provincial LDK's would be necessary; in others, the staff seems to be quite capable.

The need for a greater number of competent people in the provincial offices might be minimized if something could be done to get better service out of Bank Rakjat. Perhaps Bank Rakjat officials might do a more conscientious and quicker job of investigation if their Bank were paid a fee for its services, rather than to be obliged to undertake LDK investigations as an onerous free service. Even though Bank Rakjat officials would not profit as individuals, their record as managers would improve when such fees are added to the other income of their branches.

Perhaps all the interest income from each loan should be held in escrow until the principal is paid up. Perhaps the government guarantee should be limited only to the principal sum, so that Bank Indonesia, Bank Rakjat, and the LDK itself would all have a pecuniary reason to prevent or to collect arrears. Perhaps a special effort should be made to bring LDK's records up to date, and to publish more detailed analyses of arrears.

New Lending might be stopped in the areas that have the worst record, so that provincial authorities would have some incentive to undertake greater responsibility for the LDK's success. Certainly it would be advisable to raise the limit on loan decisions by provincial Boards (perhaps to Rp 300,000) to take into account the effects of inflation on the cost of starting new businesses, and to inspire local authorities to take more interest in the program. Anything that is done will have to be closely related to the current plans for the establishment of provincial development banks, which are not yet clear.

Under Indonesia's present conditions there is a definite need for a program of government lending to smaller enterprises, such as has been undertaken by the LDK. Indonesia's would-be entrepreneurs start with very little experience, and very small resources. They are in no position to qualify for more normal forms of credit, even if these become available. Many of today's larger enterprises, which have progressed to the point where they can effectively use credit through private channels, started out with loans from the LDK and similar institutions. They might not have been able to start without some such source of government credit.

There has been a tendency to try to overcome the defects of LDK by setting up rival institutions to work in the same field, such as the Small Industries Fund (Dana Industri Ketjil) or DIK, and provincial banks. However, as the experiences of the DIK and of LDK itself have shown, the mere setting up of a new institution does not necessarily solve any problems.

The Dana Industri Ketjil was established at the urging of the Ministry of Industry officials, largely in reaction to the growing conservatism of the LDK. Industry Service officials became impatient with the time-consuming investigations, committee meetings, and formalities. They hoped that the difficulties of starting new industrial enterprises could be overcome by greater generosity in providing government credit.

Dana Industri Ketjil loans are administered through Bank Rakjat, but the Bank does not participate in any way in making decisions. Credits are granted for amounts of around Rp 10,000, after investigation by representatives of the Industry Service at the Residency level. Final action on applications is taken by the Provincial Inspectorate. Statistics are not readily available on the operations of the Dana Industri Ketjil, but the problems seem to be about the same as those under the LDK program.

The Bank Industri Negara (State Bank for Industry) or BIN, is the largest industrial financing agency of the government. Although originally started to mobilize private capital, it has depended almost exclusively on the credit and resources of the government. Assets are $50 million at the present BE rate of exchange, and probably are worth over $100 million at their replacement cost.

According to the latest available information, the liabilities of the Bank Industri Negara were as follows:

Table 29

Liabilities of Bank Industri Negara, 1955-1958

In Millions of Rupiah

	December 1955	December 1957	June 1958
Paid-up Capital & Reserves	272	618	627
Bonds	194	471	509
Current Account Deposits			
Special government deposits for relending to specific enterprises	n.a.	438	438
Other government deposits	n.a.	21	91
Other deposits	n.a.	25	47
Total Current Account Deposits	340	484	576
Credit from Bank Indonesia	55	77	92
Subtotal	521	1,650	1,804
Miscellaneous	31	85	n.a.
Total	552	1,735	n.a.

Sources: Bank Industri Negara, "Report on the First 5 Years of Its Existence," Djakarta, 1956, page 193.
Bank Indonesia, "Report for the Year 1957-1958," Djakarta, 1958, pages 101-102, and "Berita No. 15, Triwulan Kesatu dan Kedua 1958," Djakarta, August 1958, page 17.

The interest and principal of BIN bonds are fully[1] guaranteed by the Government of the Republic of Indonesia. Around Rp 100 million of the bonds have been sold to Dutch and other holders of blocked Rupiah. The remainder is almost entirely in the hands of Indonesian institutional investors. Recently the BIN was told to cease drawing directly on the government for financing. However, by issuing government-guaranteed bonds, the BIN continues to have access to the government's credit.

The BIN was originally established as an independent agency, to get around the difficulty of financing industrial undertakings through normal government procedures. According to its 1956 report,

> ". . . for financing of various private and semi-official enterprises an autonomous body was needed, because the implementation of such financial transactions is a matter which for organizational and administrative reasons cannot be executed within a ministry. . .it has become increasingly apparent that the organization of an official Government office is not suited to make the necessary day-to-day decisions and to execute them speedily, as is essential for commercial or industrial enterprises. Besides the bookkeeping of the State Budget is not suitable for the administration of the various items connected with the issuance and repayments of advances to industry."[2]

The BIN was organized to make loans or buy shares in productive enterprises, and also to provide technical assistance. Although only authorized to make long-term loans, the Bank has had to supply working capital loans to enterprises under its control, and particularly to those which have been losing money. Unfortunately, the Bank has not had sufficient technically trained employees to fulfill these functions well.

Despite what seems to be a very large payroll, the managers consider that the Bank is understaffed. An ambitious scholarship program has been started, to add another 40 university-trained engineers and economists, and 80 high-school graduates as junior officials. To make room for the

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1/ See "Prospectus Bank Industri Negara. . .Pindjaman à 5½% per 1972. . .", Djakarta, 1958.

2/ Bank Industri Negara (Indonesian State Bank for Industry), "Report on the first 5 years of its existence (April 4th, 1951-April 4th, 1956)", Djakarta, 1956, page 11.

growing staff, the present elaborate building of the Bank will be supplemented by Djakarta's first skyscraper, now under construction.

Although originally established to foster private enterprise, its main activity at present is in the development of government-sponsored industries. In this function it acts as a promoter and manager, rather than as a bank. According to the intention of its founders, the BIN was supposed to sell off its direct participations in industry as soon as the enterprises were firmly established. Some have already been sold (e.g.a shoe factory and a dairy farm, both taken over by co-operatives), and the Bank is trying to get government permission to sell others.

However, the government has been reluctant to let some enterprises out of its control. To some extent this has been because of fear that shares would be snapped up by Chinese interests, in the absence of Indonesian buyers. To some extent the government and the Bank have been reluctant to sell off the profitable enterprises, while potential buyers have been reluctant to buy the unprofitable ones.

Terms of the Bank Industri Negara's loans are relatively favorable. Loans are usually for a period of five years, at 7½% interest (plus a commitment charge of 1% on unused lines of credit). In addition the borrower must pay 5-10% of his net profits for five years as a "risk premium," or reward to the Bank for the risks involved in industrial lending. When the BIN began its activities, private borrowers were asked to put up 50% of the required capital. This requirement turned out to be too stringent, and was reduced to 33%.

Sometimes a private bank is called upon to act as the administrator of the loan, particularly in outlying areas where the BIN does not have offices of its own. However, the private bank is not expected to bear any of the risk itself.

The Bank's program of lending to private industry has not been very successful. In the Bank's experience, Indonesian entrepreneurs are not accustomed to using long-term financial loans, particularly from government-sponsored institutions. At present, according to high officials of the Bank, some 90% of all its loans to private firms are in arrears. In many cases, the Bank has taken over defaulting debtors, only to be accused of trying to squeeze out private entrepreneurs. Often attempts to collect are met with denunciations of the Bank as an agent of imperialism and a merciless exponent of capitalism. Control of a large number of widely scattered credits to smaller businesses has turned out to be physically difficult and expensive, eating up an undue share of the Bank's earnings. In any case, the Bank's managers point out, they do not have enough trained personnel to do a proper job.

According to the Bank's Board of Directors, the most successful part of its program has been in management of agricultural enterprises, including tea and rubber estates, and five sugar mills. In most cases these were taken over from a Dutch predecessor organization, set up to undertake the rehabilitation of war-damaged enterprises. The BIN has been less successful in managing a number of new industrial enterprises, established by other government agencies and later turned over the BIN for administration. In the words of one high BIN official, "many government agencies consider us to be a wastebasket, into which they can throw their failures." The BIN also manages a number of successful State-owned industries, including the $17 million Gresik cement plant (financed by a U.S. Export-Import Bank loan), a ramie-spinning plant in Central Sumatera, and a large cotton textile mill in Central Djawa.

By June, 1958, the BIN had made Rp 1,363 million in loans, and Rp 274 million in participations. Of the loans, 16% went to sugar plantations, 5.5% to other plantations, 62.5% to industry, 5.5% to warehousing and shipping, 7.5% to mining and 3% to other types of enterprises.

For the future, the BIN would like to concentrate on the large-scale processing of agricultural and silvicultural raw materials, by establishing paper, cotton- and ramie-textile and fiber-bagging mills. The Bank already has established a successful bagging factory using rosella fiber. Experiments conducted under the Bank's auspices have shown the possibility of growing cotton in Eastern Djawa and on some of the islands of Nusa Tenggara (albeit at a higher cost than U.S. cotton).

It is sometimes suggested that BIN should do more to finance private industries. However, BIN itself does not want this job. BIN managers are contemptuous of much of the industry built up in recent years, considering it a "hydrocephalic" (wasserköpfig) or parasitical growth. Private industrialists, they say, seem to look only for quick profits, and therefore have gone into assembly operations using a maximum of imported parts. The existing economic system, built up under the Dutch, is in their opinion a mixture of liberalism and controlled economy. In some areas of the economy fierce competition prevails, while in others special protected positions or monopolies were established for Dutch and certain other foreign investors.

The Indonesian population, in their opinion, was not able to develop its own entrepreneurial and managerial middle class. The BIN now seeks to act as a substitute for the missing middle class, particularly in developing larger enterprises, with capitalizations of around Rp 50 million. Indonesian private businessmen are able to raise amounts of perhaps Rp 1-2 million, but are not able to handle very large projects.

To the extent that private businessmen need financial help for their smaller enterprises they should, in the opinion of BIN's leaders, be directed to appropriate institutions like Bank Rakjat, with its 35 years of experience in small-scale credit. The BIN would welcome "competition" from other agencies in lending to private industry. For one thing, at present the onus of turning down unsuitable applications rests entirely on the BIN. Of every 100 applications that are brought in, some 90-95 are turned down.

In line with its efforts to become more of a managing agency for government industries (and less of a bank for private industries) the BIN is now opening up branches in Surabaya, Semarang, and Medan, and is preparing to open others in Padang, Bandjermasing and Makassar. The branch in Surabaya will have a special sugar office to manage the BIN sugar refineries.

As is perhaps inevitable for an institution of its size, Bank Industri Negara is the subject of much criticism in Indonesia. It is said that many if not most of its enterprises are losing money, and that most of those which make money do so as a result of their privileged access to import licenses. Some private entrepreneurs claim that after informing itself of their plans and turning down their applications, the BIN went ahead with an identical project on its own. It is said that the Directors and other high officials of the BIN spend much of their effort on ensuring themselves of high salaries, luxurious automobiles, and other perquisites of office.

It is difficult to assay the truthfulness of these criticisms. However, perhaps the most serious criticism is one which appears to be true. This is the charge that the BIN is subject to detailed intervention from politically minded figures in the government. It is a fact that the Board of Directors of the BIN is not independent, but is subject to instructions on policy from the Cabinet-level Monetary Board. It also seems to be a fact that instructions to the Bank (whether through the Monetary Board or through less formal channels) sometimes are based on political rather than economic criteria. Many of the Bank's apparent mistakes seem to have been committed against the will of the Bank's own directors in response to such political instructions.

Other government banks have taken part in long-term financing of industry at various times. Bank Negara Indonesia made a number of loans to industry before the BIN was established. At present Bank Rakjat also has taken some hesitant steps in this direction. There is a "gentlemen's agreement" giving BIN first refusal rights, but in several cases Bank Rakjat has been allowed to lend to industries (such as a singletfactory, a nail factory, and several small textile mills), usually when BIN lacked the financial resources to take on the project itself.

Bank Rakjat usually asks industrial borrowers to put up as security land, houses, or factory buildings, valued at 130% of the loan, and usually lends only up to 50% of the total cost of the project. The Bank does not consider machinery to be good security for a loan, since it is difficult to sell. Admittedly, very few potential entrepreneurs have sufficient resources to meed these conditions.

The program for cooperatives, administered by the Ministry of Commerce's Cooperative Service (Djawatan Kooperasi) is perhaps the most successful of all the government's long-term credit efforts. By the end of 1956, the loans outstanding amounted to Rp 56.6 million, borrowed by 3,454 cooperatives. The average loan was a mere Rp 16,393. (See Table 30.) Losses of this program have been negligible (although loans to cooperatives by other agencies, such as the LDK and the Mechanization Program, have been much less successful).

There are a number of reasons for the excellent lending record of the Cooperative Service. The Service has a number of very competent and devoted officials, who deal with the problem of cooperative development as a whole, rather than confining themselves to one aspect (such as financing or technical equipment). The Service insists on a maximum of self-help, and thus appeals to the pride of the beneficiaries. It refuses to lend until a cooperative collects a substantial share of the necessary capital from its own members. Loans to cooperatives are made at 10% interest, plus 10% compulsory savings. Cooperatives usually are required to find two-fifths of the necessary capital from their own resources.

Cooperative Service officials work closely with borrow ers before, during, and after the granting of the loan, to make sure that they money is used wisely and that new enterprises are properly administered. The Service is trained to work by persuasion, so that borrowing cooperatives not only are told what they should do, but also learn why it is in their own interest to follow the advice they receive. Caution has been exercised in venturing into fields requiring much technical knowledge. The Service is only now beginning to encourage cooperatives to start mechanical industries.

Total capital of the cooperative movement is now around Rp 700 million; only around Rp 70 million has come from government loans. As cooperatives succeed, they are encouraged and persuaded to set aside part of their profits as savings, which help to finance other cooperatives or their own future expansion plans. The movement is now planning to establish a Cooperative Bank in each province, to work as a chain with the central Bank Kooperasi Indonesia. Boards of Directors will come entirely from the cooperative movement, and there will be no direct government participation or control.

Table 30

Government Credits and
Subsidies to Cooperatives

In Thousands of Rupiah

	Credits		Subsidies	
Year	Amount	Number of Coops	Amount	Number of Coops
1950	2,135	7	25	14
1951	4,992	35	70	12
1952	3,137	71	144	29
1953	37,740	2,280	204	56
1954	45,928	3,894	145	61
1955	51,275	3,356	172	69
1956	56,623	3,454	98	58

Source: Djawatan Kooperasi

It is now government policy to encourage the cooperatives to stand on their own feet. This process has been facilitated by the recent passage of a Cooperative Law which for the first time gives cooperatives definite status as juridical persons.

The Indonesian cooperative movement began with credit unions for farmers, to combat the extortion by money lenders. Some handicraft industries, such as leather, sawmill, umbrella-making, iron and tile manufacture also have received cooperative credit. A strong cooperative also developed with government support in the batik industry. Only in 1955, however, was a serious effort made to branch out into other marketing and producing cooperatives. Cooperatives have even been founded successfully among such unlikely groups as small merchants (who have joined to build an impressive shopping center) and former prostitutes (now producing clothing and household articles).

The cooperative movement has now begun to take over plants of the LP3I (e.g. a large textile mill, taken over by the batik cooperative, a tannery, etc.). Finally, the movement has begun to buy up existing private industries, particularly for cooperatives whose savings have increased substantially above their reasonable needs for reserves. The copra cooperative, for example, has just purchased an oil factory in Kalimantan. In Central Djawa, a cooperative is erecting a cannery at a cost of Rp 60 million.

Chapter 6

Foreign Investment

To most Indonesians, "colonialism" means the studied arrogance that has been displayed by some white men to justify their rule over men of another color. To the average Indonesian, foreign investment means about the same thing as colonialism. In the limited experience of many Indonesians, a foreign investment is a business that discriminates against Indonesians. The average Indonesian probably does not like foreign investment of any kind, and does not want any more of it to enter his country.

A small minority of Indonesians (though perhaps a majority of those with higher educations) accept more or less reluctantly the fact that Indonesia needs foreign investment. Members of this small group recognize that their country needs not only foreign capital, but also foreign technical skill. Needless to say, almost all of them would prefer to obtain needed capital and skill as a gift or easy loan from some foreign government. However, many of them now recognize that aid from government sources is not enough, and does not provide all the kinds of help that are needed. There is, therefore, increasing willingness to let foreign private investors in, but only to the minimum extent that their presence is necessary to Indonesia. Practically no Indonesian would seriously think of welcoming foreign investors without qualification.

The attitude of this group towards foreign investors has been well stated by the Indonesian Finance Minister, Mr. Sutikno Slamet, in a speech to the American Association in Djakarta in May, 1957:

> ". . .For practical reasons, we have to leave a large field to private enterprise, probably to foreign enterprise because of the lack of capital and skill within the country. . .In Asia for the greatest part the Western enterprises remained foreign enclaves. Spirit, technical skill and capital did not become a part of the country where the enterprise has been established. Intentionally I mention capital in the last place because personally I put much more emphasis on the acquisition of necessary spirit and skill. . .
>
> "Against this background it is easy to understand why people in general are more in favor of forms of enterprise where responsibility will be directly

given to Indonesians. One rather extreme form is outright nationalization.

"There are other forms, however, which may commend themselves and are more beneficial for the economy than nationalization. I have especially in mind here the form where capital and management is supplied by foreign business for a fixed period of time. During this period the capital owner receives an agreed return on his capital annually. Moreover it may be agreed that he receives a fair share of the profits, if the venture proves to be profitable. . .I believe that such a form of cooperation, if necessary with some modifications, may be attractive also for foreign companies, who want to invest in these countries.

"For us it is attractive because since after a certain period of time the whole responsibility and ownership of the enterprise will be turned over to Indonesian nationals, the preparation and education for this responsibility can be undertaken systematically."

Dr. Loekman Hakim, Governor of Bank Indonesia, has expressed similar views on foreign investment in banks (in a speech to the Association of National Banks on 8 March, 1957):

". . .The question then arises, what is to be done about joint banks, of which the capital is partly foreign. This question can be viewed from two angles, from the (. . .short-term. . .) banking point of view and from that of an investment of foreign capital or foreign loan. From the banking point of view it is not possible to approve the establishment of a joint bank with foreign capital, as it increases the number of non-national banks in Indonesia. But if considered as an investment of foreign capital or as a foreign loan obtained through a joint bank, a joint bank may bring with it certain advantages.

"For that reason I feel that joint banks should be allowed to be established under certain conditions for the purpose of assisting in the development of Indonesia. The conditions may cover the management, the amount of foreign capital and the amount of Rupiah capital, the length of the permit and the rates of interest. It is also essential that the Government should fix the field

> of activity of joint banks. Joint Banks should not carry out general banking business, but should have the task of financing development projects. . .
>
> ". . .Thus, in my opinion, a joint bank, seen from the financial point of view, is a body that collects Indonesian savings and savings from a foreign country for the purpose of financing development projects in Indonesia.
>
> "In view of the task that can be given to a joint bank, a joint bank of this nature should not fall under the above mentioned ban against the establishment of new foreign banks. In my opinion it would not be necessary for the joint bank to have any branch offices in Indonesia."

There is no doubt that Indonesia's present government is sincere in its desire to attract more private foreign investment. In the Second Five Year Plan, now under preparation, the assumption is made that foreign investment will increase substantially. Recently the government risked severe political difficulties to put through parliament a new foreign investment law. By Indonesian standards, the new law represents a substantial concession to foreign investors, and is an important step forward.

The law establishes an administrative procedure to license foreign investment, for the first time since Indonesia obtained her independence. Certain fields, such as public utilities (including generation of atomic energy) are barred to foreign investors, as are "enterprises generally operated by Indonesian nationals." A Foreign Investment Council, consisting of the Ministers of Industry (as Chairman), Commerce, Finance, Foreign Affairs, Labor, the Director-General of the State Planning Bureau and the Governor of Bank Indonesia, can take the decision to grant licenses to others.

New investors may be guaranteed against expropriation or forced sale to Indonesian nationals for a maximum of 20 years (30 years in the case of agricultural estates). After the guarantee expires, the Council has, according to the law, the right to arrange for transfer of the property to a "national" entrepreneur. The number of foreign nationals who may be employed is subject to restriction, and foreign investors may be required to train Indonesians to replace some of their foreign staff over a period of time. Profits and approved salaries of foreign personnel may be transferred freely. Permission to repatriate capital may also be given.

Unfortunately, most foreign investors, in or out of Indonesia, seem to consider the new law to be some kind of warning to stay away. This is a measure of the great gulf that separates Indonesia and foreign private investors. There are, of course, some foreign investors who are interested only in making quick profits, who would find a 20 year guarantee against nationalization more than adequate. Such investors probably do not need a foreign investment law at all. The nature of their operations is such that they can -- and do -- take advantage of opportunities to invest clandestinely, without legal sanction or unwelcome attention from the tax authorities.

However, the type of foreign investors needed by Indonesia usually do not think in terms of a quick profit. They are interested in long-run development rather than speedily getting their money back. Their motives for making foreign investments are not solely the impersonal ones of pecuniary return. Development of a foreign subsidiary involves a considerable investment of scarce managerial and technical talent, as well as an investment of financial resources. While the latter might be justified by the hopes of a quick return, the former usually is undertaken for other reasons, such as the desire to establish long-term markets or dependable sources of raw material supply.

Today, many countries are anxious to encourage foreign investment. Countries looking for foreign investors are particularly interested in firms whose interests extend beyond immediate financial profits, and which are equipped to help in technological advancement. There is severe international competition for such foreign investors, involving advertising campaigns, special promotion offices in the U.S. and other investing countries, tax incentives, and other encouragements. In most cases, countries desiring foreign investment start by offering permanent guarantees against expropriation. In some cases guarantees are offered for a <u>minimum</u> period, such as 20 years. Indonesia is one of the very few countries that offer protection for a <u>maximum</u> period of time. Indonesia's foreign investment law does not meet the competition offered by other countries.

Paradoxically, one of the most active and most successful countries in attracting new foreign investment is the Netherlands. To make up for the loss of Indonesian earnings and markets, the Netherlands has offered special tax concessions, financial facilities, planning help, and generous guarantees to foreign investors. An extensive program of advertising and salesmanship has been undertaken. Particular efforts are made to attract industrial firms that can provide new technical skills, and employment for the Netherlands' rising population.

Needless to say, most of the many countries which seek to encourage foreign investment do not want and do not expect that that would lead to imperialistic encroachments on their sovereignty. None are in any way willing to tolerate insulting behavior on the part of foreign investors.

Indonesia could take a number of steps to attract foreign investors. Passage of a mining law (now under preparation) would make it legally feasible for foreign capital to help in opening up Indonesia's mineral resources. Signature of a guarantee of investment agreement with ICA would allow American investors to obtain U.S. Government insurance against inconvertibility, expropriation, and war risks, at no expense to the Indonesian government. The establishment of a foreign investment promotion office in Djakarta would do much to give foreign investors the impression that they are welcome. Such an office would help interested persons to cope with the difficult Indonesian government procedures and the language barrier, which makes them seem even more difficult than they are. An advertising and promotional campaign abroad would be desirable, but may be somewhat premature until some of the other steps are taken.

By far the most important step that could be taken would be somehow to encourage one or two substantial new investments. This would prove to potential investors that new foreign investment in Indonesia is not impossible. It would also help to demonstrate to Indonesians that new foreign investment can be in the interests of their country. To some extent, there is still a certain interest on the part of would-be investors in extractive industries such as petroleum and mining, since Indonesia's natural resources present a number of favorable opportunities for investment. However, with the end of the special protection granted by the Dutch administration, there is no longer any group that is generally interested in the investment possibilities of Indonesia. On the contrary, the political and economic uncertainty of recent years has frightened away most potential investors, and only a few are willing to think seriously about Indonesia.

Past imperialism has caused misunderstanding between Indonesians and potential foreign investors in two ways. One (already mentioned) was by leaving the impression that foreign investment means domination and racial discrimination. The other was by leaving the impression that foreign investors are eager to come to Indonesia. During the period of colonial rule there were indeed many foreigners who were anxious to work and invest in Indonesia. This was particularly true during the depression of the 1930's, when work was scarce at home both for men and for money. However, much of this eagerness was the result of the special privileges offered by the colonial system, rather than of the intrinsic desirability of Indonesia as a place to invest.

Many Indonesians were genuinely surprised when foreign investors failed to rush in to fill the vacuum left by the departure of the Dutch after the West Irian crisis. However, under existing conditions of world-wide economic activity there are few unemployed technicians, and on the whole there is no lack of opportunity for profitable employment of capital in the developed countries (such as the United States). To the extent that investors in the developed countries wish to venture abroad, they find attractive opportunities in nearer areas such as Canada, Mexico and Africa.

With an understandable urge to turn the tables and dominate the former dominators, many Indonesians propose that foreign investors be admitted only if they content themselves with 49% of the shares in an Indonesian enterprise, while Indonesian associates retain control in the form of 51% participation.

Most foreign investors, however, are just like most Indonesians: They do not want to be dominated by anybody. The desire to keep control in Indonesian hands -- even if foreign investors bring in the bulk of the money and technical knowledge -- has kept many foreign investors out of Indonesia. The few that have submitted to the 51% rule in the past sometimes have managed to retain actual control through various subterfuges. (Having contemplated the first step of cloaking their actual control, some have gone even further and have hidden the fact of foreign participation entirely. This is particularly true in cases of investment by foreign Chinese interests.)

In the final analysis, there is only one practical approach to the problem of foreign investment: foreign participants must be treated in a spirit of partnership and mutual confidence, or they will not come to Indonesia. In most cases a 50-50 sharing of control between foreign and local interests will provide a reasonably acceptable solution of the problem. In a 50-50 arrangement, neither party can go ahead against the wishes of the other, and therefore neither party can afford to try to dominate the other. Cooperation in a spirit of complete equality becomes essential if the investment is to be protected and made fruitful.

When Indonesians and foreign investors recognize the need to treat each other on a basis of mutual equality and good faith, Indonesia's foreign investment problem will begin to be solved. Until then, the basis for a contribution by foreign investors to Indonesia's development is very small.

Chapter 7

Conclusions and Recommendations: The Indonesian Development Finance Company, Inc.

In this study we have examined the relations between Indonesia's general economic problems and the special problem of financing industrial development. We have shown why industry and mining must be expanded, both on Djawa and on the outer islands. We have considered the problem of inflation, and have concluded that capital needed for development cannot be raised effectively by printing more money. We have examined Indonesia's banking system, and have found that by and large it has neither access to savings nor sufficient experienced personnel to provide long-term financing for industry. We have looked at the record of various government programs for long-term lending to industry, and have found that on the whole the results are discouraging. We have considered the possibility of attracting private foreign investment and find it limited by serious impediments within Indonesia as well as abroad.

It would be easy to let these facts be discouraging. However, there are encouraging as well as discouraging aspects to Indonesia's situation. Indonesia's problems are not mysterious: they can be identified, and they can be solved. At every point in our survey it has been apparent that Indonesia's greatest difficulty is the lack of experience. Unlike many other countries with similar problems, Indonesia has no lack of natural resources. Her resources would be adequate to support twice the population, if they could be put to work. Indonesia does lack capital, of course, but, as her Finance Minister has said, the shortage of capital is less important than the shortage of "spirit and skill."

To overcome her lack of experience, Indonesia needs time, and she needs help. So far, she has had very little time, but has made remarkable progress all the same. Perhaps the most remarkable progress in her scant decade of independence is that made by Indonesia's private industrialists. This is particularly remarkable since Indonesia's lack of experience is most acute in the field of private management. Although Indonesia's colonial rulers failed to train an adequate civil service, they had to allow some government officials to develop their skills. On the other hand, practically no Indonesians were enabled to obtain experience as industrial entrepreneurs. Thus, while it is possible to find old civil servants (and even retired civil servants) in Indonesia, it is practically impossible to find an industrialist with long experience.

Private industry's achievements so far, accomplished with relatively little aid, suggest how much more could be accomplished if some effective help were available. In no sense, however, should aid to private industry (including cooperatives) be considered a rival or alternative of the government's own industrialization plans. Indonesia's needs are so great that there should be ample room for all types of development. Indonesia's shortage of experience is so pressing that her big problem is to find competent management for the aid that is available, rather than to divide a limited amount of aid among competing competent groups. Aid to private industry is important because it taps a reservoir of competence that cannot be incorporated in the government's own industrial program. Successful Indonesian entrepreneurs usually are people who are temperamentally unsuited for government employment, and who can only contribute to Indonesia's industrial development as private individuals. In many cases, the most successful private industrialists would be unable to obtain a civil service job, because they lack the necessary formal educational qualifications. To the extent that private enterprise is allowed to develop, people of this type are able to devote their energy and talents to the satisfaction of Indonesia's need for industry. To the extent that privately owned industry is prevented from developing (e.g. by a reservation of certain branches of industry for the government or by discriminatory grants of financial advantages to government-owned enterprises), a part of Indonesia's scarce managerial resources are wasted. In some cases the individuals concerned may find alternative employment in private trade rather than industry, but probably not to the advantage of the country.

Since Indonesia's great lack is managerial talent, it is important to do everything possible to encourage the maximum use of available or adaptable people. Credit should be made available to new as well as to established entrepreneurs. Technical assistance should be available to those who have the necessary spirit, but have not yet had an opportunity to acquire the necessary skill. Assistance in marketing should be given to those who know how to produce but have not yet learned how to sell. In some cases, "spirit" may have to be infused into people who have skill and capital, but tend to apply their resources to speculation rather than to production.

In a developing society banks normally supply the credit requirements of private entrepreneurs. By exercising good business judgment, and a sense of public responsibility, the banks direct credit to those possessing the needed skills and "spirit." In this manner credit is reserved for enterprises that are able to make proper use of it, and others are encouraged to equip themselves as worthy recipients of bank credit. Indonesian banks are not yet able to serve industrial progress in this way.

Spurred on by inflationary conditions, the banks have more or less deliberately neglected industry to concentrate on more lucrative, less risky, and more familiar lending to trade. Therefore the government has been forced to establish *ad hoc* institutions outside the banking system, such as the LDK, DIK, and Bank Industri Negara. Unfortunately, these have not been entirely successful. To an even greater extent than existing institutions, the new financial agencies have been handicapped by Indonesia's basic problem of lack of experience. As government agencies, they have had particular difficulty in convincing borrowers of the need to pay back loans. In some cases, they have suffered from more or less well-meaning political interference, which at times has made it difficult for them to decide objectively on the merits of loans. Efforts to reduce the possibility of political intervention have led to the swaddling of operations in massive red tape. To avoid these difficulties, it would be desirable to encourage the banks to enter into their normal roles as mentors and censors as well as the suppliers of credit for industrial development.

Indonesia's need for rapid industrial development is urgent, and cannot safely be left unsatisfied. However, it may well be left unsatisfied, if private entrepreneurs are not given every reasonable stimulus and assistance to devote their human and financial resources to industrial progress. We have shown that Indonesia's banks and other credit agencies as they function today are not giving, and are not equipped to give, the necessary stimulus; in fact, the credit agencies themselves need assistance. However, it is possible and desirable to bring to the private industrialist, on a merit basis, the financial and technical assistance that he needs. This can be done in a manner that will place no drain upon the human and financial resources of the Government. It can be done with and through the existing national banks, in a way that will indoctrinate them with the principles of sound banking, and will inculcate in them a sense of moral obligation for the industrial development of the Indonesian economy.

We therefore propose the formation of a new credit institution,

(a) to be capitalized from private resources, both domestic and foreign,

(b) to receive foreign exchange loans (repayable in Rupiah) from the U.S. Development Loan Fund,

(c) to be under private management, but operating within the government's economic development policies,

(d) to work through the national banks on a basis of sharing the risks and the profits, in the negotiation and servicing of loans,

(e) to have trained technical staff, so that decisions on loans may be made on objective grounds and with the help of adequate information, and

(f) to lend to privately owned enterprises with borrowers widely dispersed throughout Indonesia.

Insofar as possible, the need for government guidance on details -- as distinct from general policies -- should be avoided. Indonesian government agencies already are overburdened with responsibilities, and do not have enough trained personnel to meet existing demands. Government procedures are often time-consuming and government officials are subject to arbitrary pressures which they do not have the time to counteract properly. The limited resources of men and money available to the government are in great demand to meet a multitude of pressing needs. It is therefore important, to the extent possible, to develop an institution that can run itself within the framework of the government's general policies, without calling on the government for day-to-day decisions.

This is particularly important because some past efforts by the government to help private industry have been abused by the beneficiaries. Some government loans to private business are in default, and there seems to be a widespread feeling that obligations to the government do not have to be met. As a result, many government leaders are justifiably skeptical about the desirability of further generosity towards private interests, and are looking for signs that private industry is willing and able to help itself. Therefore the new institution should if possible represent a self-help effort, relying as little as possible on government resources, guarantees, or sponsorship.

Finally, the new institution must take into account the fact -- inescapable under present circumstances -- that Indonesia must obtain additional foreign capital in some way if she is to make reasonable economic progress while retaining her dearly bought political freedom. At present low living standards, Indonesian savings amount in good years to perhaps 6% of her national income. Even this extremely low figure for capital formation is not being realized under present abnormal circumstances. Real progress can only come, therefore, from productive application of foreign capital, or by sacrificing freedom to squeeze abnormal savings out of the already low living standards of the population.

Private and cooperative industry cannot flourish in an economy of large forced savings. The proposed institution therefore would be self-defeating if it did not itself help to solve the problem of capital shortage, both by attracting new foreign capital and by helping to ensure the productive use of savings that now escape from social control (particularly the so-called "hot money"). The new institution should seek to appeal to as many potential new sources of capital as possible. For example, it should be available as a channel for private as well as public foreign capital, for European as well as American capital, for equity as well as loan capital.

For the time being, some of the efforts to tap new sources of foreign capital may be of limited practical usefulness. They may serve more as tokens or precedents, than as a large immediate contribution to Indonesia's immediate needs. However, such precedents may be particularly important in the near future, since they would help to obtain serious attention for Indonesia's new foreign investment policies.

Finally, if possible something should be done to bring in foreign private investment, not only to raise capital, but also -- and primarily -- to obtain the benefits of foreign managerial and technical skills. To the extent possible, the understandable desire of most Indonesians to limit foreign participation in their economy must be taken into account. However, account should also be taken of understandable unwillingness of foreign investors to come in where they seem to be unwanted.

In summary, a plan is needed that takes account of Indonesia's difficulties, and despite those difficulties will help Indonesia's small and medium-scale entrepreneurs to develop industrial activity. It should provide for a maximum use of existing Indonesian banking facilities, so as to avoid the need to build up a large staff of its own. It should provide for the availability of foreign experience and technical assistance, in a manner fully consistent with Indonesia's desire for national independence.

In our opinion, this can best be done as follows:

1. A joint Indonesian-foreign corporation (Perseroan Terbatas) should be established in Djakarta, with the name of "P.T. Badan Pembiajaan Pembangunan Indonesia (Indonesian Development Finance Company, Inc.)," hereafter called BPPI. The share capital will be Rp 9 million.

2. The share capital will be divided equally between foreign investors and Indonesian private shareholders, as follows:

a. Rp. 4.5 million will be divided among a number of foreign investors that are interested in the economic development of Indonesia. Possible investors include:

California-Texas Oil Co. (American)
Goodyear Tire & Rubber Co. (American)
Hoechst Chemical Co. (German)
Montecatini (Italian)
National Carbon Co. (Eveready batteries; American)
Olivetti (Italian)
Siemens Electrical Co. (German)
Standard Vacuum Oil Co. (American)

b. Rp. 1.5 million will be taken by the Indonesian Private National Bankers' Association (Perbana)

c. Rp. 1.5 million will be taken by the Indonesian Chamber of Industries (Madjelis Industri)

d. Rp. 1.5 million will be taken by the Escomptobank, provided that it will carry out its plans to become a private national bank in the near future.

The foreign investment will be made in foreign exchange, under the provisions of the new foreign investment law.

3. The BPPI will be authorized to issue Rp. 50 million of non-voting cumulative preferred stock as bearer shares. These could be sold either to foreign investors or to buyers within Indonesia, particularly holders of "hot money." The preferred stock will pay 4% dividends on the foreign exchange amount invested, or on the equivalent in Rupiah at the current rate of exchange for capital imports.

4. The Board of Directors of the BPPI will consist of two representatives of the foreign investors and three representatives of the Indonesian private shareholders. The Board of Directors will decide on all important actions of the BPPI.

5. The BPPI should have a Governmental Advisory Board composed of the Director-General of the Biro Perantjang Negara, and representatives of the Ministry of Industry, Ministry of Finance, and Bank Indonesia. The Board will advise the BPPI on the general economic policy of the government.

6. The Board of Directors of the BPPI will appoint an Indonesian Manager (Direktur), who will be assisted by an Indonesian staff of approximately eight professionals in carrying on the day-to-day work of the corporation. The Indonesian staff will be helped by a Technical Assistance and Training Team, of an approximately equal number of experts, to be provided as economic aid by the U.S. ICA.

7. The BPPI will apply as soon as possible to the U.S. Development Loan Fund for a loan of 10 million dollars. The loan should bear 4% interest and should be repaid over ten years in Rupiah (at the rate of exchange for capital imports) to a blocked account of the Development Loan Fund (DLF) in Indonesia. The BPPI will endeavor to obtain approval of the DLF to re-lend the Rupiah as a revolving fund to promote Indonesian private industrial development. While the Indonesian Government will approve of the borrowing by the BPPI, it will <u>not</u> guarantee the loan in any way.

8. The BPPI will seek to spread its activities equitably over the entire area of Indonesia. It will lend a maximum of 20% of its resources in any one province, and a maximum of 50% in any one island of the Republic of Indonesia.

9. A private or cooperative productive enterprise that wishes to borrow from the BPPI will go first to any national bank of its choice (such as the Bank Rakjat, Indonesian Banking Corporation, a provincial cooperative bank, etc., etc.). In principle, the borrower will be expected to provide at least 25% of the necessary capital himself (in Rupiah), and to show some record of successful operation as an industrialist (even if only on a small scale).

10. The national bank would examine the proposal, and if satisfied would agree to sponsor the application to the BPPI. In sponsoring the application, the national bank would guarantee some or all of the risk.

11. The staff of the BPPI would also examine the proposal, particularly to make sure that it is technically and economically sound, and that adequate technical management is available or will be obtained by the borrower. The BPPI staff may provide technical assistance to the borrower to help him to qualify for a loan. The staff will then make its recommendation to the Board of Directors of the BPPI.

12. If the Board of Directors approves the loan, foreign exchange or Rupiah will be made available by the BPPI through the borrower's bank, to pay for machinery, construction, etc. Imports will be licensed "without foreign exchange" by the Biro Devisen Pardagangan after a routine price check. Payment of TPI will be deferred by the government in accordance with the terms of the loan by the BPPI.

13. The borrower will pay interest and amortization in Rupiah at the rate of exchange for capital imports. Collections will be made through the bank which has guaranteed the loan. The guaranteeing bank will receive a part of the interest income from the borrower.

An application to the U.S. Development Loan Fund, based on this proposal, made by the Perbana, Madjelis Industri, and Escomptobank, follows this Chapter. We recommend its approval by the U.S. and Indonesian Governments.

Extract from Application to the
Development Loan Fund

1. Letter from the Committee of Founders of P.T. Badan Pembiajaan Pembangunan Indonesia to the Development Loan Fund.

December 4, 1958

Development Loan Fund
Washington 25, D.C., U.S.A.

Gentlemen:

The undersigned Committee of Founders of the "P.T. Badan Pembiajaan Pembangunan Indonesia" (Indonesian Development Finance Company, Inc.), hereinafter called BPPI, hereby apply for a loan of $10,000,000, to finance small and medium scale industrial development by Indonesian private enterprises. Proposed terms of the loan are as follows:

1. The loan is to be repaid in installments over ten years, beginning two years after funds are drawn down. It is anticipated that the full amount of the loan will be drawn down within two years after the loan is granted.

2. The loan may be used to purchase capital goods and services, including spare parts and initial working stocks for existing and new enterprises, to be imported into Indonesia for the account of private Indonesian enterprises (including cooperatives) which borrow from the BPPI.

3. Interest to be charged by the Development Loan Fund will be three and one-half percent per annum.

4. Interest and amortization will be paid by the BPPI in Rupiah to a special account in the name of the Development Loan Fund.

5. The loan will not be guaranteed by the Government of Indonesia. However, the Government has approved the general terms of our proposal, and will be asked to approve the details of the loan from the Development Loan Fund when they become available. Our correspondence with the Indonesian Minister of Industry is attached as Appendix A.

The BPPI will be a privately owned joint Indonesian-foreign corporation under Indonesian law. A translation of the proposed charter is attached as Appendix B. The share capital of Rp. 9,000,000 will be divided into 18 voting shares, as follows:

Nine shares will be owned by foreign investors. Among the possible foreign investors are:

California-Texas Oil Co.
Goodyear Tire & Rubber Co.
Montecatini
National Carbon Co.
Olivetti
Siemens & Halske A.G.
Standard Vacuum Oil Co.

Three shares will be owned by the Madjelis Industri Indonesia (Indonesian Council of Industries). Information on this organization is attached as Appendix C.

Three shares will be owned by the Persatuan Bank-Bank Nasional (Association of Private National Banks). Information on this organization is attached as Appendix D.

Three shares will be owned by the Escomptobank N.V. Appendix E gives information on this bank.

The shareholders will elect a Board of Directors consisting of two representatives of the foreign shareholders and three representatives of the Indonesian shareholders. The Board of Directors will appoint an Indonesian manager. The U.S. International Cooperation Administration will be asked to provide a technical assistance and training team of approximately eight experts to assist in the development of an Indonesian staff.

The BPPI will make long-term loans to private industrial and mineral enterprises, through and with the guarantee of existing national banks or other appropriate financial institutions in Indonesia. The borrower will be expected to provide around 25% of the total financial requirements from his own resources. The BPPI will lend no more than 20% of its total available resources in any one province, and no more than 50% in any one island of the Republic of Indonesia.

Appendix F gives further details and explanations related to this proposal, which has been prepared by the Continental-Allied Company, Inc., under a contract financed by the International Cooperation Administration to provide consultation and assistance to the State Planning Bureau (Biro Perantjang Negara).

We will, of course, be glad to make available any further information that may be desired by the Development Loan Fund.

Sincerely yours,

Committee of Founders of the
P.T. Badan Pembiajaan Pembangunan
Indonesia

c/o Escomptobank N.V.
Djakarta/Kota, Indonesia

/s/	/s/	/s/
Escomptobank N.V.	Madjelis Industri Indonesia	Persatuan Bank-Bank Nasional
(J.D. Massie, Managing Director)	(Harlan Bekti, Member Board of Directors)	(Sadjito, Chairman)

2. Letter from Committee of Founders of BPPI to the Minister of Industry, Indonesia.

The Committee for the Foundation of
the Indonesian Development Finance Company, Inc.

November 3, 1958

His Exc. The Minister of Industries
Republic of Indonesia
D j a k a r t a

Your Excellency:

The Escompto Bank, the Board of Industry, and the Association of National Banks have agreed to be the founders of the P.T. BADAN PEMBIAJAAN PEMBANGUNAN INDONESIA (BPPI = Indonesian Development Finance Company, Inc.) under the following conditions:

1. Fifty percent of the shares of stock will be owned by the Indonesian founders of the company.

2. Fifty percent of the shares of stock will be sold to foreign capital investers.

3. The Indonesian founders will elect 3 members of the Board of Directors. The foreign investers elect two members of the Board of Directors.

4. The BPPI will make long-term loans to Indonesian business enterprises, be they privately owned or owned by cooperative bodies. The loans will be made through already existing national banks.

5. The BPPI will have a Consultatory Board to be composed of high Government functionaries to aid the company in meeting such requirements as are in agreement with the general economic policies conducted by the Government.

6. The Indonesian founders immediately will request the US Development Loan Fund for the loan of US$10,000,000.- which will be repaid in rupiahs to a blocked account. The Indonesian Government will not be requested to give a guaranty for the loan.

more.

7. The Indonesian founders will request from the International Cooperation Administration of the US Government for experts to assist the BPPI Board of Directors.

Enclosed herewith please find a copy of the BPPI corporate charter.

We understand that approval for the details of our proposal has to be secured from the concerned Government agencies including the Monetary Council, the Foreign Investment Board, and the Ministry of Justice. However, we would highly appreciate your giving us the Government's approval in principle for our proposal.

Yours very truly,
The Committee of Founders
BPPI

____
Escompto Bank

____
Board of Industry

____
Assn. of National Banks

3. Letter from the Minister of Industry to
The Committee of Founders, B.P.P.I.

THE MINISTRY OF INDUSTRY
Republic of Indonesia

Djakarta, November 10, 1958.

No. 9419/M

Enclosure:

Subject: The $10 million loan from the Development Loan Fund.

The Committee of Founders
B.P.P.I. (Indonesian Development Finance Corporation)
D j a k a r t a

Dear Sirs,

Your letter of November 3, 1958 is in our possession and has been considered by us. In reply please note that the final approval of the proposal submitted by you will be issued as soon as it has been scrutinized by the appropriate agencies. This also means:

1. The thorough examining by the Monetary Council of the actual conditions of the proposed $10,000,000,- loan from the Development Loan Fund.

2. Scrutiny by the Government competent officials of the actual conditions of the proposed investment of capital by foreign private shareholders in the B.P.P.I. (Indonesian Development Finance Corporation).

3. Approval by the Ministry of Justice of the B.P.P.I!s Charter (literally: of the Rules of the B.P.P.I; trl).

4. Clarification of the status of the Escompto Bank, which is now in the stage of being discussed with the Government agencies that have authority in the matter.

5. Other conditions may be determined after the proposed details have been scrutinized.

However, though the matter is still dependable on the settlement of conditions, which need the detailed approval of the Government, I hereby can state my approval in principle of the proposal you have made. I would suggest you send in an application to the Development Loan Fund for a loan amounting to $10 million, which will be paid back in rupiahs to a blocked account. I would say it would be better that the Government be not asked to guarantee this loan.

The Minister of Industry

(Ir. F. J. Inkiriwang)

DRAFT CHARTER OF "INDONESIAN DEVELOPMENT FINANCE COMPANY, INC."

LIMITED LIABILITY CORPORATION (PERSEROAN TERBATAS) P.T. BADAN PEMBIAJAAN PEMBANGUNAN INDONESIA (INDONESIAN DEVELOPMENT FINANCE COMPANY, INC.)

Witnesseth:

On this ______ day of __________________, there appeared before me, ____________________________, a notary in Djakarta, in the presence of witnesses that I, the notary, know and will list at the end of this document, the following persons;

____
____
____
____

who are known to me, and who declare, subject to the provisions of the law, the establishment of a limited liability corporation having a charter as follows:

NAME AND DOMICILE

Article 1

This Corporation acts in the following name: "P.T. BADAN PEMBIAJAAN PEMBANGUNAN INDONESIA (INDONESIAN DEVELOPMENT FINANCE COMPANY, INC.)" and has its domicile in Djakarta.

PURPOSE AND GOAL

Article 2

The purpose and goal of this Corporation are as follows: to lend or otherwise invest foreign exchange or rupiah in medium and small-scale industrial, mining and other productive developments that will further the economic progress and welfare of the Republic of Indonesia, and for this purpose to borrow or otherwise obtain resources, both in Indonesia and abroad, on terms that will be mutually beneficial to Indonesia and the source of capital.

a. The Corporation may make long-term loans or investments, either in terms of rupiah or in terms of foreign exchange, to industrial, mining and other productive firms organized under the laws of the Republic of Indonesia, for economic developments located within Indonesia.

b. No more than 20% of the Corporation's total resources may be loaned or invested for use in any one province, provided also that no more than 50% may be for use within any one island of the Republic of Indonesia.

c. In principle, loans or investments shall be made through and with the guarantee of a bank or other appropriate institution or consortium of institutions. The Corporation shall satisfy itself as to the ability of the guarantors to fulfill their obligation.

d. In principle, the borrower or beneficiary shall in every case be required to participate in the cost of the new investment to a minimum of 25% of the total.

e. In addition to lending its own resources, the Corporation may, to the extent permitted by law, guarantee the obligations of Indonesian firms to foreign lenders, up to the total to be determined by the Board of Directors.

f. The Corporation shall not compete with the short-term credit facilities provided by existing banks in Indonesia. However, the Corporation may make long-term loans or investments for permanent working capital requirements, as well as for the purpose of financing fixed capital investments.

g. The Corporation shall not compete with the existing government agencies in the long-term financing of government-owned and large-scale enterprises, but will lend or invest to finance privately or cooperatively owned enterprises.

h. The Corporation may provide technical and managerial services to businesses and financial institutions within Indonesia, or to persons outside Indonesia who are interested in the possibility of investing in the develolment of Indonesian industry. The Corporation may charge a fee for such services at its discretion.

i. The Corporation shall use its best efforts to help the Indonesian economy by mobilizing private savings, particularly savings which are not now available for productive investment ("hot money").

DURATION

Article 3

This limited liability corporation begins on the day when this Charter is approved by the authorities in accordance with decisions concerning paragraph 51 of the Commercial Code, and continues for a period of 75 years.

CAPITAL

Article 4

1. The voting share capital of the Corporation amounts to Rp. 9,000,000 (nine million rupiah) divided into:

   a. 9 (nine) Series A shares, each amounting to Rp. 500,000 (five hundred thousand rupiah);
   b. 3 (three) Series B shares, each amounting to Rp. 500,000 (five hundred thousand rupiah);
   c. 3 (three) Series C shares, each amounting to Rp. 500,000 (five hundred thousand rupiah);
   d. 3 (three) Series D shares, each amounting to Rp. 500,000 (five hundred thousand rupiah).

2. The above-mentioned voting share capital has been partly paid in and will be fully paid in by the time this Charter is approved by the government authorities, up to a total of Rp. 9,000,000 (nine million rupiah).

SHARE CERTIFICATES

Article 5

1. Share certificates are issued in the name of the owner.

2. The name of the owner is written on the share certificate by the management.

3. One certificate is issued for each share, and is accompanied by a dividend participation warrant, having one coupon for each dividend participation to be received.

4. Share certificates have a serial number and are signed by the Chairman and Secretary of the Board of Directors, while dividend warrants and their coupons must bear the same number as the accompanying share.

5. Share certificates may be divided.

6. The Corporation only recognizes one person as the owner of a share; if a share is divided or for other reasons becomes the property of several persons, those persons holding joint ownership are required to appoint one among them or some other person as their joint representative, and only this representative alone is entitled to exercise the rights conferred by law on the aforesaid share.

7. A person who legally controls a share must submit to this Charter and to all decisions taken legally by the general meeting of shareholders.

NON-VOTING PREFERENCE SHARES

Article 6

1. The Corporation may issue cumulative non-voting preference shares up to a total of Rp. 50,000,000 (fifty million rupiah).

2. Preference shares are issued to the bearer. They may be sold to persons within Indonesia, or to foreign investors.

3. The corporation may undertake to redeem preference shares out of its reserves within a specified period of time.

4. The rate of dividend on preference shares is 4 (four) per cent. The nominal value of the shares may be stated in terms of foreign currency for foreign shareholders, and shall be an equivalent amount of rupiah at the effective official exchange rate for capital imports for shareholders within Indonesia, to be determined annually as of the day when the books of the Corporation are closed.

DUPLICATES

Article 7

1. If share certificates, dividend warrants and/or coupons are destroyed and cannot be employed again, the Board of Directors, at the request of the person concerned, issues to him duplicates.

2. Original certificates then are cancelled and a proces-verbal of this action is made by the Secretary of the Board of Directors, and is also signed by the Chairman; it is reported in the next general meeting of shareholders.

3. If share certificates, dividend warrants and/or coupons are lost, the Board of Directors, at the request of the person concerned, issues duplicates of the lost certificates, if in its opinion the loss is adequately proven, and guarantees considered necessary by the Management in any particular case are provided.

4. After the aforesaid duplicates are issued the original certificates no longer are valid with respect to the Corporation.

5. The issuance of duplicates because of loss of the original shares must be advertised in the State Gazette (Berita Negara) and in a daily newspaper which appears at the seat of the Corporation.

6. Any costs connected with the issuance of duplicates must be paid by the person concerned.

SHARE REGISTRATION BOOK

Article 8

1. A share registration book is provided for the share certificates, in the office of the Corporation; in this book are written the name and residence of the shareholders, as well as other information which is considered necessary.

2. Every change of residence of a shareholder must be reported in writing to the Board of Directors.

3. If this report is not made, all calls and notices can be made legally at the last residence address written in the share registration book.

4. Transfer of shares must be based on a written statement signed by the transferor and the receiver of the transfer, or representatives, or must be based on other documents which in the opinion of the Management appear to be a legal basis for the transfer.

5. The aforesaid transfer is executed by noting the surrender, in writing, in the share registration book, and on the transferred share certificate, showing the date and signature of the Chairman and the Secretary of the Board of Directors. These persons only permit the share to be transferred if conditions of transfer which are specified in these statutes have been fulfilled.

6. From the day of the call for a general meeting of stockholders until the day of this meeting, transfer of shares is not permitted.

7. The Board of Directors is required to maintain the share registration book in the best possible manner.

8. Every shareholder has the right to see the aforesaid share registration book during the Corporation's office hours.

OWNERSHIP OF SHARES

Article 9

1. Voting shares in this Corporation may only be owned, and the rights of shareholders may only be exercised by private persons, or by legal bodies whose members or shareholders and whose Board of Directors consist in the majority of private persons. Corporations owned or controlled by foreign governments or by the Government of Indonesia are not considered to be private persons for purposes of this paragraph.

2. Shares of Series B, C and D may only be owned, and the rights of shareholders may only be exercised by persons or bodies recognized by the Indonesian government as Indonesian national persons or bodies.

3. As a transitional measure, subject to the approval of the Indonesian Government, shares of Series D may be owned for three months by a private bank, domiciled in Indonesia, which is being reorganized so as to obtain recognition as an Indonesian private national bank. If the Board of Directors wishes, and if the approval of the Indonesian Government is obtained, this period may be extended.

TRANSFER OF VOTING SHARES

Article 10

1. If for any reason the holder of a voting share wishes to sell it, or no longer qualifies as a shareholder under the terms of Article 8, the share must be offered for sale at the nominal value to those other shareholders who are qualified to purchase shares in that series.

2. If the other qualified shareholders do not exercise their rights to purchase the share, it will be offered to other qualified persons who have been approved by the general meeting of shareholders.

3. If these conditions are not fulfilled, the share ceases to have voting rights, and ceases to be entitled to payment of dividends.

MANAGEMENT

Article 11

1. This Corporation is managed by a Board of Directors which has five members.

2. The Board of Directors selects from among its members a Chairman, a Deputy Chairman, and a Secretary.

3. The members of the Board of Directors are elected by the general meeting of shareholders, from nominations which are made by the holders of shares as follows:

   a. The holders of shares of Series A will nominate at least 4 (four) candidates, of which two will be elected;

   b. The holders of shares of Series B will nominate at least 2 (two) candidates, of which one will be elected;

   c. The holders of shares of Series C will nominate at least 2 (two) candidates, of which one will be elected;

   d. The holders of shares of Series D will nominate at least 2 (two) candidates, of which one will be elected.

4. The members of the Board of Directors are elected for an indefinite period; however, for the first time for a period of three years, but can be re-elected thereafter. The general meeting of shareholders retains the full right to dismiss them at any time.

5. The Board of Directors selects one of its members or some other person as a Manager, who can be assisted by several Deputy Managers in conducting the day-to-day business of the corporation.

6. Members of the Board of Directors may be given salaries and/or allowances whose amount is fixed by the general meeting of shareholders, while the Manager and Deputy Manager can be given salaries and/or allowances that are fixed by the Board of Directors.

7. If for any reason a vacancy occurs in the membership of the Board of Directors, the general meeting of shareholders must be called within one month after occurence of the vacancy to fill it, taking into account the provisions of paragraphs 1 and 3, above.

POWERS OF THE MANAGER

Article 12

1. The Manager directs the Corporation in and out of courts of justice, and therefore is entitled to act and sign in the name of the Corporation, binding the Corporation with regard to others, or binding others with respect to the Corporation and exercising all rights and powers that concern the property of the Corporation as well as those that concern the Management.

2. The Manager must obtain written agreement (permission) from the Board of Directors, (which is sufficiently documented by instructions from the Chairman, or his Deputy, together with the Secretary and one member) in the following cases.

   a. Lending or borrowing money;

   b. Purchase of real property for the Corporation, sale, mortgaging or any other transfer or encumberment of real property and business enterprises;

   c. Obligating the Corporation as a guarantor or cosigner;

   d. Pawning of objects in the possession of the Corporation

3. The Deputy-Manager helps the Manager when the Manager is prevented from acting, or is not present (which does not have to be proven to other parties) and assumes all the rights and powers of the Manager.

4. Division and relations of work between the Manager and Deputy-Manager are determined by the Board of Directors.

BOARD OF DIRECTORS

Article 13

1. The Board of Directors has the authority to supervise the activities of the Manager and Deputy-Manager, and conducts its activities as provided in the by-laws of the Board of Directors.

2. The members of the Board of Directors, together or individually, have the right to enter during business hours the buildings, premises or other places that are used and/or controlled by the corporation, and have the right to inspect books, documents, correspondence, to inspect and audit the cash on hand and to obtain other information on the situation of the corporation and on all actions which are taken.

3. The Manager and Deputy-Manager are required to give information concerning situations which are questioned, as needed for supervision and investigation.

4. The Board of Directors, by an absolute manjority vote, has the power at any time to suspend from duty or to discharge the Manager and/or Deputy-Manager if he/they act contrary to this Charter or neglect their duties, or for any other important reasons.

5. If the Manager and/or Deputy-Manager are suspended from power, the Board of Directors within one month is obliged to provide for a meeting of the members of the Board, which meeting shall decide whether the Manager and/or Deputy-Manager in question should be dismissed, or whether the aforesaid suspension of duties shall be cancelled. During this meeting the person in question is given an opportunity to be present and to defend himself. This meeting is led by the Chairman; if the Chairman is not present, by the Deputy, and if he also is not present, by a person elected from among those that are present.

6. If the meeting of members of the Board of Directors does not take place within one month after the above-mentioned suspension from duty, that suspension from duty is cancelled in accordance with the law.

7. The Board of Directors holds a meeting at any time, if this is considered necessary by one of its members or by the Chairman.

8. The call for a meeting of the Board of Directors is made in writing, not less than fourteen days before the holding of the meeting is considered necessary, and if the matter for discussion should have to be settled immediately, the time can be shortened to seven days.

9. The meeting of the Board of Directors is only able to take legal decisions if attended by more than half the members, or their alternates.

10. Each member of the Board of Directors has the right to cast one vote.

11. All decisions are taken by majority vote in the usual way. If the number of votes for and against is equal, then the decision is taken by a lottery if it concerns a person, and is considered negative if it concerns other matters.

12. In every meeting minutes are made at the initiative of the Chairman, on such matters as decisions signed by him, and the persons among the members who are present.

13. Decisions of the Board of Directors are also taken outside the meeting in written form, provided that proposals which are introduced have been made known to all members of the Board of Directors, and have been accepted by at least as many votes as are needed in the meeting to decide the issues which have been raised, when attended by all members.

14. In the meeting of the Board of Directors the Manager and Deputy-Manager may be invited to join and attend to bring advice and information where necessary.

BOARD OF ADVISERS

Article 14

1. The Board of Advisers is established to review the general policies of the Corporation, and to advise the Board of Directors whether those general policies are in conformity with the general economic policies of the Republic of Indonesia.

2. The Board of Advisors consists of:

   The Director General of the State Planning Bureau
   The ______________________ of the Ministry of Industry
   The ______________________ of the Ministry of Finance
   The ______________________ of Bank Indonesia

   Members of the Board of Advisers may be represented at meetings of the Board of Advisers by an alternate.

3. The Board of Advisers meets regularly once every three months. It may hold extraordinary meetings at the request of any one of the members, or of the Board of Directors of the Corporation. The Board of Advisers is entitled to obtain any information it may desire as to the policies or operations of the Corporation, from the Board of Directors or from the Management. The Board of Advisers may report on its findings to the Board of Directors, or to the Monetary Board of the Government of the Republic of Indonesia.

4. The Board of Advisers does not intervene in the day-to-day operations of the Corporation, and does not influence decisions on individual loans.

5. If considered necessary by the Board of Directors, they may appoint one or more other advisers, who are authorized to give advice where necessary and if requested by the Board of Directors or by the Manager and Deputy-Manager.

6. Conditions of appointment and salaries/fees of advisers are decided by the Board of Directors.

BALANCE SHEET AND PROFIT AND LOSS STATEMENT

Article 15

1. The bookkeeping year of the Corporation runs from 1 January to 31 December. At the end of the month of December in every year, for the first time at the end of December, nineteen hundred and fifty nine, the books of the Corporation will be closed.

2. In closing the above-mentioned books, the Manager prepares a balance sheet and profit and loss account, which is reviewed and accepted by the Board of Directors, along with other documents, justifying the year's activities. These must have been made available at the office of the Corporation at the latest fourteen days before the beginning of the annual general meeting provided by Article 16 below, for review by the shareholders.

3. The above-mentioned balance sheet and profit and loss account must be signed by the members of the Board of Directors, or by the Chairman of the Board in the name of the members of the Board of Directors.

4. Approval of the balance sheet and profit and loss statement by the general meeting of shareholders implies the granting of full approval and release to the Manager and Deputy-Manager concerning their actions during the bookkeeping year in question, concerning the activities mentioned in the annual reports, and grants full release to the Board of Directors on its management.

GENERAL MEETING OF SHAREHOLDERS

Article 16

1. Every year, at the latest in the month of June, for the first time in June, nineteen hundred and sixty, there must be held a general meeting of shareholders.

2. In this annual general meeting

   a. The Board of Directors gives a report on the activities of the share company and the results which have been achieved in the preceding bookkeeping year, particularly as regards their management;

   b. Proposes a balance sheet and loss account for the previous year (after obtaining an audit by independent experts) to the meeting, for its consideration;*

   c. Stipulate the division of profits and the size of dividends;

   d. Discusses matters raised by the Board of Directors and the shareholders.

3. Proposals by the shareholders only may be included on the agenda of the meeting if requested in writing to the Board of Directors by a shareholder or shareholders representing at least one-fourth of the number of shares which has been issued, and these proposals are received sufficiently early so that the Board of Directors may employ adequate time to inform the stockholders, bearing in mind the time of the invitation which is decided for the general meeting of shareholders.

<u>EXTRAORDINARY GENERAL MEETING</u>

Article 17

1. An extraordinary general meeting of shareholders takes place at any time if considered necessary by the Board of Directors.

2. The Chairman of the Board of Directors is authorized to call and organize an extraordinary general meeting at the written request of a member of the Board of Directors or of a shareholder or shreholders representing at least one-fourth of the capital which has been paid in to the Corporation, in a written request stating the questions to be considered.

3. If the Chairman of the Board of Directors neglects to call the above-mentioned meeting within one month after the request letter is received, the signers of the request letter have the right to call the meeting themselves at the expense of the Corporation, with due regard to the above-mentioned regulations in this Charter, in which meeting a Chairman is chosen by and from among those who attend, and all decisions which are reached during this meeting bind the Corporation, provided they do not conflict with this Charter, and those attend explain the necessity of the steps which are outlined here.

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* Intended to provide for an annual outside audit although this is not yet customary in Indonesia.

PLACE AND CALL FOR A MEETING

Article 18

1. All general meetings of shareholders take place at the domicile of the Corporation.

2. The call for a general meeting of shareholders is performed by an advertisement in a daily newspaper which appears at the seat of the Corporation, or with a registered letter addressed to the address which is last noted in the share registration book, at least 14 (fourteen) days before the meeting takes place, and if in the opinion of the management the matters for discussion should immediately be settled, the time may be shortened to 7 (seven) days.

3. In this call must be made known the day, hour and place of the meeting, and the matters to be discussed must be outlined.

4. If all shareholders attend or are represented, the previous call as referred to above is not required, and the meeting is able to take legal decisions concerning topics which are discussed, and the meeting also may be held at any place whatsoever.

LEADERSHIP OF THE MEETING

Article 19

1. If no other method is laid down in this Charter, all meetings are led by the Chairman of the Board of Directors. If the Chairman of the Board does not attend, they are led by another member of the Board of Directors, and if none of these attend, by a person who is selected by and from among those who attend.

2. Minutes are prepared on that which is proposed and decided in the meeting, at the initiative of the Chairman, and with his signature and if possible with the signature of one shareholder who is appointed by the meeting from among those present, and the contents become a document which is binding on all shareholders.

3. These signers are not necessary if the minutes are prepared as a notary's proces-verbal.

VOTING RIGHTS

Article 20

1. Except if otherwise stated in this Charter, all decisions are taken by a majority vote in the usual way.

2. If the number of votes for and against are equal, then the decision is taken by a lottery if it concerns a person, and is considered negative if it concerns other matters.

3. In the general meeting of shareholders all shares have the right to exercise one vote, provided that one shareholder or his representative may not exercise more than three votes, and in total as the representative of other shareholders may not cast more than six votes.

4. Each shareholder is entitled to appoint in writing another shareholder or some other person as his representative.

5. The Manager and Deputy-Manager and members of the Board of Directors and in general all employees of this Corporation may not act as proxies in voting; votes by them as proxies are considered invalid.

6. The Chairman has the right to request that the aforesaid proxy documents be shown to him in the course of the meeting.

7. Except if the meeting rules otherwise, casting of votes concerning persons is done with sealed written ballots which are not signed, and concerning other matters by voice vote.

8. Blank ballots or ballots which are not valid are considered as votes which were not cast.

PROFITS

Article 21

1. Net profits as shown in the balance sheet and profit and loss accounts, as approved, are divided in accordance with the decisions of the general meeting of shareholders, which meeting will also decide the amount to be made available for reserves, provided that the general meeting of shareholders will adhere to the following principles:

   a. The first charge against net profits will be for cumulative dividends on non-voting preference shares, if any are issued under the provisions of Article 6 of this Charter.

   b. As long as reserves have not yet attained 20% (twenty per cent) of the Corporation's assets, at least one-half of the remaining net profit will be added to reserves.

2. Subject to the provision of paragraph 1 (b) above, if in the option of the general meeting of shareholders the amount of reserve funds has become sufficiently large, the meeting can determine that the part of the profit set aside for reserves will be used for other purposes.

3. If the profit and loss account for one year shows a loss which cannot be covered from the reserve fund this loss will remain written and included in the profit and loss account and in the years which follow the share company is regarded as not having realized a profit if the loss suffered and shown in the profit and loss account is not recouped.

4. Dividends which are not withdrawn in five years after they are ready for distribution fall to the Corporation.

RESERVE FUND

Article 22

1. The reserve fund is used to cover losses which are incurred, however the general meeting of shareholders can decide that this reserve fund is entirely or partly used as working capital or for other requirements.

2. The Board of Directors administers and holds the reserve fund, or employs it in order that the reserve may earn an income in the way that seems best to them.

3. Income which is obtained from the reserve fund is included in the profit and loss account.

CHANGES IN THE CHARTER

Article 23

1. Changes in provisions of this Charter, including a change of name, seat and purposes of the Corporation, dissolution of the Corporation before the time fixed, or delay to a later date, increase or decrease of the share capital (proposals concerning a reduction of capital must be published in the State Gazette by the Board of Directors in the interests of creditors) only may take place with the decision of an extraordinary general meeting of shareholders that is especially called for this purpose. This meeting must represent at least three-fourths of the capital which has been issued, and the proposal must be accepted by at least three-fourths of the number of votes that have been legally issued.

2. If in the meeting described in the above paragraph the amount of capital attending is not enough in accordance with what is required, then within one month but no quicker than seven days after the meeting a second meeting is held, and if in this meeting again the amount of capital which is represented is insufficient the decision concerning the proposals in the first meeting is taken as legal provided only that there is agreement of at least three-fourths of the number of votes which have been issued legally.

3. All the above may not take the place of the government's consent if that is deemed necessary by the government.

DISSOLUTION

Article 24

1. If this Corporation is dissolved, it must be brought into liquidation by the Manager under the direction of the Board of Directors, except if the general meeting of shareholders decides otherwise.

2. This meeting also decides the compensation for the liquidator.

3. The decision to dissolve must be registered by the Office of the National Law Court where this Corporation has its seat, and must be published in the State Gazette as information for creditors.

4. A surplus in the liquidation account is to be divided in the first place among the shareholders to the nominal amount of each share, and the balance is divided in a manner determined by the general meeting of shareholders which is especially held for that purpose.

5. This Charter exactly as written in this document or possibly with changes, retains its validity up to the day the liquidation account is approved by the general meeting of shareholders and the liquidator is given full approval and release from liability.

FINAL PROVISIONS

Article 25

In all matters which are not sufficiently provided for by this Charter the general meeting of shareholders will decide, taking into account the rules mentioned in Article 19, paragraph 3, of this Charter.

Article 26

Deviating from the provisions established in the Article concerning the appointment of members of the Board of Directors, for the first time this Board will consist of the following

Chairman

Deputy Chairman

Secretary

Members

appointments which are accepted by each one concerned and which will be confirmed in the next general meeting of shareholders. The Board of Directors and ______________________________, collectively as well as individually retain the right to transfer this power to other persons as authorized, to request approval for these statutes from the appropriate authorities and to state as well as to make modifications and/or additions with legal documents if the approval depends on the aforesaid changes and/or additions for purposes which are regarded as necessary, to make, have made and signed all necessary documents and further to do all that is regarded as fitting to settle the aforesaid matter.

Translated by: Edward A. Tenenbaum

Appendix A

LIST OF PERSONS INTERVIEWED

Indonesians

Government of the Republic of Indonesia

President	Sukarno
Aides to the President	Lt. Col. Sugandhi
	Major Sudarto
Prime Minister	Ir. R. Djuanda
Deputy Prime Minister III	Dr. Leimena
National Advisory Council	
Deputy Chairman	Ruslan Abdulgani
Foreign Ministry	
Minister	Subandrio
	Dr. Ishmael Tayeb
Economic Counselor, Indonesian Embassy, Washington, D. C.	August F. Ompie
Ministry of Finance	
Minister	Sutikno Slamet
	Dr. Sri Pamungkas
Ministry of Industry	
Minister	Dr. F. J. Inkiriwang
Secretary-General	Dr. Anondo
Chief, Directorate of Industry	Ir. R. Sanoesi
Director, Industrial Mechanization & Finance Office	R. Soedibio
	Ahmat Sumatadirdja
Lembaga Penjelenggaraan Perusahaan Perusahaan Industri (LP3I-Institute for Establishing Industrial Enterprises)	Suhartona
	Usman
Induk Puntjelupan Madjalaya (dyeing & finishing plant)	Djanusat (Manager)
Induk Perusahaan Keramik Dinojo (ceramics factory, near Malang)	Ateng Muditar (Manager)
Sumber Mas Metalworking Factory, Malang	Wuy (Deputy Manager)
	Hui (Surabaya Office)

Ministry of Commerce	
Minister	Dr. Rachmat
Chief, Credit Department (& official of Bank Menengah)	J. Kawulur
Chief, Cooperatives Office	Rusli Rahim
Lembaga Djaminan Kredit	Meinke (Secretary)
U.N. Marketing Expert	W. F. Godsey
Ministry of Veterans' Affairs	
Minister	Chairal Saleh
Biro Perantjang Negara (State Planning Bureau)	
Director	Dr. Ali Budiardjo
Deputy Director	Dr. Otong Kosasih
Secretary	Achmat Ali
Monetary Section	Dr. Suwedi G. Soejono Bambang Sumarsono
U.N. Adviser	Dr. Gould
Biro Pusat Statistik (Central Statistical Bureau)	
Director	Sarbini Sumawinata
Monetary Board	
Secretary	Atmodiningrat
Director, IBRD (Washington, D.C.)	Soemarno

Provincial and Local Governments

West Djawa Province (Bandung)	
Resident, Bandung	Basara Adivinata
Adviser	Dr. Baju
Chief, Autonomous Administration	Palemberg
Deputy Inspector for Industry	Tabrami
Administrator, Lembaga Djaminan Kredit	Sahabuddin
Central Djawa Province (Semarang)	
Governor	Mangunagoro
Secretary	Kartona
Chief of Protocol	Suroto
Chief, Autonomous Administration	Hadisubeno
Inspector for Industry	Suparti
Administrator, Lembaga Djaminan Kredit	Gunawan
Djogjakarta Sultanate (Djogjakarta)	
Chief of Protocol	Pudjioetomo
Minister of Industry and Member of Legislature	Soenarjohadi

East Djawa Province (Surabaya)	
Secretary	Abdul Rachman
Inspectorate for Industry	Assnan Hardjosukario
	Parni
	Sutian
Malang Residency	
Secretary	Sutekno
Director for Industry	R. K. Wirjosepoetro
Nusa Tenggara Province (Singaradja, Bali)	
Governor	T. M. Daudsjah
Secretary	Bagus
Chief of Protocol	I Gusti Ngurah Nguwi
Deputy Inspector for Industry	Sumarlang
Bali District (Dairah) Industry Director, Denpasar	Njoman Merati

<u>Indonesian Government Banks</u>

Bank Indonesia	
Governor	Loekman Hakim
Bank Supervision Department	Djuana Kusumahardja (Director)
Economics, Statistics & Reports Dep't	Dr. R. Soerjadi (Director)
Foreign Exchange Department	R. B. Gandasubrata (Director)
Commercial Credit Department	Tan Tiong Djen (Director)
IMF Adviser	Albert Mattera
Bank Industri Negara	
Directors	Sumanang
	Soekasno
	Tjipto
	K. Kridoharsojo
Bank Negara Indonesia	
Director	Rachmat Muljomiseno
Stock Brokerage Department	Van der Klok
Bank Rakjat Indonesia	
President	R. S. Soeria-Atmadju
Bandung - Assistant Director	Sjubri
Semarang - Deputy Inspector	Suvakman
Djogjakarta - Director	Harsojo
Surabaya - Inspector	Kappas
Singaradja - Inspector	Ulfi
Bank Tabungan Pos (Postal Savings Bank)	
Director	Darmosutanto

<u>Private Banks</u> (Djakarta, Unless Otherwise Noted)

Chartered Bank of India, Australia & China	Currie (Manager)
Bank Dagang Nasional Indonesia	Ridwan Jasid (Manager, Djakarta Branch)
Bank Denis (Bandung)	E. Hammacher R.S. Komar Haidjamasensa
Escompto Bank	J.D. Massie (Manager)
Bank Gadja Mahda	A.R. Djokoprawiro (President-Director)
Hong Kong & Shanghai Banking Corp.	F.H. King (Manager) R. Beaumont
Indonesian Banking Corporation (IBC)	Sadjito (Director)
Bank Indonesia Raya	Dr. Lucius van Dienst
P.T. Bank Kopra Indonesia (Kooperasi Rakjat)	Daut Badaruddin (President) Lim Khay Guan (Managing Director)
Bank Menengah (Bank of Middle-Class Traders' Association)	Pasaribu Soekardi (Chairman) Soemardi (Secretary)
Nationale Handelsbank	Schuette (Manager)
Bank Niaga	Yo (Assistant Manager)
Bank Perdagangan Indonesia (Surabaya)	Augustin Sjahaan Seriga
P.T. Bank Perdania (Indonesian-Japanese joint bank)	Jusup Wibisono (Director) Zainal Arifin " Sie Tjiauw Sing "
Bank Perniagaan Umum (Singaradja, Bali)	Panetja (Manager)
Bank Persatuan Tenaga Ekonomi (Djogjakarta)	Saibani Werionedio
P.T. Bank Selat Bangka	Harahap (President)

Bank Siliwangi	Husein Reksodirdjo (Director) Hsieh Kuo Chen (Director
Bank Tani Nasional	Simali
Federasi Bank di Indonesia	Zulkarnein (Secretary)
Perhimpunan Bank 2 Nasional	Sadjito (Chairman)

Private Industrialists, etc.

Josuf Amba	Mebel Rottan Sulawesi, Surabaya
Achmat Arifin	Harabandjaia Printing & Publishing Co., Surabaya
Harlan Bekti (Manager)	Technik Umum N.V.
A.M. Dasaad (President)	N.V. Dasaad Musin Concern
Isaac Dasaad (Vice President)	" " " "
Gandasasmita	Gandasasmita Metal Furniture Shop, Bandung
Gondosuhargo	GAMSTOW Metal Works, Djogjakarta
Hariono	"Majolica" Ceramica Factory, Bandung
Ginatra (Manager)	NV Perti Textile Factory, Denpasar
Husein	Tempo Sock Knitting Factory Ltd. Bandung
A. Hutaling	CV Parhao Sawmill & Box Factory, Malang
Liauw Fong Liang	Tongam Battery Factory Ltd., Semarang
Lo William	NV Mulana Toothbrush & Plastic Goods Factory, Semarang
Rasjid Malakewi	Tenaga Printing & Publishing Co., Malang
I.W. Mastra	Firma "Tresna" Co., Printing Plant, Singaradja

R. Muhadi	General Secretary, Indonesian Council of Industry
Hasjim Ning (President)	Indonesian Service Co., automobile assembly
A. Norr-Luddin	Masayoe Trading Co.
Andi Parenrengi	Opu (Sultan) of Luwu
Amir Pulus (Engineer)	P.T. Indonesian Enamel Factory
Samsi (Manager)	N.V. Perbedija Metal Works Djogjakarta (BIN subsidiary)
Hasan Sastraatmadja	Kalimadu, Ltd.
Dr. Mohammed Sadli	Director, Economic & Social Research Institute
Hadji Sjukur	Sjukur Textile Factory, Madjalaya
Soedibio (Director)	CIP Canning Factory, Denpasar
Mrs. Sumardi (Manager)	Sumardi Musical Instrument Factory, Solo
Achmad Surjono	Director, Java Enamel Factory
Tan Tek Peng (Chairman)	Kian Gwan Trading Co.
Tio Swie Lian Cigarette Factory, Surabaya	
Tsiang (Manager)	Pabrik Rokok "Panamas", Denpasar ("kretek" cigarettes)
Slamet Wedyosusanto (President)	Bumiputra Insurance Co.
Van Wely	"Aperdi" Stock Exchange Brokers
Dr. Woodiff (Dean, Economics Faculty)	University of Hassamudu (Makassar)

U.S. Officials

International Cooperation Administration, Washington

Office of Far Eastern Operations

Director	Dr. Raymond T. Moyer
Chief, Program Staff	Miss Helene Granby
Chief, Indonesian-Japan Division	Eric T. Hagberg
Indonesian Officer	Walter C. Furst

Assistant to the Director for Finance	Walter Schaefer

Office of Industrial Resources, Far East Area Operations

Chief, Operations Branch	John E. Bach
Operations Officer	Louis James Gill
Chief, Planning Branch	Nathaniel Raffler
Asst. Chief, Planning Branch	Kenneth Levick

State Department, Washington

Deputy Assistant Secretary for Far Eastern Economic Affairs	Gardner E. Palmer

Office of Southwest Pacific Affairs

Officer in Charge, Economic Affairs	Frank G. Jarvis
Assistant, Economic Affairs	Mary Olmstead
Assistant Officer, Indonesian and Pacific Island Affairs	Robert Wenzel

Development Loan Fund, Washington

Chief Loan Officer	Edmond C. Hutchinson
Loan Officer	John A. Ulinski, Jr.

U.S. Embassy, Djakarta

Ambassador	Hon. Howard P. Jones
Counselor of Embassy	James D. Bell
Economic Counselor	Herman Barger
Commercial Attache	J.A. Van Swearingen
Second Secretary	Donald B. Easum
Assistant Military Attache	Major Benson

U.S. Operations Mission (ICA), Djakarta

Director	James C. Baird, Jr.
Deputy Director	George Gurow

USOM (continued)

Industry Division

Chief	Robert Y. Grant
Deputy	Julius Demeter
Railroad Maintenance Expert	Elden V. Amen
Deputy for Mining	David A. Andrews
Training Officer	Dominus C. Davis
Industrial Technical Aids Specialist	Henry Doré
Mining Engineer	Philip W. Simmons
Industry Projects Analyst	F. William Small

Program Division

Acting Chief	Martin D. Mulholland
Economist	Harold K. Charlesworth
Program Analyst	Edward M. Young

U.S. Private Institutions

American-Indonesian Chamber of Commerce, Inc.	Ladd I. Johnson, Secretary
American Overseas Finance Co.	E. Kennedy Langstaff, Assistant Secretary
Caltex (Pacific), Ltd.	Robert Harding, Manager
Ford Foundation Mission, Djakarta	Michael Harris, Director
The Goodyear Tire & Rubber Co., Ltd., Bogor	Clark A. Failing, Managing Director Cecil Kirsten
Irving Trust Co., New York	August A. Maffry, Vice-President
Motion Picture Export Association, Djakarta	William Palmer
National Carbon Co., Djakarta	Thomas Stewart, Manager
Standard-Vacuum Oil Co.	G.L. McCoy, Vice-President for Indonesia Robert Anderson, Manager, Djakarta Kenneth Young James C. Warren
United Press International	Robert Monahan

Other Countries

Denmark

Chargé d'Affaires	Lorenz Peterson

Germany

Embassy, Djakarta, First Secretary	Dr. Hans Wilhelm Lippoldes
Deutsche Bank	Hermann J. Abs
Hoechst Indonesia P.T.	Guenther E. Fust
Siemens & Halske A.G., Indonesia	Wilfred E. Wentges

Italy

Embassy, Djakarta, Ambassador	P. La Terza
Ministry of Foreign Affairs	
Direttore Generale Aggiunto per gli Affari Economico	Minister Guido Soro
Ambassador to United States	Dr. Ortona
Banca Nazionale del Lavoro	
Direttore Generale	Ing. Ettore Lolli
Director in Milan	Dr. Fabio La Ratta
	Dr. Mario Garrone
Italconsult	Ing. Milani
Montecatini	
Amministratore Delegato	Ing. Piero Giustiniani
Olivetti	
Direzione per le Relazioni Esteri	Paolo N. Rogers

Appendix B

Table 1

Indonesian Price Indices, 1950-1958
1952 Average = 100

		Djakarta			Djawa & Madura		
		Imports[1]	Free Market Food[2]	Free Market Rice[3]	Rural Market Food[4]	Rural Market Textiles[5]	Index of Black Market Rate per U. S. Dollar
1950	av.	76	57	n.a.	n.a.	126	n.a.
1951	av.	105	95	93[6]	86[6]	111	n.a.
1952	J	104	117	138	120		83
	F	104	105	113	114		91
	M	102	106	113	108		93
	A	99	102	101	98		92
	M	99	97	91	91		88
	J	97	95	86	87	100(av.)	94
	J	99	95	85	88		105
	A	100	94	88	97		118
	S	100	97	90	100		121
	O	100	95	92	99		103
	N	98	96	95	101		107
	D	97	101	107	98		107
1953	J	102	101	105	91		113
	F	105	104	105	89		119
	M	108	105	105	85		129
	A	108	106	104	80		126
	M	109	105	99	78		115
	J	108	109	99	80	117(av.)	125
	J	107	109	99	80		135
	A	107	108	98	82		140
	S	107	105	98	83		147
	O	106	104	98	89		147
	N	104	107	98	96		137
	D	104	113	104	97		124
1954	J	105	113	106	93		130
	F	106	112	107	88		130
	M	108	110	107	84		130
	A	111	111	101	78		120
	M	113	111	98	74		118
	J	115	111	95	73	114(av.)	115
	J	117	111	93	77		132
	A	119	112	95	79		138
	S	122	113	96	83		148
	O	125	114	98	86		158
	N	127	118	104	90		161
	D	130	125	106	90		168

Appendix B, Table 1 (Continued)

		Djakarta			Djawa & Madura		Index of
		Imports[1]	Free Market Food[2]	Free Market Rice[3]	Rural Market Food[4]	Rural Market Textiles[5]	Black Market Rate per U. S. Dollar
1955	J	137	128	106	92		172
	F	143	134	106	96		173
	M	150	140	112	99		177
	A	161	142	110	96		192
	M	166	144	105	97		206
	J	167	146	104	102	215(av.)	218
	J	171	146	106	105		228
	A	167	149	107	112		213
	S	154	161	129	119		174
	O	149	164	130	121		178
	N	147	171	156	131		172
	D	144	170	154	135		163
1956	J	145	179	172	144	144	167
	F	144	184	182	149	141	177
	M	144	188	191	151	142	164
	A	142	168	145	124	139	149
	M	141	166	140	121	134	152
	J	140	164	140	124	131	157
	J	140	164	145	124	130	162
	A	142	165	145	124	129	155
	S	144	167	157	125	130	156
	O	146	174	174	131	129	159
	N	147	171	172	131	134	144
	D	148	167	163	129	134	152
1957	J	150	167	164	126	135	152
	F	151	165	161	121	135	152
	M	152	167	161	117	135	160
	A	155	165	154	112	136	167
	M	157	169	156	113	137	187
	J	161	170	157	117	144	203
	J	168	175	161	125	153	211
	A	177	189	188	136	166	233
	S	184	198	221	143	174	226
	O	185	208	245	149	186	203
	N	196	225	272	169	193	205
	D	202	259	346	214	200	224
1958	J	208	259	346	212	206	257
	F	215	259	344	211	217	277
	M	223	292	415	242	235	293
	A	235[7]	242	274	193	258	303
	M	235[7]	235	252	178	255	309
	J	245[7]	244	252	184	258	320
	J	255[7]	257	287	193	263	357
	A	260[7]	290	365			
	S			370			

Appendix B, Table 1 (continued)

1/ Unweighted index numbers of wholesale price of 44 import articles at Djakarta.

2/ Weighted index numbers of retail price of 19 food articles on the free market in Djakarta.

3/ Index numbers of the retail price of rice on the free market (Djakarta).

4/ Weighted index numbers of market price of 12 food articles in the rural districts of Djawa and Madura.

5/ Index numbers of market price of important textile goods in the rural districts of Djawa and Madura (average).

6/ Average of December, 1950 and 1951.

7/ Projected and estimated; official data not yet available.

Source: Biro Pusat Statistik, "Statistik Konjunktur", Djakarta, September 1958 and previous issues.
International Monetary Fund, "International Financial Statistics", Washington, January 1958.

Appendix B

Table 2

Per Capita Money Supply and Price Level, 1950-1958

		A	B	C	D	E	F
		Money Supply, in Billions of Rupiah	Population, in Millions	Money Supply Per Capita, in Rupiah	Index of C, 1952 = 100	Price Index, 1952 = 100	Index of Acceptability of Money (D x 100 / E)
1950	av.	3.81	76,000	50	67	76	88
1951	av.	4.67	77,100	61	82	105	78
1952	J	5.10	77,800	66	88	104	85
	F	5.11	77,900	66	88	104	85
	M	5.38	78,000	69	92	102	90
	A	5.86	78,100	74	99	99	100
	M	5.90	78,200	75	100	99	101
	J	6.16	78,300	78	104	97	107
	J	6.31	78,417	80	107	99	108
	A	5.85	78,533	75	100	100	100
	S	5.79	78,650	74	99	100	99
	O	5.96	78,766	76	102	100	102
	N	6.20	78,883	79	106	98	108
	D	6.72	79,000	85	114	97	118
1953	J	7.00	79,116	89	119	102	107
	F	7.29	79,233	92	123	105	117
	M	7.28	79,350	92	123	108	114
	A	7.02	79,466	88	118	108	109
	M	7.05	79,583	89	119	109	109
	J	7.20	79,700	90	120	108	111
	J	7.22	79,817	90	120	107	112
	A	7.27	79,933	91	122	107	114
	S	7.47	80,050	93	124	107	116
	O	7.46	80,166	93	124	106	117
	N	7.50	80,283	93	124	104	119
	D	7.64	80,400	95	127	104	122
1954	J	7.81	80,420	97	130	105	124
	F	7.70	80,540	96	129	106	122
	M	8.01	80,660	99	133	108	123
	A	8.08	80,780	100	134	111	121
	M	8.51	80,900	105	141	113	125
	J	8.81	81,020	109	146	115	127
	J	9.18	81,140	113	151	117	129
	A	9.53	81,260	118	158	119	133
	S	9.79	81,380	120	161	122	132
	O	10.10	81,500	124	166	125	133
	N	10.48	81,625	128	171	127	135
	D	11.08	81,750	136	182	130	140
1955	J	11.30	81,888	138	185	137	135
	F	11.43	82,025	139	186	143	130
	M	11.60	82,162	141	189	150	126
	A	11.72	82,300	142	190	161	118

Appendix B, Table 2 (continued)

		A	B	C	D	E	F
		Money Supply, in Billions of Rupiah	Population, in Millions	Money Supply Per Capita, in Rupiah	Index of C, 1952 = 100	Price Index, 1952 = 100	Index of Acceptability of Money (D x 100 / E)
1955	M	12.40	82,438	150	201	166	125
	J	12.55	82,575	152	204	167	122
	J	12.63	82,712	153	205	171	120
	A	12.53	82,850	151	202	167	121
	S	12.57	82,988	152	204	154	132
	O	12.15	83,125	146	196	149	131
	N	12.04	83,262	145	194	147	132
	D	12.78	83,400	153	205	144	142
1956	J	12.35	83,533	148	198	145	137
	F	11.95	83,666	143	192	144	133
	M	11.80	83,799	141	189	144	131
	A	11.76	83,932	140	188	142	132
	M	11.84	84,065	141	189	141	134
	J	11.76	84,198	140	188	140	134
	J	11.86	84,331	141	189	140	135
	A	12.31	84,464	146	196	142	138
	S	12.41	84,598	147	197	144	137
	O	12.50	84,732	148	198	146	136
	N	13.05	84,876	154	206	147	139
	D	13.89	85,000	163	218	148	147
1957	J	13.60	85,129	160	214	150	143
	F	13.54	85,250	159	213	151	141
	M	13.74	85,375	159	213	152	140
	A	14.74	85,500	172	230	155	148
	M	15.35	85,625	179	240	157	153
	J	15.52	85,750	181	243	161	151
	J	16.30	85,875	184	246	168	146
	A	16.71	86,000	194	260	177	147
	S	16.88	86,125	196	262	184	142
	O	17.33	86,250	201	269	185	145
	N	17.63	86,375	204	273	196	139
	D	18.91	86,500	219	293	202	145
1958	J	19.01	86,625	219	293	208	141
	F	20.00	86,750	231	310	215	144
	M	19.62	86,875	226	303	223	136
	A	20.28	87,000	233	312	235 1/	133 1/
	M	21.22	87,125	244	327	235 1/	139 1/
	J	21.65	87,250	248	332	245 1/	136 1/
	J	22.48	87,375	257	344	255 1/	135 1/
	A	23.33	87,500	267	357	260 1/	137 1/

1/ Projected and estimated; official data not yet available.

Source: Biro Pusat Statistik, "Statistik Konjunktur (Monthly Survey)", Djakarta, September 1958 and earlier issues, and "Statistical Pocketbook of Indonesia 1957", Djakarta, 1958.

Appendix B

Table 3

Price of Gold in Bars, 1950-1958
Converted into U.S. Dollars at Free Exchange Rates

		Lebanon	Hong Kong	Djakarta	Djakarta: Rupiah per gram	Djakarta: Black Market Rate for U.S. Dollar
		Dollars per Fine Ounce				
1950	Dec.	40.13	44.47	63.5	29.62	14.50
1951	Dec.	39.00	42.71	59.8	31.72	16.50
1952	J	39.10	43.00	58.8	31.90	16.87
	F	39.02	42.25	57.1	32.80	18.50
	M	38.34	41.25	53.2	32.25	18.87
	A	37.80	40.00	52.4	31.65	18.75
	M	37.85	40.35	54.0	31.25	18.00
	J	38.20	40.00	50.6	31.30	19.25
	J	37.94	40.40	49.5	34.25	21.50
	A	37.95	40.65	50.0	38.62	24.00
	S	37.45	40.50	49.4	38.50	24.75
	O	37.95	40.75	52.2	35.25	21.00
	N	37.23	40.15	49.3	34.45	21.75
	D	37.81	40.48	49.7	34.75	21.75
1953	J	37.92	40.70	48.9	36.12	23.00
	F	37.60	40.06	49.8	38.87	24.25
	M	37.53	39.51	50.0	42.25	26.25
	A	37.10	39.39	48.8	40.37	25.75
	M	37.00	39.24	52.4	39.62	23.50
	J	36.74	39.20	50.4	41.25	25.50
	J	36.46	38.32	46.7	41.32	27.50
	A	36.67	38.22	45.5	41.65	28.50
	S	36.50	38.04	44.9	43.30	30.00
	O	36.09	37.58	44.1	43.25	30.00
	N	35.20	36.88	45.7	41.12	28.00
	D	35.57	37.25	46.8	39.50	25.25
1954	J	35.39	37.21	46.8	39.87	26.50
	F	35.53	37.02	45.7	39.12	26.62
	M	35.18	36.97	45.7	38.62	26.25
	A	35.30	37.19	49.5	39.00	24.50
	M	35.38	38.44	52.0	40.37	24.12
	J	35.32	38.25	54.7	41.37	23.50
	J	35.32	38.07	53.7	46.62	27.00
	A	35.27	38.13	47.1	42.75	28.25
	S	35.20	38.20	48.1	46.80	30.25
	O	35.27	37.97	46.2	48.00	32.25
	N	35.21	37.93	46.8	49.50	32.87
	D	35.27	38.22	46.8	51.50	34.25
1955	J	35.21	38.42	45.3	51.00	35.00
	F	35.25	38.06	46.1	52.42	35.37
	M	35.26	38.02	45.1	52.37	36.12
	A	35.28	37.94	45.0	56.62	39.12

Appendix B, Table 3 (continued)

		Lebanon	Hong Kong	Djakarta	Djakarta: Rupiah per gram	Djakarta: Black Market Rate for U.S. Dollar
		Dollars per Fine Ounce				
1955	M	35.25	37.86	44.0	59.37	42.00
	J	35.19	38.00	44.2	63.25	44.50
	J	35.28	37.91	41.7	62.37	46.50
	A	35.14	37.97	42.7	59.75	43.50
	S	35.23	38.02	47.1	53.75	35.50
	O	35.13	38.16	48.6	56.62	36.25
	N	35.21	37.98	51.6	54.87	35.00
	D	35.21	38.04	48.5	51.87	33.25
1956	J	35.08	37.99	48.0	52.62	34.12
	F	35.15	38.09	44.5	51.75	36.12
	M	35.16	38.29	47.0	50.62	33.50
	A	35.17	38.19	47.3	46.37	30.50
	M	35.15	38.12	47.4	47.37	31.00
	J	35.17	38.05	45.7	47.00	32.00
	J	34.98	38.21	44.5	47.25	33.00
	A	35.28	38.09	46.2	47.00	31.62
	S	35.28	38.02	46.9	47.87	31.75
	O	35.26	38.30	45.2	47.25	32.50
	N	35.55	38.03	51.9	49.25	29.50
	D	35.23	37.90	48.6	48.62	31.00
1957	J	35.12	38.49	48.9	48.87	31.00
	F	-	38.26	49.5	49.50	31.00
	M	35.11	38.28	47.5	50.00	32.75
	A	35.10	38.10	47.6	52.12	34.00
	M	35.09	38.51	48.5	59.75	38.25
	J	35.28	38.32	45.0	60.00	41.50
	J	35.18	38.24	44.5	61.50	43.00
	A	35.17	38.17	44.9	68.50	47.50
	S	-	38.42	44.3	65.50	46.00
	O	35.17	38.54	49.8	66.50	41.50
	N	35.08	38.38	48.8	65.50	41.75
	D	35.05	38.35	45.9	67.50	45.75
1958	J	35.17	38.43	42.4	71.50	52.50
	F	35.21	38.42	40.4	73.00	56.75
	M	35.29	38.33	39.3	75.50	59.75
	A	35.24	38.21	40.3	80.00	61.75
	M	35.14	38.37	42.7	86.50	63.00
	J	35.18	38.16	41.7	87.50	65.25
	J	35.74	38.30	42.4	99.25	72.75
	A	35.45	38.25			
	S	35.32	38.34			
	O	35.34	38.23			

Sources: Biro Pusat Statistik: "Statistik Konjunktur", Djakarta, November 1954, p. 89, March 1957, p. 119, September 1958, p. 123; "Statistical Abstracts", Djakarta, 1956, p. 108. International Monetary Fund, "International Financial Statistics", Washington, 1952-1958.
Franz Pick, "Pick's Currency Yearbook, 1955", New York, 1956, p. 272, for price of gold in Hong Kong, January-November 1952.

Appendix C

Extract from 1958 Annual Report of Dr. Loekman Hakim, Governor of Bank Indonesia

In fact, the time has come to subject our economic philosophy to a thorough and exhaustive examination, since Indonesia will enter upon a new era if and when the present political crisis is overcome as anticipated.

Generally speaking, Indonesia's economic development has inadvertently gone the way of individual enterprise and has followed individual lines of thought. The liquidation of the colonial economy has been interpreted as a replacement of Dutch entrepreneurs by their Indonesian counterparts. The fact has been overlooked that the Indonesian people are poor and lack experience. In fact, it is doubtful whether national development can cope with a great many obstacles if it is entrusted to individual enterprise which lacks capital and skill. In actual practice, entrepreneurs in need of capital take the view that the Government is duty bound to provide them with their requirements. This occurred in the past and the oddness of this attitude should be realized, since Government money is public money, which, if utilized, should benefit the whole public and not the individual. Supplying capital to individual entrepreneurs implies that any loss will come to the charge of the public as a whole, while any profit will be to the advantage of the entrepreneur concerned. Such a policy -- which, I reiterate, has generally not been pursued intentionally -- actually leads to the growth of a national capitalist group, which does not come into being through its own efforts and through carrying its own risks, but thanks to Government aid.

I doubt whether our revolution had as an object the creation of a group of individual entrepreneurs living on the money of the people -- the creation of a small, though national, group growing prosperous by the sweat of people. I also doubt whether the system of bringing our country to development through individual energy and effort is in keeping with our condition. It has become clear that the individual is weak in Indonesia and he needs the support of the Government, while the Government has to bear the losses and does not share in the advantages reaped. It is obvious that Government support is indispensable in present conditions. This, however, poses the question why, if this is actually the case, the Government itself should not undertake national development. Of course, there are risks. But then, Government support to private enterprises does not eliminate such risks, while any profits will fully come to the benefit of the Government -- that is, to the benefit of the public in general and not to the benefit of a small group -- if the Government engages in such enterprises for its own account. This will bring the Government-implemented work of development closer to the fifth principle of Pantja Sila, the ideology of our State. Furthermore, I think it more in line with the conditions in our State if the work of development is implemented by the Government. The skill our people lack due to century-long colonial domination, can more easily be acquired by the Government than by individual entrepreneurs since the necessary foreign experts prefer Government guarantees to the guarantees of a private entrepreneur. Thus, the Government is in a better position to overcome the shortages of capital and skills. For this reason I firmly believe that the Government must play the leading role in the work of national development.

Besides, conditions abroad have developed in such a manner that private enterprise in the sense of the 19th century liberal capitalist philosophy has practically disappeared. The economy in socialist countries is obviously in the hands of the Government, while private entrepreneurs in Western countries have associated into large units, such as the European Coal and Steel Community, the gigantic enterprises in the United States, etc. In this connection it should be remembered that as an outcome of the experience gained in the European Coal and Steel Community, six Western European countries have agreed to set up a Common Market. This implies that trade between those six countries (The Netherlands, Belgium, Luxembourg, West Germany, France, and Italy) will be conducted on a free basis, unhampered by import duties and similar obstacles. All this will be accomplished in 11 to 15 years. It is only a matter of great regret that this effort to attain a larger marketing area than the national market has been used to establish a common import tariff against non-member countries. Import duties at a rate of 30% will be imposed on agricultural products such as tobacco -- a discrimination strongly to the disadvantage of non-member countries such as Indonesia, if compared with the member countries or with countries having special relations with the common market. Italian or Congo tobacco, for instance, will freely enter the Common Market, while Indonesia will have to pay 30% import duty. This high rate of duty is a striking form of protection, which runs counter to the basic objects of the G.A.T.T. It also counters the trend to increase world trade by removing various obstacles. A common tariff of import duties is a less desirable result of the idea of association which is steadily gaining ground. Indonesia and the other countries that stand to be harmed by this measure must make associated efforts to remove the obstacles created by the European Common Market countries.

This is one more reason why it would seem inexpedient to me if Indonesia, as yet weak, should counter the formidable foreign economic units -- in the west as well as in the east -- by insignificant units based in individual enterprise still lacking strength due to inadequate capital, skill and experience.

If Indonesia aims at rapid and sound development, it must supersede the small units which so far have been the vehicles of economic development.

I do not mean that all economic activity in Indonesia should be in the hands of the Government. But, it is my strong belief that the Government must play the leading role in national upbuilding, while private enterprise should only be carried on if those small units are run on cooperative lines, or combined into large-scale associations.

As a matter of fact, the economic philosophy just set forth is supported by a principle that has been alive in our society for centuries and forms part of the Indonesian national identity. I refer to the principle of "gotong rojong" (mutual help). Any weakness has always been overcome in Indonesia by combining potentials under the "gotong rojong" principle. Our sovereign national Government has been the most outstanding achievement of the "gotong rojong" system of our people. This very same "gotong rojong" can be applied in such a manner that minuscule units of private enterprise work with greater efficiency, thus counterbalancing the large-scale foreign units. As the training of private entrepreneurs generally takes time, the Government would do well to take the lead in the present state of emergency.

Source: Bank Indonesia, "Report for the Year 1957-1958", Djakarta, 1958, Pages 22-24.