

Report No. 1187-IND

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Public Sector Investment and Financial Resources in Indonesia

May 24, 1976

The World Bank
East Asia & Pacific Programs

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CURRENCY EQUIVALENT

US\$1.00	=	Rupiahs (Rp) 415
Rp 1.00	=	\$0.0024
Rp 1 million	=	\$2,410

Fiscal Year

April 1 - March 31

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This report
was prepared
by the Resident Staff
in Indonesia under
the direction of Jean Baneth

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LAND AREA (THOU KM ²)	SOCIAL INDICATORS DATA SHEET					
	INDONESIA			REFERENCE COUNTRIES (1970)		
	1960	1970	MOST RECENT ESTIMATE	BANGLADESH	INDIA	PHILIPPINES ^{**}
GNP PER CAPITA (US\$)	60.0	100.0	130.0	80.0	110.0	220.0
POPULATION AND VITAL STATISTICS						
POPULATION (MID-YR, MILLION)	95.4	115.6	124.4	70.8	538.1	36.9
POPULATION DENSITY PER SQUARE KM. PER SQ. KM. AGRICULTURAL LAND	50.0 ..	61.0 ..	65.0 426.0	496.0 ..	168.0 ..	123.0 ..
VITAL STATISTICS CRUDE BIRTH RATE PER THOUSAND	43.0 ^{/b,b}	42.0	42.0	44.0	38.0	45.0
CRUDE DEATH RATE PER THOUSAND	21.0 ^{/b,b}	21.0	21.0	21.0	16.0	12.0
INFANT MORTALITY RATE (/THOUS)	125.0 ^{/b,b}	..	..	140.0	130.0	90.0
LIFE EXPECTANCY AT BIRTH (YRS)	48.0	47.0	51.0	48.0	50.0	56.0
GROSS REPRODUCTION RATE	2.8	3.2	3.1	3.1	2.9	3.3
POPULATION GROWTH RATE (%)						
TOTAL	2.1	2.0	2.0	2.7	2.3	3.0
URBAN	..	3.6	3.2	..	4.0	4.0
URBAN POPULATION (% OF TOTAL)	15.0	17.0	18.0	..	20.0	32.0
AGE STRUCTURE (PERCENT)						
0 TO 14 YEARS	42.1	44.1	44.1	..	42.0	43.1
15 TO 64 YEARS	55.4	53.4	53.4	..	55.0	53.4
65 YEARS AND OVER	2.5	2.5	2.5	..	3.0	3.5
AGE DEPENDENCY RATIO	0.8	0.9	0.9	..	0.8 ^{/a}	0.9
ECONOMIC DEPENDENCY RATIO	1.3	..	1.5	..	1.2 ^{/a}	1.5
FAMILY PLANNING						
ACCEPTORS (CUMULATIVE, THOUS)	..	259.3	4808.2	..	11308.0	354.0
USERS (% OF MARRIED WOMEN)	..	..	..	..	..	8.0
EMPLOYMENT						
TOTAL LABOR FORCE (THOUSAND)	30600.0	..	40100.0	22300.0	221000.0 ^{/b}	12300.0
LABOR FORCE IN AGRICULTURE (%)	68.0	..	62.0	71.0	71.0	51.0
UNEMPLOYED (% OF LABOR FORCE)	5.4	2.0 ^{/a}	5.4 ^{/a}	..	3.0 ^{/a}	7.0
INCOME DISTRIBUTION						
% OF PRIVATE INCOME RECEIVED BY-						
HIGHEST 5% OF HOUSEHOLDS	..	..	..	16.7 ^{/a}	25.0 ^{/d}	..
HIGHEST 20% OF HOUSEHOLDS	..	..	..	42.3 ^{/a}	53.1 ^{/d}	..
LOWEST 20% OF HOUSEHOLDS	..	..	..	7.9 ^{/a}	4.7 ^{/d}	..
LOWEST 40% OF HOUSEHOLDS	..	..	..	19.6 ^{/a}	13.1 ^{/d}	..
DISTRIBUTION OF LAND OWNERSHIP						
% OWNED BY TOP 10% OF OWNERS	48.0 ^{/b}	..	..	34.0 ^{/e}	..	..
% OWNED BY SMALLEST 10% OWNERS	3.0 ^{/b}	..	..	1.0 ^{/e}	..	..
HEALTH AND NUTRITION						
POPULATION PER PHYSICIAN	41000.0	27650.0	23680.0	7600.0 ^{/b}	4800.0	..
POPULATION PER NURSING PERSON	..	8010.0	6960.0	72030.0 ^{/b}	5110.0	..
POPULATION PER HOSPITAL BED	1350.0	1720.0	1450.0	8120.0 ^{/c}	1620.0	850.0
PER CAPITA SUPPLY OF -						
CALORIES (% OF REQUIREMENTS)	89.0	89.0	83.0	..	93.0	85.0
PROTEIN (GRAMS PER DAY)	43.0	43.0	38.0	..	53.0	45.0
-OF WHICH ANIMAL AND PULSE	15.0 ^{/c}	10.0	..	..	16.0	22.0
DEATH RATE (/THOUS) AGES 1-4	..	..	..	..	..	7.0
EDUCATION						
ADJUSTED ENROLLMENT RATIO						
PRIMARY SCHOOL	59.0	69.0	66.0	50.0 ^{/d}	68.0	108.0
SECONDARY SCHOOL	6.0	12.0	12.0	15.0 ^{/d}	28.0	48.0
YEARS OF SCHOOLING PROVIDED (FIRST AND SECOND LEVEL)	12.0	12.0	12.0	10.0	12.0	10.0
VOCATIONAL ENROLLMENT (% OF SECONDARY)	20.0 ^{/a}	29.0	28.0	1.0	6.0 ^{/e}	10.0 ^{/a,b}
ADULT LITERACY RATE (%)	47.0 ^{/a}	..	60.0 ^{/b}	..	..	..
HOUSING						
PERSONS PER ROOM (AVERAGE)	..	..	1.8	..	..	..
OCCUPIED DWELLINGS WITHOUT PIPED WATER (%)	..	..	44.0 ^{/c}	..	..	..
ACCESS TO ELECTRICITY (% OF ALL DWELLINGS)	..	..	64.0	..	..	66.0 ^{/b}
RURAL DWELLINGS CONNECTED TO ELECTRICITY (%)	..	..	39.0	..	..	23.0 ^{/c}
COMUNICATION						
RADIO RECEIVERS (PER THOUS POP)	7.0	114.0	..	6.0	21.0	45.0
PASSENGER CARS (PER THOUS POP)	1.0	2.0	3.0	1.0	1.0	8.0
ELECTRICITY (KWH/YR PER CAP)	19.0	20.0	23.0	11.0	111.0	235.0
NEWSPRINT (KG/YR PER CAP)	0.2	0.2	0.2	..	0.3	1.2 ^{/c}

SEE NOTES AND DEFINITIONS ON REVERSE

NOTES

Unless otherwise noted, data for 1960 refer to any year between 1959 and 1961, for 1970 between 1966 and 1970, and for Most Recent Estimate between 1971 and 1973.

** The Philippines has been selected as an objective country for its geographical similarity and because of its apparent advanced stage of economic development.

INDONESIA 1960 /a Excludes West Irian; /b 1963; /c 1961-63.

1970 /a Registered applicants for work.

MOST RECENT ESTIMATE: /a Unemployed workers seeking their first job; /b 10 years and over, ability to read and write in either Latin or non-Latin characters; /c Inside only.

BANGLADESH 1970 /a 1966-67, households; /b Registered, not all practicing in the country; /c Government hospital establishments only; /d Approximate enrollment as percentage of population in 6-10, and 11-15 age groups respectively; /e 1967-68.

INDIA 1970 /a Ratio of population under 15 and 60 and over to labor force age 15-54 years; /b AID estimate of labor force in age group 15-59. IBRD report gives a figure of 180.4 million based on 1971 population census. The difference is due to changes in the definition of a worker. In the 1971 census, persons were classified only on the basis of their main activities. This led to the exclusion of several categories such as housewives; /c Registered applicants for work; /d 1967-68; /e 1967.

PHILIPPINES 1970 /a Public education only; /b 1967; /c Imports only.

***, 1974

DEFINITIONS OF SOCIAL INDICATORS

Land Area (thou km²)

Total - Total surface area comprising land area and inland waters.
Agric. - Most recent estimate of agricultural areas used temporarily or permanently for crops, pastures, market & kitchen gardens or to lie fallow.

GNP per capita (US\$) - GNP per capita estimates at market prices, calculated by same conversion method as World Bank Atlas (1972-74 basis).

Population and vital statistics

Population (mid-yr. million) - As of July first; if not available, average of two end-year estimates.

Population density - per square km - Mid-year population per square kilometer (100 hectares) of total area.

Population density - per square km of agric. land - Computed as above for agricultural land only.

Vital statistics

Crude birth rate per thousand - Annual live births per thousand of mid-year population; usually five-year averages ending in 1960, 1970 and 1975 for developing countries.

Crude death rate per thousand - Annual deaths per thousand of mid-year population; usually five-year averages ending in 1960, 1970 and 1975 for developing countries.

Infant mortality rate (thou) - Annual deaths of infants under one year of age per thousand live births.

Life expectancy at birth (yrs) - Average number of years of life remaining at birth; usually five-year averages ending in 1960, 1970 and 1975 for developing countries.

Gross reproduction rate - Average number of live daughters a woman will bear in her normal reproductive period if she experiences present age-specific fertility rates, usually five-year averages ending in 1960, 1970 and 1975 for developing countries.

Population growth rate (% - total) - Compound annual growth rates of mid-year population for 1950-60, 1960-70, and 1960 to most recent year.

Population growth rate (% - urban) - Computed like growth rate of total population; different definitions of urban areas may affect comparability of data among countries.

Urban population (% of total) - Ratio of urban to total population, different definitions of urban areas may affect comparability of data among countries.

Age structure (percent) - Children (0-14 years), working-age (15-64 years), and retired (65 years and over) as percentages of mid-year population.

Age dependency ratio - Ratio of population under 15 and 65 and over to those of ages 15 through 64.

Economic dependency ratio - Ratio of population under 15 and 65 and over to the labor force in age group of 15-64 years.

Family Planning - acceptors (cumulative, thou) - Cumulative number of acceptors of birth-control devices under auspices of national family planning program since inception.

Family planning - users (% of married women) - Percentages of married women of child-bearing age (15-44 years) who use birth-control devices to all married women in same age group.

Employment

Total labor force (thousand) - Economically active persons, including armed forces and unemployed but excluding housewives, students, etc., definitions in various countries are not comparable.

Labor force in agriculture (%) - Agricultural labor force (in farming, forestry, hunting and fishing) as percentage of total labor force.

Unemployed (% of labor force) - Unemployed are usually defined as persons who are able and willing to take a job, out of a job on a given day remained out of a job, and seeking work for a specified minimum period not exceeding one week, may not be comparable between countries due to different definitions of unemployed and source of data e.g., employment office statistics sample surveys, compulsory unemployment insurance.

Income distribution - Percentage of private income (both in cash and kind) received by richest 5%, richest 20%, poorest 20%, and poorest 40% of households.

Distribution of land ownership - Percentages of land owned by wealthiest 10% and poorest 10% of land owners.

Health and Nutrition

Population per physician - Population divided by number of practicing physicians qualified from a medical school at university level.

Population per nursing person - Population divided by number of practicing male and female graduate nurses, "trained" or "certified" nurses, and auxiliary personnel with training or experience.

Population per hospital bed - Population divided by number of hospital beds available in public and private general and specialized hospital and rehabilitation centers; excludes nursing homes and establishments for custodial and preventive care.

Per capita supply of calories (% of requirements) - Computed from energy equivalent of net food supplies available in country per capita per day, available supplies comprise domestic production, imports less exports, and changes in stock, net supplies exclude animals' feed, seeds quantities used in food processing and losses in distribution, requirements were estimated by FAO based on physiological needs for normal activity and health considering environmental temperature, body weights, age and sex distributions of population, and allowing 10% for waste at household level.

Per capita supply of protein (grams per day) - Protein content of per capita net supply of food per day, net supply of food is defined as above; requirements for all countries established by USDI Economic Research Services provide for a minimum allowance of 60 grams of total protein per day, and 20 grams of animal and pulse protein, of which 10 grams should be animal protein; these standards are lower than those of 75 grams of total protein and 23 grams of animal protein as an average for the world, proposed by FAO in the Third World Food Survey.

Per capita protein supply from animal and pulse - Protein supply of food derived from animals and pulses in grams per day.

Death rate (/thou) ages 1-4 - Annual deaths per thousand in age group 1-4 years, to children in this age group, suggested as an indicator of malnutrition.

Education

Adjusted enrollment ratio - primary school - Enrollment of all ages as percentage of primary school-age population, includes children aged 6-11 years but adjusted for different lengths of primary education for countries with universal education, enrollment may exceed 100% since some pupils are below or above the official school age.

Adjusted enrollment ratio - secondary school - Computed as above: secondary education requires at least four years of approved primary instruction; provides general, vocational or teacher training instructions for pupils of 12 to 17 years of age correspondence courses are generally excluded.

Years of schooling provided (first and second levels) - Total years of schooling; at secondary level vocational instruction may be partially or completely excluded.

Vocational enrollment (% of secondary) - Vocational institutions include technical, industrial or other programs which operate independently or as departments of secondary institutions.

Adult literacy rate (%) - Literate adults (able to read and write) as percentage of total adult population aged 15 years and over.

Housing

Persons per room (average) - Average number of persons per room in occupied conventional dwellings in urban areas, dwellings exclude non-permanent structures and unoccupied parts.

Occupied dwellings without piped water (%) - Occupied conventional dwellings in urban and rural areas without inside or outside piped water facilities as percentage of all occupied dwellings.

Access to electricity (% of all dwellings) - Conventional dwellings with electricity in living quarters as percent of total dwellings in urban and rural areas.

Rural dwellings connected to electricity (%) - Computed as above for rural dwellings only.

Consumption

Radio receivers (per thou pop) - All types of receivers for radio broadcasts to general public per thousand of population excludes unlicensed receivers in countries and in years when registration of radio sets was in effect, data for recent years may not be comparable since most countries abolished licensing.

Passenger cars (par thou pop) - Passenger cars comprise motor cars seating less than eight persons; excludes ambulances, hearses and military vehicles.

Electricity (kwh/yr per cap) - Annual consumption of industrial, commercial, public and private electricity in kilowatt hours per capita, generally based on production data, without allowance for losses, in grids but allowing for imports and exports of electricity.

Newspaper (kg yr per cap) - Per capita annual consumption in kilograms estimated from domestic production plus net imports of newspaper.

ECONOMIC INDICATORS

<u>GROSS NATIONAL PRODUCT IN 1974</u>		<u>ANNUAL RATE OF GROWTH (% constant prices)</u>		
	<u>US\$ Mln.</u>	<u>%</u>	<u>1960 - 65</u>	<u>1965 - 70</u>
GNP at Market Prices	22479	100.0	1.9	4.9
Gross Domestic Investment	4330	19.3	3.3	11.5
Gross National Saving	4251	18.9	5.8	5.1
Current Account Balance	- 79	0.4	.	.
Exports of Goods, NFS (net oil)	4351	19.1	1.5	7.8
Imports of Goods, NFS	1,220	18.8	0.2	10.9

OUTPUT, LABOR FORCE AND PRODUCTIVITY IN 1971

	Value Added ^{1/}		Labor Force ^{2/}		V. A. Per Worker	
	<u>US\$ Mln.</u>	<u>%</u>	<u>Mln.</u>	<u>%</u>	<u>US \$</u>	<u>%</u>
Agriculture	4221	44.8	30.5	69.0	138	65
Industry	1915	20.3	3.0	6.8	638	300
Services	3279	34.9	8.3	18.8	395	185
Unallocated	-	-	2.4	5.4	.	.
Total/Average	<u>9415</u>	<u>100.0</u>	<u>44.2</u>	<u>100.0</u>	<u>213</u>	<u>100.0</u>

GOVERNMENT FINANCE

	Central Government			
	(Rp Blrs.)	% of GDP		
	<u>1975/76*</u>	<u>1974/75</u>	<u>1974</u>	<u>1973</u>
Current Receipts	2166	1759	17.9	15.0
Current Expenditure	1296	1001	10.2	10.8
Current Surplus	870	758	7.7	4.2
Capital Expenditures	1273	966	9.8	7.3
External Assistance (net)	403	234	2.4	3.2

*Provisional estimates

<u>MONEY, CREDIT and PRICES</u>	<u>1970</u>	<u>1971</u>	<u>1972</u>	<u>1973</u>	<u>1974</u>	<u>1975</u>
	(Billion	Rp.	outstanding end period)			
Money and Quasi Money	330	469	695	987	1452	1995
Bank credit to Public Sector	57	129	58	37	- 2)	2663
Bank Credit to Private Sector	306	451	555	936	1126)	

(Percentages or Index Numbers)

Money and Quasi Money as % of GDP	9.9	12.8	15.2	14.6	14.8	..
General Price Index (Sept. 1966=100)	612	638	680	891	1253	1492
Annual percentage changes in:						
General Price Index	12.3	4.2	6.6	31.0	40.6	19.1
Bank credit to Public Sector	- 5.0	126.3	- 55.0	- 36.2	.	
Bank credit to Private Sector	77.9	47.4	23.0	68.6	20.3)	136.9

NOTE: All conversions to dollars in this table are at the average exchange rate prevailing during the period covered.

1/ Conversion at an exchange rate of Rp. 390 = US\$1.

2/ Total labor force; unemployed are allocated to sector of their normal occupation. "Unallocated" consists mainly of unemployed workers seeking their first job.

.. not available
. not applicable

TRADE PAYMENTS AND CAPITAL FLOWS

BALANCE OF PAYMENTS

	<u>1973</u>	<u>1974</u>	<u>1975*</u>
	(Millions US \$)		
Exports:			
Oil (net)	2173	4351	4778
Non oil	564	2169	2957
Imports	1609	2182	1821
Resource gap	-2817	-4220	-5474
Factor service:			
Interest	-158	-210	-508
Investment income	-46	-64	-224
Balance on current account	-802	-79	-1204
Direct Foreign Investment	290	462	506
Net MLT Borrowing			
Disbursements	572	664	2387
Amortization	-87	-80	-218
Subtotal	485	584	2139
Capital Grants	52	62	..
Other Capital (net)	217	-126	-2250
Other items n.e.i	83	-261	-174
Increase in Reserves (+)	325	642	-983
Gross Reserves (end year)			
Net Reserves (end year)	783	1425	442
Fuel and Related Materials			
Imports	4	4	90
of which: Petroleum	2	1	86
Exports			
of which: Petroleum (net)	564	2169	2957

MERCHANDISE EXPORTS (AVERAGE 1973-75)

	<u>US \$ Mln</u>	<u>%</u>
Oil (net)	1473	39.1
Rubber	416	11.0
Timber	602	16.0
Palm oil	132	3.5
Tin	138	3.7
Coffee	99	2.6
All other commodities	907	24.1
Total	3767	100.0

EXTERNAL DEBT, DECEMBER 31, 1975

	<u>US \$ Mln</u>
Public Debt, incl. guaranteed	7875
Non-Guaranteed Private Debt	..
Total outstanding & Disbursed	—
DEBT SERVICE RATIO for 1975 ^{1/}	%

	<u>IBRD</u>	<u>IDA</u>
Public Debt, incl. guaranteed	9.9	..
Non-Guaranteed Private Debt	..	—
Total outstanding & Disbursed	—	—

IBRD/IDA LENDING, (March 31, 1976)(Million US \$):

RATE OF EXCHANGE

Through <u>July 1971</u>	<u>Since August 1971</u>	Outstanding & Disbursed	93.8	332.0
US \$ 1.00 = Rp. 375	US \$ 1.00 = Rp. 415	Undisbursed	367.2	229.8
1.00 = US \$	1.00 = US \$	Outstanding incl. Undisbursed	461.0	561.8

^{1/} Ratio of Debt Service to Exports of Goods and Non-Factor Services, with oil exports on a net basis (i.e. excluding factor payments and imports of the oil companies).

*Provisional

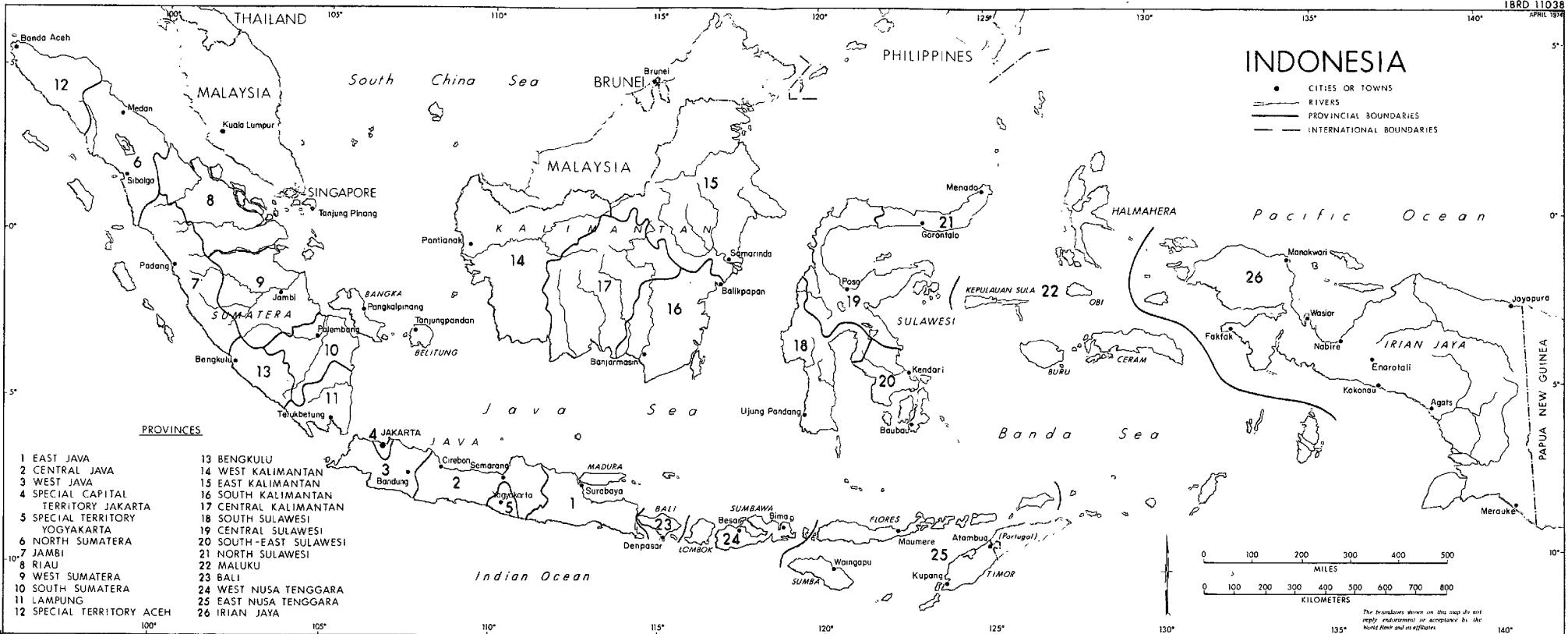
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May 19, 1976

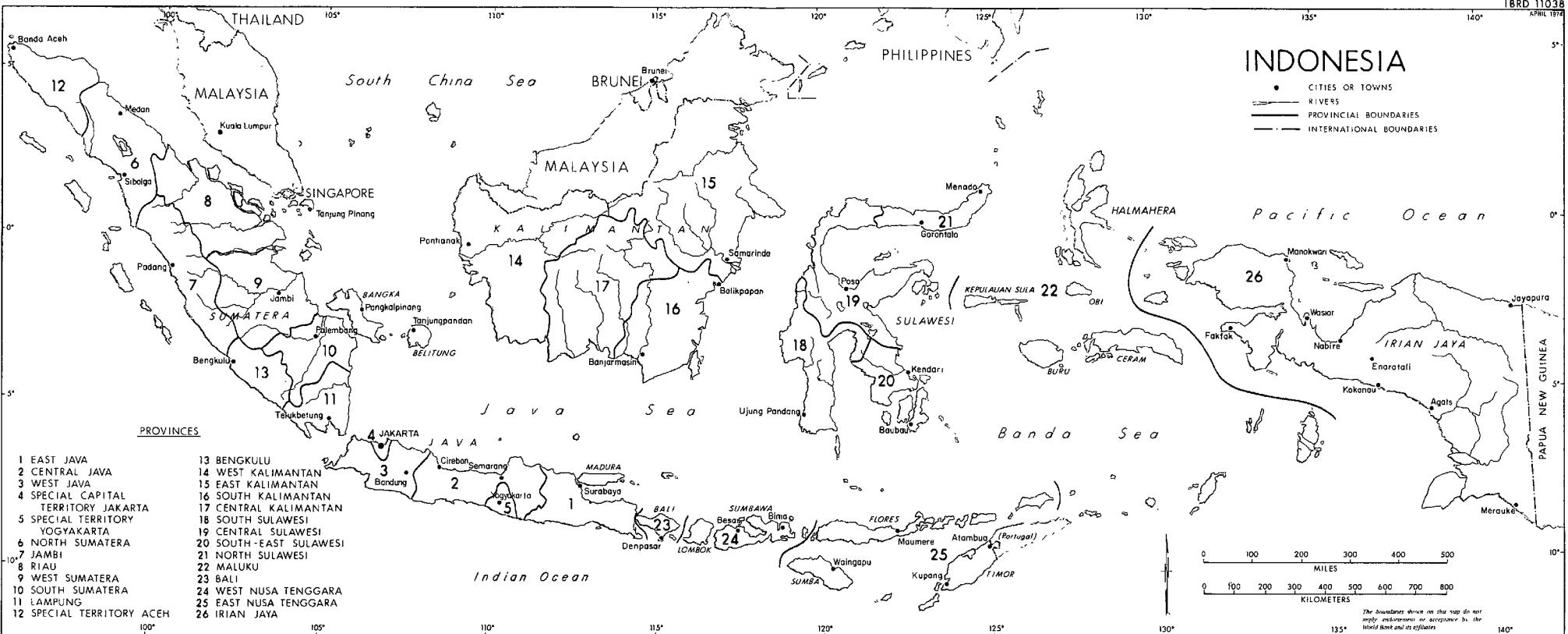
INDONESIA

• CITIES OR TOWNS
 - RIVERS
 — PROVINCIAL BOUNDARIES
 - - - INTERNATIONAL BOUNDARIES



INDONESIA

- CITIES OR TOWNS
- RIVERS
- PROVINCIAL BOUNDARIES
- INTERNATIONAL BOUNDARIES



SUMMARY OF FINDINGS AND RECOMMENDATIONS

i. This year's World Bank Economic Report does not deal with the short-run situation, nor with a deep analysis of the structural problems and long-term prospects of the Indonesian economy. Its scope is limited to an examination of the public sector investment program over the three years 1976/77-1978/79, which will close the period covered by Repelita II, the second five-year development plan. Public sector here includes not only the central government, but also public enterprises whose investments are financed partly from the central government budget, partly from the enterprises' own savings and partly by borrowing from domestic and foreign banks and from foreign suppliers.

ii. Circumstances have compelled us to focus particular attention on the impact of projected financial resource availabilities on these public sector investment plans. However, the real aim of the examination is not simply to prepare bankers' sums; it is to examine these plans in the light of the needs of Indonesia's fast expanding population, in particular, the need to provide the poorer segments of this population with growing opportunities for productive employment. Unfortunately, in the time available and under the prevailing circumstances, the planned examination of the investment program and of its employment and income effects could be only a preliminary one; we hope to improve and elaborate on it in the coming year.

iii. The progress of Indonesia continues to be impressive in most respects. Agriculture has succeeded in providing better nutrition to a growing population, while also producing growing exports of timber, rubber, palm oil, coffee and a variety of lesser products. Where ten years ago there was practically no industry, self-sufficiency has been achieved in textiles, and can be foreseen at an early date in cement and fertilizer. Other types of manufacturing have been started and are expanding. Petroleum production has increased rapidly. Production of other minerals, in addition to tin and bauxite, has started, including notably copper and nickel. Jakarta - one of the world's fastest growing cities - and other towns have acquired some of the trappings of modern urban life, while at the same time an imaginative effort is also being made to alleviate the lot and improve the living environment of the urban poor. Irrigation, transport, electric power and other infrastructure facilities have been improved and expanded. Education facilities and school enrollment have greatly increased.

iv. This advance on a broad front was facilitated by the rise of oil revenues, from \$150 million in 1969 to \$3 billion in 1975/76. However, there were other important contributory factors: an initially well-balanced investment program, a pragmatic approach to the exploitation of natural resources, frugality in military expenditures, and encouragement to private investment, both domestic and foreign. Certainly, all was not well in Indonesia: there was in particular justified concern about the growing pressure of population in Java; but most things were improving.

v. However, below these visible and real improvements of the past seven years and despite the formulation of a well-balanced second five-year development plan, a set of difficult and unanticipated problems has accumulated in the past two years. Following the increase in oil prices, the official investment program was revised upwards, in keeping with the improved resource situation. While dynamic and fairly large, this revision was well in keeping with the Government's projected resource availabilities and by itself it created no problems.

vi. These arose elsewhere. It was known that the State Oil Company, Pertamina, was also independently undertaking an investment program of its own, which - beyond the normal needs of petroleum exploration, production, refining and distribution - extended to heavily capital-intensive investments in natural gas liquification, petrochemicals, steel, office and hotel buildings, housing, ocean-going tankers, etc. It was the general impression that Pertamina's own resources - including what it could itself borrow abroad and service - would cover the costs of this investment program. In fact, it subsequently appeared that such was far from being the case and this resulted in serious liquidity problems. The Government stepped in to stem an incipient crisis just in time, inter alia, by undertaking to assist Pertamina in servicing its debts. Furthermore, it launched a comprehensive reexamination of Pertamina's investment programs. This disclosed that some of the Pertamina projects outside the oil sector were not carefully planned, some represented investments of doubtful merit, some were unnecessarily costly and involved incautious contractual arrangements. Some had undoubted merit but were encountering cost overruns. Furthermore, as already said, their aggregate financial magnitude was beyond Pertamina's own financing capacity and was far greater than had until recently been appreciated by the Government. Pertamina had, in short, preempted a substantial part of the resources which the Government had expected to be available, and had planned to devote to the purposes expressed in Repelita II in the course of the coming years.

vii. Following this review the Government decided to reduce, defer or abandon many of the on-going and planned Pertamina projects. It launched an effort to renegotiate contracts. This process has met with some success and is still underway. Furthermore, full Government control

was imposed on all foreign borrowings of Pertamina (and of all public sector firms), and this has made it impossible for them to borrow abroad without Government approval in future. Nevertheless, principally to meet Pertamina's obligations, the Government's foreign assets, instead of growing had to be significantly depleted and substantial medium-term cash borrowings had to be arranged in private financial markets. Most of Pertamina's short-term debt has now been paid, but large resources will continue to be absorbed by already incurred foreign debt, by additional debt which must be incurred for the completion of those projects which it is not economical to stop or further reduce in size or cost, and by the domestic costs of those projects.

viii. Indonesia's financial difficulties were further compounded by the fact that in 1975/76 oil revenues fell substantially short of anticipations, because of the unexpected decline in consumption in Indonesia's principal markets. One of the effects of this unanticipated shortfall in Government revenues was that reliance had to be placed on commercial foreign credits and on the domestic banking system to finance a considerable share of investment by public enterprises. The reliance on domestic credits contributed to an increase in overall liquidity which exceeded 40 percent despite a substantial decrease in foreign exchange reserves. This in turn contributed to inflation at the rate of about 20 percent in 1975/76, a rate higher than that prevailing in Indonesia's principal trade partners and competitors. A continuation of inflation at this rate, in addition to its undesirable domestic effects, including an adverse impact on income distribution, would result in balance of payments difficulties.

ix. When these circumstances became fully known to the Government, it realized clearly that they confronted it with a number of serious and difficult problems. It had to find the resources to service the enlarged foreign debt, to complete those elements of the Pertamina program which cannot be abandoned or deferred, and to carry out as much as possible of the investment program envisaged in Repelita II, so as to restore to the overall public sector investment program the intended balance. This original thrust of the program was intended to make it contribute most effectively to increasing the income earning opportunities, and improving the living conditions of the poorest and most underprivileged sections of the population.

x. A year ago the Government and the World Bank estimated that service on the debt contracted as of the end of 1973 would amount to about \$300 million in 1978, thus leaving plenty of room for further borrowing. It now appears that service on debts contracted as of the end of 1975 will peak at \$1256 million in 1978, excluding obligations contracted by Pertamina on account of oil tankers which are currently being renegotiated. This enlarged debt service will, in future years, sharply reduce net resource inflows which were of the order of \$500-600 million in 1973 and 1974, and well in excess of those amounts in 1975 and 1976. The Government realizes that nevertheless, in order to prevent debt service from rising beyond prudent limits, new borrowing after 1976 would need to be sharply reduced, despite buoyant export projections.

xi. Confronted with these problems the Government has taken a series of important, far-reaching and difficult decisions. It has decided that foreign borrowing must be cut back sharply from the 1976 level of about \$3.4 billion to \$2.1 billion in 1977 and \$2 billion in 1978, before being allowed to rise again to about \$2.9 billion in 1980 and to \$5.8 billion in 1985. Especially in the early years, it aims to effect most of the reduction through a cut in the least concessionary borrowings. This decision is dictated by the necessity to keep the debt service manageable. It reflects the hope that Indonesia will be able to borrow about \$1.4 billion on concessional and semi-concessional terms in 1976 and slowly rising amounts thereafter. It also reflects the assumption that borrowing from other sources, including export credit agencies and private banks, is likely to be on much harder terms and must therefore be restricted. Even the prudent borrowing program resulting from this decision will give rise to debt service ratios approaching 20 percent in 1979 (not including the above mentioned obligations on account of tankers) and declining slowly thereafter. The Government appreciates that even with such a prudent program net foreign resource transfers will be reduced to a fraction of their earlier levels in the years 1977 through 1980.

xii. The Government has also decided to increase domestic revenues in the next few years much faster than was originally contemplated and to levels much higher than those likely to result from a mere continuation of existing tax policies and procedures. It has also decided substantially to reduce the increase in net liquidity to a relatively modest annual rate of less than 25 percent, and to allot to public sector enterprises a reduced share of the increased liquidity, thus giving the private sector increasing scope for resuming its dynamic role in production and investment.

xiii. Further, the Government has also decided to reduce selectively the aggregate size of the planned or proposed public sector investment program. As already mentioned, a substantial part of this reduction has already been achieved by reductions and replanning in the scope and cost of some Pertamina projects and by elimination of others. Further such reductions are planned and further renegotiation of existing contracts is in progress. The Government also intends to defer or to shift more fully to private capital a number of new large capital-intensive projects which had been contemplated. It also intends very carefully to examine and where necessary and feasible, to reject or defer proposals for the purchase of costly equipment for transport, telecommunications and power. It believes that restraint on these types of investment should reduce, and perhaps even eliminate the need for reducing other planned programs. These actions have shifted and will further shift the balance of the total public sector investment program back towards greater emphasis on directly improving the income earning opportunities, productivity and living conditions of the mass of the population. Together, the actions already taken and the further set of actions decided by the Government constitute an effective response to the situation confronting it.

xiv. As indicated above, official concessional and semi-concessional development assistance of not less than \$1.4 billion is required in the current year. International organizations should be in a position to provide half of this. Bilateral development assistance should provide the other half, of which at least \$600 million should come from bilateral IGGI sources. As a substitute for harder term borrowing which will still be necessary, larger amounts of concessional and semi-concessional terms would be desirable and would be an appropriate complement to the actions the Government itself has taken and plans to take. To the extent that they can be provided, debt management would be facilitated, the immediate sharp compression of net transfers from abroad would be attenuated, and the continued expansion of the essential elements of the public sector investment program would be facilitated. In view of the projected reduction of net resource transfers in the next few years, it would also be helpful if part of the official development assistance were to take quick disbursing forms.

INTRODUCTION

1. This year's World Bank economic report on Indonesia does not concern itself with the short-run evolution of the economic situation. That is described in the report of a recent IMF mission, with which the Bank staff has had ample discussions and with whose findings and conclusions it is in general agreement. Nor will it, like last year's Basic Report, examine most of Indonesia's economic sectors and most major aspects of its development policy. This report's more modest main aim is an assessment of Indonesia's public sector investment programs over the remaining three years of the current Second Five-Year Development Plan (Repelita II), mainly from the point of view of their consistency with financial resource availabilities, and to the extent feasible, from that of their likely impact on employment. Public sector here is defined to include central government and public enterprises. Part of the public enterprise investment program has been financed from the central government's budget in the form of Government equity participation but partly also financed from bank credits and the public enterprises' own savings.

2. This concentration on public sector resources and investment is not motivated by an under-estimation of the private sector's contribution to development, in the past or in future. However, the public sector occupies the commanding heights of the Indonesian economy. It has command over the bulk of resources, it traces the way and provides the means of development. Direct employment creation by the public sector will not, and cannot be expected to absorb a large fraction of the six million new entrants into the labor force over the next five years; private services, labor-intensive industry, food and plantation agriculture must bear the brunt of that burden. However, the public sector must provide vital support, both by leaving enough resources available to finance private investment, and by gearing its own investment programs to provide appropriate support and to shoulder directly part of the burden.

3. The bulk of Indonesian planning and project executing agencies have made great and effective efforts to further the second Repelita's targets, which strongly emphasized the need to provide additional incomes and employment to the poor. Vast amounts were spent on irrigation and on rural roads, on plantations and on paddy development, on schools and on rural clinics. In many such fields, expenditure and achievements during the first two years of the Plan were quite consistent with overall plan allocations. In other fields, where expenditure lagged behind targets, the time spent was nevertheless put to good use in preparing for the future expansion of the programs. Progress has been impressive. Those who doubt the testimony of statistics can find convincing visual evidence by travelling through Java. Furthermore, while one cannot deny that many of the rich have become richer, it also seems quite clear that most of the poor have become less poor.

4. The overall volume of public sector investment is impressive. In most fields of infrastructure, industry, irrigation, new facilities are being added to a still very low stock at a very fast rate. The cash flows of many individual enterprises and also of the public sector as a whole are influenced by the fact that investments in the process of being carried out and therefore not yet productive, are a high proportion and in many cases a multiple, of total capital stock. Conversely, however, the large stock of investment now in the process of being completed, which is the source of present difficulties, contains a promise of fast growth when the present investments mature and become productive.

5. Nevertheless, the situation is in some respects quite different from what was foreseen in the Plan document, or even last year. The outstanding feature of this divergence is that by early 1975 the public sector of Indonesia had become committed to a number of heavily capital-intensive, expensive investments in industry, in infrastructure, in administrative and service buildings. A very large part of these commitments was incurred by the national oil company, Pertamina.

6. The widespread impression was that Pertamina's resources would cover the financial needs of its investment programs. This assumption has proved to have been quite incorrect. The amounts of Pertamina's investments were substantial and could not be covered by its own resources. Even after they were sharply curtailed by cancellations and renegotiations of contracts, Pertamina's investments will amount to about US\$1.1 billion in 1976/77, not including such investments as will be financed by Pertamina's own current earnings nor the settlement of large but not fully defined obligations on account of tankers (which are currently being renegotiated). Furthermore, this year's debt service payments on account of Pertamina's debt - not including payments to be made on account of tankers - amount to more than US\$400 million.

7. Even if the 1975 fall in export prices and slowdown in the growth of oil revenues had been correctly foreseen, the discovery of the Pertamina burden was clearly cause enough for the Government to reexamine the investment program, the policies which help to determine resources, and overall priorities. In a first stage, before the long-term impact of the problem had been fully understood, this reexamination led to sharply increased reliance on foreign borrowings in 1975, and, because many projects are now too advanced to be conveniently stopped, also in 1976. However, the Government has decided also to increase its domestic resource mobilization effort, and beyond this, to curtail investments as much as is necessary to return to domestic equilibrium and prudent foreign borrowing. It will bring the brunt of these cuts on capital-intensive undertakings, by reducing to the minimum, in the next two to three years, new project starts in industry and new purchases of expensive equipment for transport and communications.

8. We would have liked to examine in detail the impact of the public sector investment program on incomes and employment. This report must fall well short of this ambition for lack of data and of time. The first chapter will aim at estimating the domestic resources likely to be available for public sector investment. Chapter II will trace the outlines of a reasonable foreign borrowing program. Chapter III will describe the overall magnitude of the public sector investment plans and programs, and their rough composition. It will also briefly examine at least in qualitative terms, their implications for Indonesia's income and employment growth rates.

9. The time horizon of this report is March 1979, the end of Repelita II. However, with respect to foreign borrowing, the present is dependent on the future; current borrowing ability is limited and determined by future repayment ability. Consequently, whatever the hazards of long-term projection exercises, particularly in fields where even the present and the past are little-known, we cannot avoid projecting certain aspects of the balance of payments until 1985. The world context assumed for these projections is that provided by the Economic Analysis and Projections Department of the World Bank: vigorous recovery of the world economy accompanied by 7 percent annual rise in international prices until 1985.

10. The domestic context is clearly dependent on the manner in which policies are conducted, but we have made the general assumption that overall GNP will grow at 7.5 percent in real terms. Part of this growth will be the outcome of past investments about to mature, and a large part should be yielded by private investment, for which the Government intends to release new resources and create additional opportunities. With proper care for the composition of the investment program, and appropriate resource allocation policies, such a growth rate is not incompatible with the likely investment by the public sector over the next three years. With proper sectoral spread of investment and reasonable income distribution policies, such a growth rate should yield very substantial benefits to the bulk of the population over the next decade.

CHAPTER I

DOMESTIC RESOURCES FOR THE PUBLIC SECTOR

Oil Revenues

11. Oil revenues are the most important determinant of the Government's domestic resources. They provided about 20 percent of total domestic Government revenues in 1970 and 59 percent in the 1976/77 budget. During this period, Indonesia's total oil production expanded rapidly, from about 220 million barrels in 1968 to 502 million barrels in 1974. Production and exports fell in 1975, but have now recovered. Thanks to the surge of exploration and development in the early 1970s, the capacity of the Indonesian oil industry is now running well ahead of actual production. Both should continue to increase over the next few years. Export volumes will, of course, also be influenced by the growth in domestic consumption, which now amounts to about 90 million barrels and has been growing at about 15-17 percent annually.

12. Table 1 below gives a likely projection of oil revenues. The 1976 figure is based on the Government projection; according to the President's budget speech, it implies an increase in the Government's share of total gross revenues. Sixty percent of Indonesia's oil is produced by Caltex under "contracts of work" arrangements. The Caltex fields are old, and their output is likely to decline in future, at a rate determined by the attractiveness of secondary recovery. For 1977 and 1978, we have used recent figures for contracts of work production, which are much higher than the very prudent official projections made in 1974 (0.77 and 0.70 million bpd compared with 0.51 and 0.34 million bpd). As contracts of work production yields more per barrel in tax revenue than production-sharing output, it is assumed that this potential production will be fully realized.

13. An increasing share of future production will have to come from newer fields exploited under production-sharing contracts, which started producing in 1971. This output has continued to rise sharply, even though demand was a limiting factor in 1975, when production was much less than had been forecast a year earlier. The expansion of output depends on exploration and development, and on demand, which in turn is determined by the rate of recovery from the world recession, by world energy policies, and by the overall attractiveness of Indonesian oil to major consumers and to integrated petroleum companies - which is a function of price and of profits, but also of longer-term political considerations. Projections are necessarily uncertain, though it seems safe to assume that output will continue to rise at a fast rate. Because of their higher costs of production, "production-sharing" oil's per barrel contribution to the budget and to the balance of payment is much lower than that of Caltex.

14. The final element in oil production is Pertamina's own output. This has also been affected by external demand and, unlike production sharing, failed to increase in 1975. Part of Pertamina's production comes from old

fields, and in a recent study it was expected to peak in 1977-79 and then decline. In any case, Pertamina only accounted for 7 percent of total production in 1975. In the next few years, its revenues are likely to be absorbed by the costs of its investments not included in the investment totals given below.

Table 1: Oil Revenues, Budget and Balance of Payments
(Fiscal Years Beginning April 1)

	<u>1973</u>	<u>1974</u>	<u>1975</u>	<u>1976</u>	<u>1977</u>	<u>1978</u>
1. Production of foreign oil companies (million bbl)	433	499	436			
2. Pro rata crude for domestic market	<u>53</u>	<u>54</u>	<u>57</u>			
3. Exports (million bbl.)	380	395	379			
4. Gross income (\$ million)	1556	4720	4711			
5. General costs (\$ million)	<u>179</u>	<u>576</u>	<u>644</u>			
6. Operating income (\$ million)	1377	4144	4067			
7. Retained by companies (\$ million)	542	1104	944			
8. Oil revenue (\$ million)	835	3040	3123	3993	4602	5376
9. Oil revenue (Rp. billion)	347	1262	1296	<u>1/</u> 1657	1910	2231
P.M.: tax per barrel produced (7/1)	1.93	6.77	7.16			
tax per barrel exported (7/3)	2.20	7.70	8.15			

1/ Includes oil revenues withheld by Pertamina. See Table 3, p. 8 for actual receipts.

15. Future Government income is determined by the volume of exports, the price in foreign markets, and the distribution of net revenue between the Government and the oil companies. This distribution is the subject of continuing negotiations, which could be unfairly influenced by the World Bank publicly making explicit assumptions about the future sharing of oil revenues; and the implicit assumptions could easily be derived if separate export volume and revenue assumptions were shown. Consequently, Table 1 above shows separate production figures only until 1975; beyond that date, only tax revenue figures are shown. They are projected to rise from Rp. 1,300 billion in 1975/76 to Rp. 1,660 billion in 1976/77 and to Rp. 2,230 billion in 1978/79. In any case, there is some negative correlation between these factors, which makes it somewhat less difficult to project revenues, which are their end result, than to project each element separately.

16. A final remark: oil prices and oil revenues have been notoriously unpredictable in the past, and there is no reason to be confident about their future behavior.

The Rate of Domestic Inflation and Monetary Financing

17. One crucial consideration for determining domestic non-oil revenues (and expenditures) is the likely level of price inflation. This is also, to a considerable extent, a normative assumption: domestic price inflation is largely a policy-determined variable.

18. Between January 1, 1974 and January 1, 1976 the Jakarta cost of living index rose by about 60 percent, i.e., at an annual rate of about 25 percent. In recent months prices have been rising at annual rates of about 20 percent, but the official assumption underlying the budget is that fiscal 1976/77 prices will be about 10-15 percent over the previous year's average level. An earlier inflationary bout had been started in 1973 by a combination of crop failures and world inflation. More recently, the main cause of inflation has been the continued fast expansion of bank credits to finance public investments. Total liquidity expanded by over 40 percent in 1975/76, despite a sizeable reduction in foreign exchange reserves; and about half of new credits have gone to the public sector, thus forcing some tightening of credits to the private sector.

19. The balance of payments is the most immediate consideration when one views the costs of inflation, and the desirability of slowing it down. Indonesian prices have got increasingly out of line with those of major trading partners and competitors. Indonesia's export earnings are most strongly influenced by the export of oil, whose production costs bear little relationship to domestic price levels. Other extractive industries, including timber, are similarly little influenced by the overall relationship of domestic to foreign prices. On the other hand, imports are responsive to relative prices. The establishment of labor-intensive export industries, which are essential for future employment, is also heavily dependent on the maintenance of reasonable domestic to foreign price ratios.

20. In view of its adverse impact on the balance of payments and on income distribution, the Government has decided to slow down inflation in the current year. Consequently, it is intended to reduce the expansion of total liquidity from the 40 percent and higher average annual rate of the past four years to about 22 percent in 1976/77, with inflation at about 10-15 percent, and to an annual rate falling to about 20 percent in 1977/78 and thereafter, with inflation at about 7 percent, i.e., the projected rate of world inflation.

21. To ensure that the private sector will play the dynamic role attributed to it in Indonesian thinking, the public sector will have to preempt a declining share of the growth in total liquidity. In 1976/77 it is the Government's intention that the public sector should preempt no more than 50 percent of the growth in total liquidity, roughly the same as the exceptionally high share in 1975/76. Thereafter, its share will gradually be reduced to about one-third - still higher than its share before 1973, but one probably in line with its increased economic role.

Table 2: Public Sector Enterprises Reliance on Increases in Liquidity
(in billion rupiahs)

	<u>1972/73</u>	<u>1973/74</u>	<u>1974/75</u>	<u>1975/76</u>	<u>1976/77</u> (estimate)	<u>1977/78</u>	<u>1978/79</u> (projection)
Total liquidity at end period	769	1203	1583	2400	2920	3504	4204
Increase in total liquidity during period	221	434	380	817	520	584	700
of which							
private sector				408	260	360	448
public sector				408	260	224	252

Tax Revenues

22. The assumption about inflation has a strong bearing on public revenue projections. Apart from the tax on oil production, the main components of Government receipts are taxes on foreign trade, domestic sales and excise taxes, and taxes on income. There are two levels at which future revenues can be intelligently discussed, and neither of them is pure forecasting. One could have a purely normative discussion of the way in which revenues should be made to behave; alternatively, one could try to project how revenues are most likely to behave if no major departure is made from past tax practices. The Government of Indonesia has recently decided to make a sizeable additional revenue mobilization effort, and we reflect these decisions in our projections, which thus show much higher revenues than would result from the mere continuation of earlier tax rates, policies and collection procedures.

Table 3: Current Government Receipts, 1976/77 - 1978/79
(in billion rupiahs at current market prices)

	1969/70	1973/74	1974/75	1975/76	1976/77	1977/78	1978/79
	-----	Actual	-----	Estimated	Budget	--Projected--	
Corporate tax on oil	48	347	973	1227	1657	1910	2231
Taxes on income: other	43	163	260	337	425	580	745
Taxes on domestic consumption	68	169	161	236	314	431	531
Taxes on international trade	81	254	301	309	348	403	472
Non-tax receipts	<u>3</u>	<u>44</u>	<u>62</u>	<u>57</u>	<u>58</u>	<u>71</u>	<u>96</u>
Total Domestic Revenues	244	977	1759	2166	2802	3395	4075
+ additional resource mobilization					<u>100</u>		
					<u>2902</u>		

23. The following brief description of various taxes shows how the revenue projections are built up:

Import duties. Imports rose rapidly in both volume and price in 1974 and 1975. They are assumed to rise further by 24 percent in 1976/77, and at a rate of about 15 percent in the following two years.^{1/} Although the value of food and fertilizer imports is falling, the ratio of dutiable imports to total imports is projected to decline slightly because of the rising share of capital goods. Average duty rates on dutiable imports are taken to remain at their recent level of somewhat over 20 percent. It is assumed that there will be a significant improvement in tax enforcement. The budget accordingly estimates that revenue from import duties will rise by 27 percent in 1976/77. Somewhat lower increases are projected for 1977 and 1978.

Sales tax on imports. Sales tax on imports is assumed to yield 40 percent of the revenue from import duties, as in the 1976/77 budget.

^{1/} This appears roughly consistent with the export and borrowing projections made later on, and also with the official balance of payments forecast for 1976/77.

Export taxes. A great decline in revenue is estimated in the 1976/77 budget, as the duties on many exports have been reduced or removed entirely. Revenue from export taxes is assumed to have lost major significance.

Sales and excise taxes. In the 1976/77 budget, sales tax collections are estimated to increase by 24 percent, as against 43 percent and 56 percent in the two previous years. Tax rates have been reduced to 10 percent on services and 5 percent on a wide range of goods, to encourage consumption of domestic products. Excise revenue has been rising at about 28 percent per annum recently and this rate of growth is projected to accelerate further. These taxes apply to a range of locally produced goods, especially cigarettes, beer and spirits, and sugar. We understand that greater effort is to be made to reduce evasion, and we assume that this will more than make up for the possible reduction in the tax on sugar, and for the negative impact of slowed-down inflation. Excise and sales taxes are clearly a major potential source of additional revenue, and vigorous growth for them can be projected.

Other oil revenue. In recent years, domestic prices of petroleum products were adjusted from time to time to meet rising costs of crude oil, refining and distribution. It is assumed that for 1977 and 1978 this policy will be continued. Net revenues from this source are projected to continue at a low level.

Personal and non-oil corporate income taxes. In the last two years, revenue from personal income tax has risen by 30 percent and 41 percent. For 1976/77, the budget estimates a further growth of 33 percent, reflecting a continued rise in nominal incomes and increased tax collection efforts. The tax holidays enjoyed by a number of private corporations under the investment incentive law will soon expire. This, and improved collection could make room for rising tax payments despite lower inflation rates.

IPEDA. Collections from IPEDA (land tax) have been declining in real terms and no improvement is projected in the 1976/77 budget. More intensive collection and wider coverage of assessed land areas rather than a significant revaluation of land values is the basis of modest increases in revenue projected for 1977 and 1978. On balance, income taxes of all sorts, including IPEDA, are projected to continue growing by 30 percent in 1977 and again in 1978.

Routine Expenditure

24. In general, current, or as they are called in Indonesia routine, expenditures have remained extremely modest. Of course, as everywhere, one can find examples of expenditures which are superfluous or excessively lavish; but on balance, there is very little that can be cut out of current expenditure without hurting development. In particular, firm control continues to be exercised over defense expenditures. Given the earlier record, we have reason to assume continued restraint over these, and only the mildest relaxation of restraints over other routine expenditures, particularly in fields where they are indispensable to social progress or economic development.

25. In fact, these assumptions may well be overly restrictive and thus lead to overstated projections of public savings. In any case, whatever the financial situation, cuts in routine expenditures below their projected level will be impracticable. In particular, personnel expenditures - which, it is true, increased substantially in 1974/75 - are projected to decline in real terms in 1976/77, and recover only in subsequent years.

Public Savings

26. Not including expenditures needed for debt service, public savings have increased from Rp. 42 billion in 1969/70 to Rp. 347 billion in 1973/74, and are projected to increase further to Rp. 2,150 billion in 1978/79. These projections are in current prices; in real terms, there were also substantial increases until 1974/75, but an actual decrease in the fiscal year just ended.

27. One cannot but be impressed by the fact that "public savings", as defined above, have increased from about 20 percent of domestic current revenues in 1969/70 to a budget level of almost 50 percent in 1976/77. True, this period saw a five-fold increase in oil revenues; but the increase in public savings did not lag much behind. Indeed, 87 percent of the corporate tax on oil was saved in 1969/70, and still over 77 percent of the much increased oil revenue in 1975/76. This is no mean achievement for a country with crying needs for current public expenditure of all sorts. Unfortunately, one must repeat the oft-made statement, that Indonesia's oil revenues are low per capita. The effort made to save them for investment is commendable, and remarkably successful; it is unfortunately not enough to provide adequate resources for investment. This is all the more so as a notable, and fast-increasing part of public "savings", as defined above, is absorbed by debt service.

28. Public savings rose in current prices only modestly in 1975/76. However, the Government has decided to renew its domestic resource mobilization efforts. This firm decision is the basis for our projection of growing revenues, which should raise public savings (before debt service) by over 60 percent in real terms over the next three years. There is no question but that this is a feasible target, and that its achievement will demand the continued exertion of technical skills and of political determination.

29. Normally, interest payments at least are added to current expenditures before deriving the current surplus. Indonesian practice has been even more conservative: both interest and principal repayments on the Government's own debt were counted as current expenditures. However, this report follows a different practice. Most of the Indonesian Government's debt service payments go to foreign lenders. When discussing resource availabilities, it seemed preferable to present foreign capital inflows on a net resource transfer basis, as well as on that of gross lending. We, therefore, excluded debt service payments from the budget, and treat them as a separate category.

Table 4: Routine Government Expenditures During Repelita I and II
 (in billion rupiahs at current market prices)

	1969/70 <u>Actual</u>	1973/74 <u>Actual</u>	1974/75 <u>Actual</u>	1975/76 <u>Est.</u>	1976/77 <u>Budget</u>	1977/78 <u>Proj.</u>	1978/79 <u>Proj.</u>
Personnel expenditures	104	259	408	593	645	850	970
Material expenditures	50	109	167	257	313	360	414
Subsidies to regions	44	113	207	285	307	368	442
Other expenditures	4	149	149	86	163	85	95
Total Routine Expenditure (not including debt service)	<u>202</u>	<u>630</u>	<u>931</u>	<u>1,221</u>	<u>1,428</u>	<u>1,663</u>	<u>1,921</u>
<u>Public Savings Estimates</u>							
Domestic revenue	244	977	1,759	2,166	2,902 ^{1/}	3,395	4,075
Public savings (before debt service)	42	347	828	945	1,474	1,732	2,154
Public savings (before debt service), in real terms [index]	100	454	818	763	1,035	1,105	1,284

N.B.: Debt service expenditures were excluded from current expenditures.

1/ Including Rp. 100 billion from additional resource mobilization effort.

30. It is worth noting, however, that interest payments on the debt of the Government proper absorbed Rp. 76 billion resources in 1975/76, and Rp. 176 billion in the 1976/77 budget. By 1979, interest payments on the foreign debt of the public sector are projected at Rp. 265 billion equivalent; total service on public debt at Rp. 780 billion. These payments will be a first charge against public savings, thus greatly reducing the resources left available to finance investment.

Savings of Public Sector Enterprises

31. The Indonesian public sector is a large one, and plays a vital role in the economy. It extends to many fields which, in some other countries are the preserve of the private sector; indeed, it encompasses all fields of large-scale production activity. The public sector owns all mineral resources (though most of them are exploited under various contractual arrangements by private firms); it owns and manages most of the large-scale plantation sector; it has plants operating or under construction in industries as diverse as petrochemicals and steel, textiles and cement, woodprocessing, pharmaceuticals and tourism, shipbuilding and plantations.

32. It would therefore be important to consider, and if possible to measure, the public sector enterprises' contribution to the financing of investment. Unfortunately, any such attempt runs into many difficulties. In particular, the accounts of some public sector enterprises were not available in time for this exercise, nor do they always allow an assessment of their contribution to financing the increase in the capital stock, in particular because the current value of their capital and their depreciation costs are often underestimated. Another problem is a lack of consistency in accounting for the cost of interest during the construction of new facilities. Furthermore, some public enterprise savings finance investments which are not included in the public sector program described in Chapter III. For instance, it has been estimated that such other investments of Pertamina, (i.e., those not included in the program described in Chapter III) roughly absorb Pertamina's entire current surplus. 1/

33. On balance, as the situation stood but a few weeks ago, one could project that over the next three years public enterprises would contribute only about Rp. 150 billion to financing those of their own investments included in the overall public sector program. This is in part because of the very large size of their investment programs as compared to their current operations; and in part because in many cases, their prices or tariffs are barely enough to meet even their current operating costs. There is one large set of exceptions to this general rule: the public sector plantation industry expected its own resources to finance about 50 percent of its very considerable investment program, and thus contribute about Rp. 100 billion to overall public sector resources over the last three years of Repelita II.

1/ This calculation does not take into account the burden of Pertamina's obligations on account of tankers.

34. However, the recent decisions of Government should yield considerable additional savings. Steps have already been taken to make new telephone subscribers contribute about Rp. 30 billion towards the cost of this year's telecommunications program, and similar steps are expected in other fields. We are therefore projecting the public enterprises' surplus at Rp. 100 billion in the current year, and at a total of Rp. 250 billion for the following two-year period.

CHAPTER II

BALANCE OF PAYMENTS AND FOREIGN RESOURCE INFLOWS

The Debt-Service Ratio

35. Foreign resource inflows, which have financed a substantial share of public sector investment in Indonesia, have a special temporal dimension. Their discussion cannot be limited to the three-year time horizon which is generally that of this report. Each year's net foreign resource availabilities are partly determined by the past, through the year's debt service burden; by the present, which bears on the state of capital markets, interest rates, the general ease or difficulty of borrowing; and the future, because their perception of the future debt service burden is a main determinant of lenders' willingness to lend, and should be a major determinant of the borrower's desire to borrow.

36. Nowadays conventional wisdom has it that whenever the debt service ratio is likely to reach 20 percent a more prudent external borrowing policy should be followed. The debt service ratio normally refers to public and publicly guaranteed debt of more than one year duration in the numerator, and to exports of goods and services (occasionally goods only), in the denominator. Also conventionally, oil exports are included net of costs, fees and profit remittances; other exports are included at their gross value.

37. The 20 percent ratio is merely a convenient convention. Its basis is the assumption that it is difficult for a country to set aside more than 20 percent of its export earnings to service public debt, without seriously reducing its ability to make other needed payments, for imports, services, private debts and profit remittances. The intensity of the difficulty naturally depends on the composition of these payments. In particular, large imports of non-essential consumer goods are easier to compress than imports of current inputs or of food. Conversely, since there are private foreign debts or direct investments, these must clearly also be serviced, and thus reduce the amount of public debt which can be conveniently serviced. In the case of Indonesia, a considerable part of the debt service will be on account of projects which directly reduce the need for imports (e.g. fertilizer and cement), and the composition of other imports renders them amenable to being further compressed in case of need. On the other hand, there are large payments to be made to private lenders and investors, which cannot be stopped.

38. There are some contractual payments not included in our tables: these are Pertamina's obligations on account of tankers. These obligations are not pure debt service; a substantial part of them is due on account of the future cost of operating the tankers. However, the Government has decided to renegotiate these contracts, and - given their terms - there seems to be a good chance of their doing so successfully, and thus reducing their cost. Nevertheless, the future burden of tankers will remain large, and it will weigh directly on the public sector. It must be kept in mind when one traces the limits of prudent borrowing.

Past Borrowing Policy, and Service on Past Debt

39. During most of the past decade, Indonesia's public borrowing policies were quite prudent. Only funds on favorable terms were accepted, and only in amounts which appeared to put no substantial strain on future debt servicing ability. Only a year ago, it seemed that new borrowing over each of the years 1976-78 could amount to about \$2 billion annually thus leaving adequate room for additional capital inflows in the course of the next decade.

40. In fact, however, Pertamina had undertaken investment programs much in excess of its financial abilities, notably by using short-term borrowings. These borrowings coincided with an unexpected shortfall of oil revenues from earlier projections. Though many investment plans were slashed, thus reducing their costs by about \$1.5 - 2 billion, nevertheless sharply increased borrowing was needed in order to consolidate short-term debt and to carry on with firmly planned projects.

41. Most of these credits came from private banks, either as cash to repay short-term debt, or as buyer's credits for equipment purchases. These loans, and the existence of Pertamina's other obligations have altered Indonesia's debt picture. Last year, our basic report projected that with adequate borrowing over the next few years, the debt service ratio would reach about 10 percent only in 1980.^{1/} It now seems that even if new borrowing in the period 1977-1980 is kept somewhat below the basic report's estimates, the 1980 debt service ratio will approach the 18 percent mark.

Export Projections

42. Over the next decade Indonesia's export prospects are good. The country has a remarkably broad natural resource base, and policies which are on the whole conducive to the efficient and fast exploitation of those

^{1/} This specifically excluded service on the 1975 cash loans arranged to refinance Pertamina's short-term debt.

Table 5: Service on Past Debts
(US\$ million)

	Service on public debt contracted before 31/12/73			Service on public debt contracted before 31/12/75			1/
	Interest	Principal	Total	Interest	Principal	Total	
1976	112	236	348	349	425	775	
1977	106	225	331	419	615	1034	
1978	100	206	306	422	834	1256	
1979	95	197	292	380	859	1239	
1980	90	207	296	322	787	1109	
1985	84	231	315	196	523	718	

Table 5a: Details of Public Sector External Debt Service Requirements
Service on Debt Contracted Before December 31, 1975
(US\$ million)

	Government			Government Enterprises								
	Direct Debts 2/			Pertamina			Other			Total 2/		
	P	I	T	P	I	T	P	I	T	P	I	T
1976	108	221	329	298	117	415	19	12	30	425	349	775
1977	385	289	674	207	121	329	22	9	32	615	419	1034
1978	574	300	875	237	115	351	22	7	30	834	422	1256
1979	633	271	904	208	104	312	19	6	24	859	381	1239
1980	591	230	820	179	89	268	17	4	21	787	322	1109
1981	381	204	585	166	74	241	14	3	17	562	281	843
1982	392	187	579	165	64	229	14	2	16	570	253	824
1983	391	171	563	139	53	192	6	1	7	536	226	761
1984	405	156	561	143	42	185	4	-	5	552	199	750
1985	414	162	576	108	34	142	-	-	-	523	196	718

1/ Figures relate to debts contracted by the Government and public enterprises including Pertamina. Excludes certain obligations on supply contracts for which financial arrangements are not yet firm as well as Pertamina's obligations on account of tankers.

2/ Includes the recent Euro-dollar financings for and on behalf of the Government.

resources. It also has abundant and hard working labor; new policies conducive to the growth of labor-intensive exports could cause overall export performance actually to exceed our projection. Naturally, individual commodity projections are always chancy. On the whole though, and assuming reasonable policies, our projection is probably realistic, provided one assumes, with the World Bank's development policy staff, that world inflation at an annual rate of 7 percent will continue well into the 1980s. Even with constant volumes (and assuming unchanged terms of trade) Indonesia's export value would then double by 1985. In fact, the projected average price increase from 1975 is even higher than 7 percent. 1975 experienced the deepest world recession since the 1930s, and it is not unreasonable to assume that the prices of the raw materials which form the bulk of Indonesia's exports will recover in relative terms.

Table 6: Projection of Export Values
(US\$ million)

	<u>Actual</u>								
	<u>1973</u>	<u>1974</u>	<u>1975</u>	<u>1976</u>	<u>1977</u>	<u>1978</u>	<u>1979</u>	<u>1980</u>	<u>1985</u>
Agric. Products of which Timber	1379 583	1784 725	1434 503	1607 695	2090 873	2422 1038	2745 1210	3077 1413	5629 2752
Metals/Minerals Manufactures & Misc.	157	281	274	322	532	844	869	954	3142
Total excl. oil & gas	<u>1609</u>	<u>2199</u>	<u>1821</u>	<u>2071</u>	<u>2791</u>	<u>3466</u>	<u>3860</u>	<u>4328</u>	<u>9429</u>
Oil and Gas (Net)	563	2169	2957	3806	4395	5122	5844	6380	9814
Total Exports	<u>2172</u>	<u>4368</u>	<u>4778</u>	<u>5877</u>	<u>7186</u>	<u>8588</u>	<u>9704</u>	<u>10708</u>	<u>19243</u>

43. While we do not show volumes and values separately, our projections are based on the assessment of the supply prospects of individual commodities by sector specialists; to the expected volume of exports, we have applied the price projections of the World Bank's commodities division. As can be seen, the result is a four-fold increase of non-oil export values between 1975 and 1985; about half of the total increase is on account of volume growth, at the respectable rate of 9 percent.

44. Part of the expected growth will be the result of large investments, particularly LNG, which will start contributing to exports in 1978, and in nickel and coal production 1/. Net oil exports are projected to grow somewhat faster than other exports until 1980, and considerably less fast thereafter. This is in part because, as domestic oil consumption grows faster than production, it will absorb a growing share of the increase in total output.

45. A last remark: except for oil and gas, all export values are projected on a gross basis. However, foreign enterprises will play a major role in developing some exports, for instance of aluminum, nickel and coal, and growing exports of such commodities will be accompanied, for a time, by growing profit remittances.

1/ LNG exports are projected net of cost, fees and profits of foreign companies.

Prudent Debt Service, Future Capital Commitment Levels and Net Resource Inflows

46. These various, and occasionally divergent, considerations must now be summarized. Despite all our reservations about any particular ratio's value as a policy guideline, it is not unreasonable to continue assuming that ratios of public debt service to total exports (merchandise + net oil) of the order of 20 percent are acceptable. However, keeping in mind the large private profit remittances and debt service, and Pertamina's obligations resulting from tanker contracts, it will be desirable to maintain towards new borrowings a somewhat more prudent posture than might otherwise be appropriate.

47. The projections clearly show that to remain within the prudent limits of borrowing, Indonesia must cut back sharply from the level of borrowing of the past two years. Such cutbacks cannot yet be implemented in 1976, because of loans that have already been arranged, and because of the need to finance cost overruns on several large projects. However, in future years the curtailment will have to be substantial indeed.

48. The borrowing projections presented in Table 7 are comparatively quite modest so as to enable us to state confidently that they are prudent. On this borrowing assumption, new commitments would amount to about \$3.4 billion in 1976. This is probably a realistic estimate. The Government is determined to exercise great restraint in future, and it has instituted mechanisms for subjecting all public sector borrowing to central approval. It has also decided to reduce new commitments to \$2.1 billion in 1977, \$2 billion in 1978, then to rise gradually and reach \$2.9 billion in 1980, and \$5.8 billion in 1985. Credits from governments and international organizations are projected to rise slowly from \$1.4 billion commitments in 1976 to about \$1.6 billion in 1980 and \$2.4 billion in 1985. Various types of credits from commercial banks would make up the rest of the new commitments. To the extent that softer credits are available, their use would clearly be preferable.

49. With such a borrowing program, and assuming disbursement patterns and financial conditions which, for each category, are similar to those of the past, debt service payments would rise to \$2 billion in 1980 (half on account of commitments made before December 31, 1975) and to over \$3 billion in 1985. Relative to projected exports, this would mean a debt service ratio rising to over 19 percent in 1979 and then falling slowly, to about 16 percent in 1985. Keeping in mind the existence of large private debt service payments and the exclusion from the calculations of the obligations contracted by Pertamina on account of tankers, it cannot be said that these ratios point to an overly restrictive borrowing program. Nevertheless, they seem sufficiently prudent; in particular, the projected slight decline of the ratio after 1980 is reassuring.

50. However tight this borrowing program, which in future years falls well short of the one proposed for the 1976-1980 period by last year's World Bank (basic) report, the Government is determined to keep within its bounds, at least until a revision is warranted by a firmly based revision of export forecasts. The net resource transfers corresponding to such a borrowing program will be so severely compressed as to almost disappear in certain years.

51. In 1975, gross disbursements of medium and long-term debt amounted to about \$2.4 billion, according to the latest estimates. Apparent net resource transfers - i.e., these disbursements minus reported service on long-term debt - amounted to over \$2 billion. True, a substantial part of these resource transfers was used for the net repayment of short-term debt, but this was also assisted by the drawdown of net foreign exchange reserves. On balance, it is most unlikely that true net resource transfers could have been less than about \$1.5 billion. Apparent net resource transfers in 1973 and 1974 were \$500-600 million, presumably augmented in those years by the accumulation of the short-term debt which was repaid in 1975.

52. Under the borrowing program outlined above, given the normal disbursement lags on project loans and the mounting debt service burden, net resource transfers would fall extremely sharply, to a low of \$130 million in 1979, and again reach the \$1 billion level only in the early 1980s. In real terms, net resource transfers would probably remain below their 1973-1975 levels in the course of the next decade. Furthermore, the contribution of net resource transfers to financing investments will be even further reduced by the need to increase foreign exchange reserves. Given current and projected import values and reserves, minimal prudence would require a \$500 million addition to reserves in 1976, a further addition of about \$250 million in the two years 1977-1978, and growing amounts thereafter.1/

53. A crucial part of the borrowing projections is the assumption about the amounts and terms of concessional and semi-concessional loans available to Indonesia. A sharp increase in these forms of lending would be most desirable. Yet even if it comes, and even more if it does not come, non-concessional borrowing must be forcefully reduced well below recent past levels. As noted, the Government has both the will and the means to enforce such a reduction.

1/ However sharp the decline in net resource transfers, it does not lead to an untenable situation from the point of view of import financing ability. With reasonable assumptions about direct foreign investment and profit remittances, the ratio of imports to GNP remains roughly stable.

Table 7: Foreign Borrowing Debt Service and Net Resource Transfer
(US\$ billion)

	Commitments	Disbursements	Debt Service			Debt Service ratio	Net Resource transfer
			interest	principal	total		
1976	3.4	2.71	.39	.43	.81	13.8	1.90
1977	2.1	1.83	.56	.63	1.19	16.6	0.64
1978	2.0	1.80	.62	.98	1.60	18.6	0.20
1979	2.4	2.02	.64	1.25	1.89	19.5	0.13
1980	2.9	2.32	.70	1.29	1.98	18.5	0.33
1981	3.3	2.66	.75	1.22	1.97		0.69
1982	3.8	3.03	.87	1.21	2.08		0.95
1983	4.4	3.46	1.00	1.35	2.35		1.11
1984	5.1	4.07	1.17	1.58	2.75		1.32
1985	5.8	4.70	1.32	1.84	3.16	16.4	1.66

N.B.: New commitments have been assumed to come from concessional, semi-concessional and non-concessional sources in proportions corresponding to those described in the text and on terms provided by such sources in the past.

CHAPTER III

OVERALL PUBLIC SECTOR RESOURCE PROJECTIONS AND INVESTMENT PLANS

54. One can now add together the domestic and foreign resource availabilities of the public sector derived in Chapters I and II, and compare them with the sum totals of sectoral investment plans.

Table 8: Public Sector Financial Resources and Investment Plans
(in billion rupiahs at current market prices)

	<u>1976/77</u>	<u>1977/78 and 1978/79</u>
Government current surplus	1474	3886
Public enterprises' savings	100	250
Bank credits for public enterprises ^{1/}	<u>260</u>	<u>476</u>
Total domestic financing	1834	4612
Net foreign resource transfers	789	349
Increase in foreign exchange reserves	- <u>200</u>	- <u>100</u>
Total financing	2423	4861
Public sector investment program	2501	4867

1/ Public enterprise reliance on the increase in total liquidity

N.B.: Slight 1976 gap between projected investments and resources is likely to be narrowed by increased carry-over of authorized undisbursed expenditures.

55. Table 8 above clearly shows one of the major problems confronting Indonesian planners over the next three years. Because of the precipitous decline of net foreign transfers, and the desire to reduce inflationary bank borrowings, the overall resources likely to be available to finance public sector investment programs will be about constant in current prices. In real terms, on an average, resources available to finance public investment in the last two years of Repelita II will be only about 80 percent of the current year's investment programs. After years of fast rising public sector investment, but with enormous remaining needs for capital in all sectors, planning for such a declining investment program and enforcing it will call for great and purposeful efforts.

56. Although investment requires both foreign exchange and local currency financing, and the respective shares of these could well be determined in advance, for macroeconomic analysis it seems unnecessary to make a sharp distinction between those. Indonesia is an open economy, and its foreign and domestic resources are essentially fungible. True, current experience of those involved with public sector investments in Indonesia is almost universally that domestic resources appear scarcer than foreign funds. By and large, foreign suppliers are still able and willing to arrange credits to finance their supplies, and therefore equipment imports are easier to finance than other investment costs. However, today's easy credits are tomorrow's resource outflow. As a consequence of large-scale credit financing of investment projects in the past few years, a large proportion of future foreign exchange resources will be absorbed by debt service, thus reducing what is available for other purposes, including current imports.

57. In order to prevent debt service from rising to unmanageable levels, future borrowing will have to be curtailed quite sharply - much more sharply even than future investment project starts. To an extent which will also greatly depend on the composition of new investment, the direct foreign exchange content of new projects will most probably much exceed the amount of new borrowing that can be prudently arranged. Therefore, new borrowing will also have to be carefully budgeted and allocated, and at least part of foreign exchange costs will have to be provided directly out of domestic resources. These domestic resources - a major part of which is generated by oil revenues earned in foreign exchange - must also be used to service foreign debts. At the margin, therefore, any additional foreign exchange expenditure on investment projects will reduce by an equal amount what is available to finance local costs. With increased stringency of budgeting for foreign loans, the present feelings of individual sector and project authorities that rupiahs are scarce and foreign exchange can always be found, should be replaced by the perception that all resources are fungible and equally scarce.

58. The composition of the investment program will be heavily influenced by the projects already in course of execution. Among them are those which have been started by Pertamina. As these projects are completed, resources will be released for other uses; or more precisely investment in other sectors need not be compressed quite as severely as resources.

Sectoral Allocation of Public Investment

59. The events and changes of the past two years, which so strongly determine the overall volume of future public investment programs also affect their content. Given the expected role of the private sector, both domestic and foreign, in industry, public investment in Repelita II laid specific stress on agriculture and irrigation, as well as physical and social infrastructure. This stress also seemed to be in keeping with the desire to increase opportunities for productive employment as fast as possible.

Table 9: Public Investment Programs by Sector
 (Rp. billion and sectoral percentages 1/)

	1976/77		1977/78-1978/79	
	<u>Amount</u>	<u>%</u>	<u>Amount</u>	<u>%</u>
Agriculture and Irrigation <u>2/</u>	398.9	19	790.0	17
Industry and Mining	179.0	9	311.0	7
Pertamina projects <u>3/</u>	462.0	-	309.0	-
Power and Gas	210.0	10	462.0	10
Communications and Tourism	490.6	24	849.0	19
Trade and Cooperatives	9.6	-	30.0	-
Manpower	1.6	-	14.0	-
Transmigration	27.3	1	117.0	-
Regional Development	190.6	9	620.0	14
Religion	6.2	-	15.0	-
Education	142.4	7	427.0	9
Health, Family Planning, Social Welfare	50.1	2	142.0	3
Housing and Water Supply	35.0	2	100.0	2
Law Enforcement	8.3	-	20.0	-
Defense	42.5	-	123.0	-
Information Service	47.8	-	30.0	-
Science, Technology, Research	27.8	-	75.0	-
State Apparatus	49.2	-	113.0	-
Government Capital Participation	<u>122.1</u>	<u>6</u>	<u>320.0</u>	<u>7</u>
Total	2501.0		4867.0	

1/ Percentages relate to total, excluding Pertamina projects.

2/ Includes INPRES, reforestation and subsidies for fertilizer.

3/ Includes Krakatau steel mill but excludes tankers.

60. In response to the increased resources brought about by the oil boom, government investment was accelerated in many sectors. Considered alone, though, neither in emphasis nor in volume did the changes in government investment by themselves constitute an exaggerated response to changed resource prospects. However, at the same time, new and vast investment undertakings were being launched by Pertamina.

61. When Pertamina could no longer carry the cost of its investment itself, financial and planning responsibility for these projects was transferred to the Government proper; it became clear that they were unduly large. They absorbed a large share of overall public sector

resources, for which other uses had been intended, thus imposing both undesirable cuts in other programs and excessive borrowings. When incorporated into the public sector's overall program, they weighted them in an unduly capital-intensive, heavy industrial direction. They were all too often unduly costly for whatever they achieved.

62. In some cases, these plans could be immediately curtailed. Over \$1.5 billion contracts have already been cancelled despite the heavy penalties often involved. In other cases, there is no choice but to carry them to completion, but as these large projects are completed, it is intended not to replace them with new project starts: thus overall emphasis will gradually shift towards less capital-intensive activities. This becomes clear when comparing the columns of Table 9. Yet it is also clear that effecting such a shift in the context of falling real investment totals is going to be a slow and painful process.

Investment in Agriculture and Irrigation

63. In Repelita II, agriculture and irrigation were scheduled to absorb about 19 percent of Government total investment. Investment plans for this sector now account for a roughly similar percentage of total planned public sector investment over the next three years. Agriculture still accounts for 90 percent of non-oil exports, and 40 percent of non-oil GDP of Indonesia. More importantly still, it employs about 70 percent of Indonesia's active population; unless a very large proportion of new entrants into the labor force find employment in agriculture, unemployment is bound to increase. Furthermore, domestic agriculture provides the overwhelming bulk of the food consumed in Indonesia. In the past few years it has managed to keep up well not only with the rising population but also with the growth in food demand associated with the rising per capita income.

64. The planned investment shown on Table 9 is probably a realistic estimate of what can be achieved with reasonable efficiency, provided adequate funds are made available in a timely fashion, not only for investment but also to cover the current upkeep and maintenance needs of previously built systems. In the past, both remote and recent, budgetary allocations often fell short of immediate needs, or were often not made available in time, with the result that the execution of agricultural projects suffered.

65. The aims of agricultural investment can be summarized as follows: increase rice production at an annual rate of about 4.5 percent, so as to progress towards self-sufficiency; this in turn requires further rehabilitation of irrigation networks, the extension of irrigation to about 240,000 ha. of new areas, and opening up substantial new areas of rainfed wet paddy through swamp development and conversion of upland into paddy fields. Output of other food crops is to grow even faster; in both cases, most new areas would be in the outer islands. Food crops development would account

for the largest part of the investments shown in Table 9, particularly as a considerable part of irrigation and swamp development expenditure is aimed at increasing the area under food crops. Another large share of the program would finance the agricultural and industrial costs of sugar development.

66. Despite the high density of population in the inner islands, the agricultural sector offers good prospects for contributing to the fulfillment of all these aims. However, many of these opportunities may not have been fully exploited.

67. Some particular aspects of this investment program require considerable caution. Swamp development, in particular, surely presents enormous long-run potential, when one considers that the so-called tidal swamps cover areas larger than the whole of Java. However, their soil and hydrology present problems. There have been indications that a highly equipment-intensive, fast approach to the development of swamp areas will be attempted in parts of Sumatra and Kalimantan, and, given the lack of knowledge about these areas, this may be less productive than a more carefully researched-phased approach.

68. On balance, however, there can be no doubt that the overall approach to food crop development is healthy, that the resources allocated to it can be absorbed efficiently, and that the sector can not only contribute to the balance of payments and the general welfare by providing better diets to a growing population, but it can also contribute to the demand for labor. While in foodcrop production, particularly in developing new cropland, private investment (notably in the form of the cultivators' own labor) has played and will continue to play a key role, public investment programs are crucial to accelerate the rate of new land development. Moreover, their employment impact compares very favorably with that of investment outside agriculture.

69. The second main thrust of agricultural investment is the estate crop sub-sector. Large and small plantations and smallholders account for the bulk of Indonesia's non-oil exports. Their future role as providers of employment is perhaps even more crucial. Tidal land development offers a major hope of new agricultural space for the future, but, as noted, a number of technical problems remain to be solved. By contrast, much of the uncultivated land in the outer islands is immediately suitable for tree crops cultivation with well-known and tested techniques, provided the resources are available for clearing land, and covering all other costs until the trees come into bearing. There are many types of tree crops, but the most important for Indonesia are rubber, whose hardiness makes it suitable for land where almost nothing else will grow, and oil palm capable of yielding more edible oil per hectare than most crops.

70. These crops are labor-intensive. 1/ Land suitable for tree crops is still plentiful. Combined with traditional systems of shifting cultivation of food crops, rubber smallholders have developed almost two-thirds of the rubber area in Indonesia. Theirs has been a low-input/ low-output system which provided little more than subsistence. With rising expectations new settlers will require more incentives than possible under the traditional systems. With better planting material, improved management and minimal infrastructure, substantially higher incomes would be possible. Utilizing the technology developed by estates, a World Bank financed transmigration project provides for an investment of about \$5,000 per family with prospects of providing a reasonable livelihood - roughly fulltime employment and a family income rising to about \$1,000 per year - well above the current average of farm families. Given the financial constraints, the Government is also exploring other approaches to settlements, with a view towards developing lower cost systems which can reach a larger number of people. If these efforts are successful, the settlement of new land can contribute greatly to employment, at least towards the end of Repelita II, and to exports in the following period.

71. The inner islands will still contribute the bulk of the increase in food production, not so much through new tangible investment as through better cultivation methods, the application of additional fertilizer and more labor. That is where the bulk of the population and of agricultural production (particularly of food crops) are now located. The high density of rural population in the inner islands does not reduce their ability to use productively further investments of man-made capital; on the contrary, precisely because of the presence of dense populations, there are many regions where the marginal productivity of investment will be high, in full conformity with the law of diminishing returns. With increasing incomes, new demands for higher value livestock, fruit and vegetable products should stimulate new types of production involving fuller use of rural labor. Therefore, it seems quite certain that, thanks to intensified cultivation methods and some investment, substantial additional labor can still be absorbed in agriculture in Java, Bali and Madura.

72. Yet about two-thirds of the area to be newly irrigated, and most of the extension of food crop cultivation, will take place in the outer islands, mainly Sumatra. More generally, for Indonesia as a whole, an even more productive line of action than combining additional capital with the abundant labor and scarce land of Java is to transfer both population and capital to parts of the outer islands devoid of both, but endowed with yet unused natural resources. These resources, though, are in forms unsuitable to the immediate application of the cultivation methods

1/ Although they require less labor per hectare than sugar or rice, land is scarcely a limiting factor in this case.

used in the inner islands. Hence the need to make haste slowly, and to combine considerable capital investment with much investigation, research and technical and management assistance to the new settlers. Because of this large investigative component, in its early days the process must be relatively slow and costly.

73. The costliness, though, is relative. The average cost of initial investment requiring one additional full-time employment is about \$3,000 in the World Bank transmigration project now, as against tens, and often hundreds of thousands in some large-scale industries (the Olefin center, whose construction is being considered but is not included in the investments listed on Table 9 would cost about \$1.4 billion and provide permanent employment to about 2400 people, including expatriates: an average investment of about \$600,000 per job).

74. The Repelita II targets for transmigration were quite ambitious. The movement of families under official schemes was to be raised from an average of 10,000 per annum in Repelita I to just below 50,000 families per year in Repelita II. In fact, only about 19,000 families have "transmigrated" in the first two Plan years, with a total two-year expenditure of less than Rp 20 billion. Current targets under consideration call for a total of just over 100,000 transmigrants for Repelita II. However, given the importance of accelerated transmigration for Indonesia's long-term development, at the same time more effort and substantive investment will have to be directed at increasing surveys and project preparation components, including more adequate basic economic and social infrastructure in the future transmigration areas.

Industry and Mining (Including Pertamina)

75. As a consequence of present plans in industry and mining, urea production is to treble within the period covered by this report; cement production has already increased from less than 0.5 million tons in 1969 to about 1.8 million in the current year, and will exceed 5 million tons by the end of the Plan period, thus allowing Indonesia to approach self-sufficiency in that year.

76. The majority of public sector investment in industry will take heavily capital-intensive forms. While a standard 500,000-ton cement plant requires about 2,000 laborers during construction - say, a total of about 6,500 man-years - it employs only about 300 people for operations. Counting a present cost of about \$100 million (Rp. 40 billion) for a standard plant, this means a \$200-300,000 (Rp.100-130 million) investment for each new permanent employment created. In the steel, fertilizer and petrochemical industries, the capital/labor ratio is much higher still; and while the steel industry creates a considerable demand for labor during its construction, petrochemicals do not.

77. The group of medium and large industrial projects now under construction - four fertilizer plants, four or five cement plants, a major steel plant, two LNG plants, at least one petrochemical project, not to mention private investments and joint ventures such as the Asahan project - represent a faster rate of addition to existing large-scale industrial capacity than was perhaps desirable; in any case, a faster rate than can be sustained, considering the likely evolution of resources. Consequently, the industrial plans described in Table 9 reflect mostly the completion of projects already underway. Indeed, some of these - in particular the plans for the Krakatau steel plant - have already been curtailed. Almost no new project starts are included in Table 9. Outside of the Pertamina sector, present thinking is either to defer most new project starts, or to let most or all of their costs be assumed by the private sector. This intention is commendable; even for projects which are well justified by themselves, their benefits have to be weighed against those of other, perhaps even more, severely constricted investments.

78. In the Pertamina sector, the intention is to carry out and complete only those investments which are clearly beneficial or which can no longer be conveniently reduced or stopped. Table 9 includes under "Pertamina" only such of those investments which are closely related to the oil and gas sector and Krakatau steel, all of which are parts of projects or of identifiable programs already underway. As noted earlier, other activities roughly balance Pertamina's own income. As these other activities are gradually completed or terminated, they will leave increasing room for new investments connected to Pertamina's directly oil related activities, which must, for the time being, also be compressed.

79. The large and fast increases in industrial investment, and their limited contribution to employment, by themselves warrant a close reexamination of public sector industrial investment plans. True, at some stage of development large industrial projects are required; but once built, they must not only be provided with management and infrastructure in order to make a contribution to development; they must also be complemented with other investments, both to provide the linkages which alone can perhaps impart to heavy industry a catalytic developmental role, and to produce the incomes and employment which heavy industry cannot directly offer.

80. Some of the large projects - in particular, the LNG plants - promise to contribute directly to future export. Others, notably the cement and fertilizer plants, substitute for imports which would otherwise have been necessary. Yet even assuming substantial further investment, the projected net value of LNG exports in 1985 will fall well short of the projected value of rubber or even of palm oil exports in that year.

81. All this is not to say that Indonesia should not have invested in basic industry, nor even that it should stop making further investments there. However, given the continued shortage of capital, costly basic industrial plants can properly form only a small part of the overall development effort; they must at least be accompanied by other developments, including industries capable of directly contributing to the satisfaction of

domestic demands, exports, and to income-generation and employment for a large labor force. When the Government was considering sectors where future commitments to investment could be slowed down with relatively little harmful impact on the achievement of Indonesia's development aims, heavy industry obviously came high on the list.

82. The resources released by the late Plan years' intended decrease in public sector industrial investment will find an effective use in other sectors. Their most effective contribution will perhaps be in small and medium scale industry whose development will be stimulated by the relaxation of credit restrictions imposed by the heavy demands large-scale heavy industry is now placing on financial resources. In turn, the development of downward industrial linkages - plastics, fibers, textiles, garments, metal fabricating - and of upward linkages in simple engineering will put the further development of heavy industry on a more secure, more developmental basis.

Electric Power

83. The investment program of the electric sector represents a substantial increase over actual past achievements. Power investments in the 1974/75 and 1975/76 amounted only to Rp. 78 billion and Rp. 169 billion equivalents. The projected expansion is very fast, no doubt motivated by the current underdeveloped state of the electric power sector whose per capita installed capacity is one of the world's lowest. Despite large captive capacities, Indonesia suffers from power shortages and suppressed demand. Consequently, it is difficult to argue that the projected investment would create capacities in excess of demand. Whether physical work can proceed at the projected rate is quite another question. In fact, some delay behind the program is likely.

84. The main obstacles are financial. Given the present rate structure and the fact that the capacity to be constructed is a multiple of capacity already operating, PLN (the national power authority) will at best be able to finance 10-15 percent of this investment program out of its revenues. More to the point, the proposed program would absorb about 10 percent of total projected public sector investment over the Plan period, as against about 7 percent in the original Plan document.

85. In some general way, the growth of the electric power sector is an essential part of the development process. Yet, many of the large industrial plants already under construction often also build their own captive power supply. While this is certainly not an efficient way of generating power in general, these arrangements must naturally be taken into account when the overall power investment program is contemplated. A large proportion - unfortunately not precisely quantified - of PLN's power goes directly to private consumers and to commercial and office establishments. The growth in such consumption could probably be slowed down, preferably by means of increased rates, which would also allow the PLN to finance a larger share of its investment program out of its own savings.

Transport

86. The investment projections in the transport sector involve increases in the annual levels of investment throughout the sector. Highways and bridges reflect essentially the original Repelita II projections, somewhat reduced in physical terms and revalued for price inflation. These figures may not fully take into account past delays in implementation. Investment in 1974/75 and 1975/76 lagged behind those years' targets, and for the remainder of the five-year period, too, some shortfall in accomplishments is likely.

87. Against Repelita II projections of 8,000 kms road improvements, the current sectoral plans correspond to a total of 6,000 kms completed in five years. In fact, though, it is likely that not much more than half this length of roads can be improved because of physical constraints. In new road construction, too, a shortfall - though a lesser one - is likely. Physical comparisons are less easy for bridges, but it seems that in terms of meters constructed, physical constraints may also prevent the fulfillment of the target.

88. Financial constraints aside, it is the absorptive capacity constraints that limit the volume of construction work that can be done. To overcome these constraints, large doses of expatriate consulting expertise are being injected into the highway program, notably through the recent World Bank Highways IV loan. Only if these services are really effective over the next four or five years will Bina Marga's (the public works department) own managerial and operational capacity be built up to cope with a physical road program of the size and dynamism now envisaged.

89. Clearly, a financial target can always be met, if only by undertaking too many projects at the same time. That should be carefully avoided, and amounts that cannot be used in a cost-effective manner transferred to other programs. On the other hand, road communications are important enough to justify a major effort to build up organizations capable of building roads and bridges at the desired pace. In financial terms, what this means is that the Bina Marga investment program may have to be cut somewhat to reflect the past delays in gearing up for project execution, but if possible, should not be cut so much as to further hinder this gearing-up process in future.

90. For other land communications (mostly railways) and for sea communications, the situation is different. A significant part of investment in these sectors requires foreign exchange. By and large, provided money is available, it is faster to get imported equipment than to carry out civil works. Indeed, the recent and near future investment program in railway and sea communications comprise a large element of equipment purchases: locomotives, wagons, switchgear ships (not including tankers). We have no

indication of the physical targets corresponding to the financial railway investment plans. Despite the known escalation of prices, though, they are probably much in excess of the program described in connection with the 1974 World Bank-financed railway project. This is confirmed by independent information that indeed the railway authority are in the process of arranging contracts for at least some important components of such an expanded program. Deliveries of equipment by foreign suppliers can be arranged; and even credit financing for them can be obtained, if longer term financial constraints are disregarded. There is, however, a real question as to whether all equipment can be effectively installed: for instance, a large amount of track material delivered over the past year still awaits installation.

91. In sea transport, particularly inter-island transport, large new investments are scheduled. The inter-island program evaluated in the course of the appraisal of the recent World Bank shipping loan, and financed in part by that loan and in part by bilateral funds, corresponds to about 120,000-125,000 DWT of ships for the next three years. There is also a major plan component for dockyards and shipyards, and for ports.

92. Overall, given the size of Indonesia, the diversity of its terrain, and the paucity of the existing transport network, one cannot argue that almost any level of transport investment could be excessive in an absolute sense. Indeed, large specific needs are not at all met by public sector investment, and require ongoing private transport investments, connected notably with timber. Furthermore, little provision has yet been made for the transport investment needs connected with the exploitation of new mines. For instance, the proposed Shell coal project, whose projected benefits are included in our export figures, will generate transport needs for coal amounting to many times the present volume of all Indonesian railway traffic.

93. Transport investment is in general capital-intensive. Particularly for sea and rail communications it does not give rise to much direct employment. As most transport investment is not financially self-supporting, nor even do the railways and shipping lines fully cover their operating costs, it is important to take into account these associated investment costs when considering the economic and financial implications of the productive projects themselves. In other words, the overall capital costs of those projects will be seen to be even larger, and their economic return lower, than if associated infrastructure costs were disregarded. Because of the overall compression of the investment program made necessary by the resource shortage, it is currently intended to severely curtail new transport equipment purchases in the next few years.

94. Finally, it has been amply demonstrated that for many tasks it is technically feasible to substitute much more labor-intensive methods for the capital-intensive construction methods now generally used in Indonesia. Such a substitution is sufficiently desirable from the economic and social points of view to justify the major organizational effort it requires.

Post and Telecommunications

95. The telecommunications investment program is a large one - close to a billion dollars over the three last years of Repelita II, well over \$1.0 billion if expenditures in 1975/76 are included. It is a sharply decreasing program. This is related to the fact that, as is also the case with most large-scale industrial investment, the telecommunications investments included in Table 9 have been quite firmly decided, contracted and financed. Thus, although some delays in execution may occur, which would, incidentally, increase its costs, the program's basic composition is already firmly determined.

96. Its main components are the installation of electronic telephone exchange facilities with capacity for 217,000 additional lines in Jakarta and 230,000 additional lines elsewhere; a 130 percent increase in new telex lines; improved long distance systems, using a variety of sophisticated transmitting equipment, including microwave and coaxial cables, a tropo-scatter, and a domestic satellite system to serve 40 locations; and consultancy services. The financing of the foreign exchange costs of this program has in large part already been arranged, through the conclusion of about \$800 million equivalent buyers' credit agreements.

97. Indonesia has fewer telephones per inhabitant than most other countries: less than 0.25 per 100, as against 0.30 in India, 0.65 in Thailand, 3 in South Korea and 30 in West Germany. There is an acute need for additional telecommunications equipment, and the planned system will at best only meet future demand. There is even something to be said for the decision to go directly for the most modern types of equipment, instead of the more conventional ones which still serve well those countries where the telecommunications system developed gradually. Yet it is not clear that the differences between systems (which can be considerable: the electronic exchange equipment purchased by Indonesia costs 2-3 times as much as conventional, EMD and cross-bar systems) have been fully examined in the light of financial as well as technical considerations. Similarly, the decision to go in for turnkey contracts instead of competitive bidding also gained time, but at a cost.

98. Although the satellite system will probably be installed in time, the completion of the telephone exchanges and cable network may slip by about a year due to delays in the completion of buildings. According to contract terms, it does not seem that this will delay the payment schedule due on the equipment. In any case, whatever the advantages of the existing arrangements, or their possible drawbacks, existing arrangements are the key words. Their modification would involve punitive costs, and cannot really be envisaged. However, the need for any further telecommunication investment during the remainder of the plan period should be very carefully weighed in the light of the overall financial situation. Indeed, current plans call for no major additional investment beyond existing arrangements.

99. One must also note that the telecommunications system is far from self-financing; indeed, it does not even meet its current costs. The recent decision of the Government to make Perumtel finance a substantial part of its rupiah costs through advance payments of would-be subscribers is therefore particularly commendable.

Regional and Local Development: The INPRES Program

100. The INPRES program is a typically Indonesian solution to a problem which, unfortunately, is not only Indonesian itself. The problem is centralized bureaucracy, which may function more or less well for defining and administering large projects and programs at the national level, but is rarely able to define, and even less to administer, programs which have a direct impact on provincial or village life. Broadly speaking, what the INPRES program does is to give money to lower level administrations, provided that they complement it with their own funds, that they use it for investment, broadly defined, and that they follow certain uniform but simple accounting and project evaluation rules. "Investment" financed by the INPRES program can include the repair and maintenance of existing facilities: this is not the program's least important advantage. These free programs account for about 60 percent of INPRES in the current year; the remainder of the funds are earmarked, notably for primary school buildings and for simple clinics, and, starting this year, for erosion control (reforestation) and for the improvement of traditional markets.

101. The INPRES program seems to have been remarkably successful in achieving its aims. It has generally used the most labor-intensive methods to produce productive assets. It has distributed wealth in the provinces and the countryside, tangible proofs of the country's unity, and of the Government's concern; and it has generally created productive assets geared to local needs. The INPRES program, in any case, needs to be preserved, and allowed to grow at least as fast as other investment.

Investment in Education, Training and Culture

102. In terms of its overall costs, the development program in education is a small fraction - 10 percent - of total public sector development expenditures. In terms of its importance for the development process, it is second to none. It is therefore gratifying that, on the whole, the physical targets assigned to the sector are likely to be fully met.

103. The size and diversity of the program, and the progress already achieved, are remarkable. In terms of sheer numbers, probably no developed country matches it: 300 million books of all sorts to be produced, 800,000 teachers to receive training of some sort, almost 100,000 educational institutes of one sort or other to be built or upgraded. The program advances on course, and is continuing to receive high priority. Yet these numbers - which include the schools to be built or upgraded under the INPRES program - also hold another sort of implication; they give an indication of the size of the young generation, for whom productive work must be found tomorrow.

Other Social Sectors

104. Social welfare. The Plan called for very modest targets in terms of individuals helped, relative to the population size, for a variety of social welfare or rehabilitative activities - e.g., orphanages, aid and training for physically handicapped, aid for the destitute, etc. Progress towards these goals has also been modest during the first two years of the Plan. However, it is still planned to achieve the physical targets without significantly exceeding the planned budget.

105. People's housing. Repelita II calls for construction of 20,000 units of low cost housing and 53,000 lots - housing sites - through sites and services programs in addition to other less ambitious goals. Until now most of the preparatory activities have been geared towards land acquisition and land development and only 2,200 low cost houses have been actually built. The seemingly slow progress can be attributed to the usual teething troubles of the newly established housing development corporation. Further plans call for increased spending. This sector apparently has very high priority for the Government, especially in view of the President's strong public commitments to achievement of the targets. However, the existing organization needs to be further strengthened in order to be able effectively to execute such vastly increased tasks. One of the most interesting aspects of the program, and the one which deserves highest priority, is the "kampung" improvement program to improve the living environment and provide basic urban amenities to the poor in Jakarta and other large cities.

106. Manpower. Vocational training, in terms of persons completing the training cycle, is about 50 percent behind original targets. The Padat Karya Program to undertake labor-intensive public works is making good progress with 238 kecamatan projects underway by 1975/76, 169 scheduled for 1976/77 and 368 planned for the last two years of the Plan. Other programs (rehabilitation and construction of vocational training centers, etc.) are progressing more or less on schedule. A new modular curriculum and a program for training instructors in their use has been devised. This is being undertaken with the assistance of international organizations and bilateral donors. Progress in this area is essential not only to the successful operation of the infrastructure now being built, but also for the future development of labor-intensive industry.

107. Water supply. Plan targets for water supply include increasing the supply of water to cities by 12,000 liters per second. Programs for improvement of village and rural water supply are also to be undertaken. The cost of such programs has risen sharply from original estimates, and physical achievements to date have been less than 10 percent of the five-year target. More attention is given to village and rural water supply, which contribute a major component of the health INPRES program. The target set for Repelita II would increase the number of people served by pure water from 2.3 percent to 9.5 percent of total population and would in effect serve an additional 9 million people.

108. Health. Sectoral goals include establishment of several major hospitals, community health centers in every kecamatan, malaria, tuberculosis and cholera prevention program, supply of village wells and hand pumps, assignment of rural doctors and paramedics. The physical goals have already been exceeded in some cases and good progress is being made on all other items. The financial targets of the Plan are not expected to be exceeded.

109. Family planning. Indonesia's family planning program has been generally marked by successful realization of the goals set for Repelita II. The number of clinics which render family planning services has exceeded the Plan targets by more than 10 percent for the first two years of the Plan.

110. The number of clinics providing post-partum care have similarly exceeded Plan targets. For the balance of Repelita II it is planned to continue this accelerated pace of setting up such clinics. The program has been similarly successful in training manpower needed (about 20,000 out of a total of 27,000 technicians trained during 1974/75 and 1975/76). While the program's physical progress has been more than reasonable in all fields, there is widespread agreement among knowledgeable observers that, in terms of new acceptors, progress has been much better still. At least in Java, its achievements extended well into villages not yet touched by its buildings. Because of its dynamism and flexibility, and subject only to confirmation of its achievements by the planned 1976 partial census, it deserves all the financing it can use.

111. By more efficient use of the existing community health clinics for the Family Planning Program, the Government hopes to be able to meet or exceed the Plan target for acceptors without exceeding planned expenditures for this sector. In this it is likely to succeed.

112. Information and communications. Physical and financial targets for TVRI and RRI have been or will be far exceeded because of the satellite program. Foreign costs expenditures alone in 1975/76 and 1976/77 have surpassed total Repelita II estimates for the sector. For 1977/78 and 1979/80, foreign commitments will be largely ended and rupiah support for the sector will continue at more modest levels.

CONCLUSIONS

113. The large industrial and infrastructure investment programs reflect one main current of aspirations in the Indonesian development thinking, which arises from Indonesia's circumstances. Traditionally, colonial Indonesia was an agricultural country, and its level of industrial development lagged well behind that of, say, India or China. Then, after 1940, little development took place for 25 years, except in food production, which managed to keep up, albeit just barely, with population. When in the mid-sixties the reconstruction and rehabilitation effort started in earnest, it naturally concentrated on the commodity-producing sectors: food, plantation crops, petroleum, mining and timber. In this, it was remarkably successful so that by the early 1970's, the country had succeeded in providing personal incomes which were generally above abject poverty levels. Transport and telecommunication infrastructure and the industrial sector, however, remained considerably less developed than those of many a poorer country. Furthermore, in Jakarta and a few other cities, rich Indonesians and a large expatriate population amplified demands for modern amenities through their conspicuous consumption.

114. When resources became more abundant in 1974, some investments were upgraded or accelerated. There were occasional excesses, but on balance, even in retrospect, one cannot say that the accelerated program, considered by itself alone, had become excessive or diverged overly from its original aims. Indeed, had it been by itself, even the unexpected short-fall of 1975 oil revenues from earlier expectations could have been handled with ease.

115. The above Government program did not stand by itself, however. Very much part of the public sector, yet separate and almost autonomous, another program was developing. It originated in the oil sector, but was not limited to it, and extended throughout the country, to all economic sectors: to petrochemicals and steel, to hotels and air transport, to rice estates and roads. It even extended to investments overseas and on the seas. This sector undertook to create capital at a rate which was not even remotely related to its present and foreseeable future resources. The Government program, meanwhile, seems to have proceeded on the assumption that Pertamina's investment undertakings and resources were balanced.

116. It became apparent in 1975 that Pertamina was unable to carry on with its plans, and the Government took over direct responsibility. It was discovered that overall resources could not cover the total financial needs, and even after purposeful, vigorous slashing, more capital-intensive projects are left to be carried out than the Government would have liked, while future resources have been so preempted by debt service that all programs, including those which will create incomes and employment for the poor, must be restrained.

117. This, then, is the problem. The Government appreciates it fully, and is determined to tackle it vigorously. It has the means to do so. Reducing investment is always extremely difficult, both from economic and other points of view; but even so reduced, public sector investment will be higher than could have been reasonably projected for this period, a few years ago. Raising domestic resources and controlling inflation are difficult, too; but the Government of Indonesia has confronted and carried out more difficult tasks in the past, and should be able to carry out the decisions indicated in this report, and even to exceed their aims. Finally, if the problem is tackled vigorously now; if the unavoidable cuts in investments are combined with a vigorous shift in the composition of public investment towards less capital-intensive, faster gestating forms; if new project starts are delayed just in the period when old projects are completed and start yielding their benefits; if in the meanwhile addditional resources are released for accelerated private investments: there is no reason then that this adjustment should noticeably slow down the growth of income now, and if the adjustment is vigorous enough, investment can resume its growth within the next three to four years. We have no precise measure and no model, but a sector-wise examination shows that the attainment of a real growth rate in excess of 7 percent remains feasible; and while this would not lead to a speedy solution of Indonesia's income and employment problems, it would greatly help towards it.

118. Investment is not all. Now that resources have again become scarcer, not only are investment programs being carefully reexamined, but also the overall policy context of development. Apart from the continued fostering of food production, perhaps no other aim is quite as critical as that of developing labor-intensive industries competitive enough to export and to supply the domestic market without undue protection. This is vital not so much as a source of foreign exchange earnings and savings, but as a source of incomes and employment for Indonesia's population. As yet, the present industrial structure shows few signs of being adapted to such needs. While the textile industry which requires heavy protection from imports, and the 28 assembly plants in which more makes of automobiles are assembled than in any other country (at an import cost of about 100 percent) are caricatures of the situation, they are also signs of a serious structural problem which the Government is determined to tackle.

119. Finally, one should not forget the aid community. Indonesia has the world's fifth largest population, the third among the developing countries, the second among substantial aid recipients. Through good management and some luck, it has not only turned past aid into a remarkable increase in its own welfare, but also into a remarkable contribution to world welfare through the improved exploitation of its natural resources. In terms of direct contribution to development, and in terms of improved world trade, aid buys a lot in Indonesia.

120. Capital inflow into Indonesia is not limited by the amount of capital the developed countries can make available: there is a plethora, rather than a shortage of credits on hard terms. It is limited only by Indonesia's prudence relative to the future debt servicing burden. A return towards a softer mix of capital inflows is indispensable. Any increase in the average grant element of new aid makes it that much easier to attenuate the sharp fall of net resource transfers. Prudence, for Indonesia, will consist in reducing hard borrowing, raising more domestic resources, carefully re-examining and re-equilibrating its investment program. True prudence, for the aid community, will consist in more real aid.

121. We assume that such true prudence will indeed be exercised, and that the international community will increase its efforts to provide to Indonesia financing on concessional terms. Of course, aid givers also face economic and social limitations. Taking these into account, we have estimated that at least \$1.4 billion official development aid should be provided to Indonesia in the coming year; of this amount, the bilateral members of the IGGI should contribute at least \$600 million. Given the likely evolution of resource transfers over the next two years, it would be very helpful if a part of this aid could take very quick disbursing forms.

INDONESIA

- CITIES OR TOWNS
- RIVERS
- PROVINCIAL BOUNDARIES
- - - INTERNATIONAL BOUNDARIES

