Volume Title: Developing Country Debt and Economic Performance, Volume 3: Country Studies - Indonesia, Korea, Philippines, Turkey

Volume Author/Editor: Jeffrey D. Sachs and Susan M. Collins, editors

Volume Publisher: University of Chicago Press

Volume ISBN: 0-226-30455-8

Volume URL: http://www.nber.org/books/sach89-2

Conference Date: September 21-23, 1987

Publication Date: 1989

Chapter Title: External Debt Management

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Chapter URL: http://www.nber.org/chapters/c9022

Chapter pages in book: (p. 114 - 129)

7 External Debt Management

7.1 Introduction

In the preceding chapters we identified historical and political economy factors and showed how they have influenced economic policymaking in Indonesia. The distributional impact of fiscal policy (chapter 4) was the outcome of the interaction between the comparative-advantage-based economic program of the technocrats and the political concerns of President Soeharto. The pattern of allocation of subsidized credit (chapter 5) and the granting of monopoly import licenses (chapter 6) showed clearly the need to cater to both economic nationalist aspirations and the rent-seeking activities of key political allies. In this chapter, we will see how these economic policies (especially fiscal policy) have affected the accumulation of external debt and how the resulting Pertamina crisis set the tone for external debt management after mid-1975.

7.2 Trial by Fire

The Soeharto government is no stranger to external debt management, having inherited an external public debt of $2 billion. It cut its teeth on the economic stabilization and rehabilitation program of 1966, within which rescheduling the Soekarno debts and arranging for new capital inflows to support the balance of payments were key components. The situation was grim. Indonesia had defaulted on its 1965 debt service because the swingeing current account deficits of 1961–65 had completely drained the foreign exchange reserves and turbulent domestic conditions had caused the country to be shut out from the private external credit market. Faced with debt payments (including arrears) of $530 million for 1966, which was 70 percent of GDP and 132 percent of exports, Indonesia requested a meeting with its debtors to organize her debt.[1]

The result of the debt rescheduling meetings that year in Tokyo (September) and in Paris (December) was that the major Western countries gave Indonesia the following:

> 100 percent relief from principal and interest payments on credits of more than 180 days, related to contracts effective prior to July 1, 1966 [and which were due in 1966 and 1967]. The new schedule of payments [was] to start January 1, 1971, after a 4-year grace period, and the rescheduled or refinanced amount [was] to be repaid over a period of eight years on an ascending scale starting at 5 percent in 1971 and reaching 20 percent in 1978 . . . The Paris meeting also reaffirmed that, in respect of the interest rate on the rescheduled payments, interest during the respective grace periods (moratorium interest) should not exceed 4 percent per annum; that

> this interest should not be payable during the grace periods, and when paid, should not be compounded. (World Bank 1968, 54–55)

Given the desperate situation of Indonesia, the Western countries established the IGGI to draw up a long-term plan of official assistance and to coordinate the form of aid to maximize its effectiveness. To ensure maximum institutional flexibility, IGGI was not given formal status and, operationally,

> The IGGI is a series of meetings between Indonesia and its donor countries and organizations; it is not based on an international agreement, nor do its conclusions and recommendations represent such agreements. (Posthumus 1971, 7)

The terms of IGGI lending were kept as soft as possible: repayment period of twenty-five years, including seven years of grace, and an interest rate of 3 percent. IGGI was also generous in the amount of official assistance it granted (in millions of dollars): 1967, 167.3; 1968, 361.2; 1969/70, 507.7; 1970/71, 609.7; 1971/72, 633.7; and 1972/73, 670.0 requested (Posthumus 1972).

The mix of generous external assistance and corrective economic policies implemented by the Soeharto government imparted a new dynamism to the Indonesian economy and boosted it to a higher growth path. The annual average growth rate from 1968 to 1972 was 8.2 percent compared to the average rate of 1.2 percent in the preceding five years.

7.3 Debt Management in the 1970s

The inflow of foreign resources to finance government spending was substantial in the early days of the Soeharto regime. They financed 20 to 28 percent of total government expenditure from 1967 to 1972/73. Since 1968, all of foreign borrowing has been officially designated in the budget under the development expenditure category. Whether Indonesia's dependence on external funds has decreased or increased in the 1970s depends on the measure of dependence. If the focus is strictly on the actual financing of government expenditure, then the role of foreign borrowing has diminished. The ratio of foreign resources to expenditure declined secularly from 27 percent in 1969/70 to 17 percent in 1979/80 (see table 7.1). The growth of the petroleum and LNG sector since 1971 brought in tax revenues at a rate faster than the rise in government expenditure, hence reducing the role of foreign financing.

On the other hand, if the issue of foreign borrowing rests on fears of an excessive debt-service burden in the future, then an appropriate measure of external financial dependence is the amount of annual government borrowing in the international markets normalized by the GDP. The movement of this

Table 7.1 **Trends in Aggregate Expenditure and Revenue, FY1969 to FY1979 (in billions of rupiahs)**

	69/70	70/71	71/72	72/73	73/74	74/75	75/76	76/77	77/78	78/79
Total expenditure	342.7	467.8	557.0	736.3	1,164.2	1,977.9	2,730.3	3,684.3	4,305.7	5,299.3
Total revenue	251.6	354.7	440.0	590.6	967.7	1,753.7	2,241.9	2,906.0	3,534.4	4,266.1
Foreign borrowing	91.1	113.1	117.0	145.7	196.5	224.2	488.4	778.3	771.3	1,033.2
As percentage of expenditure	26.6	24.2	21.0	19.8	16.9	11.3	17.9	21.1	17.9	19.5
As percentage of GDP	3.4	3.5	3.2	3.2	2.9	2.1	3.9	5.0	4.1	4.3
Memo item										
GDP deflator (1980 = 100)	13.9	15.4	16.3	18.5	24.6	36.2	40.7	46.6	52.7	58.4

	79/80	80/81	81/82	82/83	83/84	84/85	85/86	86/87	87/88
Total expenditure	8,076.0	11,716.1	13,917.6	14,355.9	18,311.0	19,380.8	22,824.6	21,421.6	23,583.2
Total revenue	6,696.8	10,227.0	12,212.6	12,418.3	14,432.7	15,905.5	19,252.8	17,832.5	17,236.1
Foreign borrowing	1,379.2	1,489.1	1,705.0	1,937.6	3,878.3	3,475.3	3,571.8	3,589.1	6,347.1
As percentage of expenditure	17.1	12.7	12.3	13.5	21.2	17.9	15.6	16.8	26.9
As percentage of GDP	4.0	3.0	2.9	3.1	5.3	4.0	3.7	3.5	5.9
Memo item									
GDP deflator (1980 = 100)	77.4	100.0	111.2	119.6	136.3	152.6	165.8	170.9	176.0

measure in the face of the rapid economic growth which Indonesia experienced indicates the extent to which the government had mobilized internal resources to replace foreign credit in development financing. The ratio of foreign borrowing to GDP showed a slight increase, from 2.9 percent in 1970–74 to 4.5 percent in 1975–79. This resource inflow measured in real terms—foreign borrowing normalized on the GDP deflator indexed on 1980—was Rp 657 billion in 1969–70 and Rp 1,468 billion in 1977/78, a doubling of the annual inflow in eight years.

The continued heavy borrowing was partly the result of the government's unwillingness to increase taxes by broadening its tax base and partly the result of the greater availability of foreign credit at favorable interest rates. By 1974 international credit markets had rescinded whatever credit restrictions they had imposed on borrowing by the Indonesian government in the aftermath of Soekarno's economic Armageddon. Three reasons were responsible for this change: one, the avalanche of oil revenue increased the creditworthiness of the Indonesian government; two, there was a boom in commodity prices in the early 1970s; and, three, lending opportunities decreased in OECD countries whose medium-term economic prospects were rather bleak after the 1973 OPEC price increase.

The eagerness of the international financial community to lend to Indonesia is best captured by the casualness with which it committed $10.5 billion in loans (as of February 1975) to the state oil company, Pertamina, most of it in the two years before 1975. These loans were extended to Pertamina without access to any detailed official financial statements of the oil company!

The improvement in the creditworthiness of Indonesia can be clearly seen by comparing the years 1970 and 1980 in table 7.2. Of the $12.5 billion increase in publicly-guaranteed debt in this period, 41 percent of it came from private creditors. Concessionary lending from official creditors was no longer the only important source of external funds, and it was only natural after 1973 that official loans declined. The IGGI loans were no longer as eagerly sought after the OPEC-1 oil price increase because the advice ("policy recommendations") which was dispensed with the loans was resented in many circles as a foreign intrusion into the domestic policymaking process. Furthermore, the newfound petroleum wealth of the Indonesian economy reduced the intensity of the charitable feelings which made concessionary loans possible in the first place.

The ending of private credit rationing against Indonesia was amply justified by political and economic developments. Since 1970 the Soeharto regime had been firmly in power with neither strong domestic opposition nor outstanding regional tension being a credible threat. On the economic front, the export sector showed an amazing ability to earn foreign exchange and the economy was increasingly showing signs of growing beyond 7 percent annually. Despite the sixfold increase in debt between 1970 and 1980, the

Table 7.2 **External Public and Publicly-Guaranteed Debt[a] of Indonesia, 1970–80**

	1970	1973	1974	1975	1976	1977	1978	1979	1980
Debt outstanding and undisbursed	2,947.2	6,693.6	9,060.9	11,741.2	14,572.5	16,134.6	19,037.3	21,199.8	24,451.9
Debt outstanding and disbursed (DOD)	2,443.2	5,248.8	6,358.2	7,994.0	10,001.6	11,658.3	13,149.7	13,277.8	14,971.3
Private creditors	282.6	1,218.9	1,739.4	2,990.1	4,089.1	4,583.1	4,761.1	4,767.8	5,464.9
Total debt service (TDS)	82.2	207.5	291.6	523.5	760.6	1,261.7	2,062.1	2,099.6	1,758.5
Private creditors	42.4	114.8	168.4	388.9	573.6	985.3	1,632.9	1,535.7	1,127.6
Principal ratios (%)									
DOD/XGS[b]	205.5	158.8	85.2	113.8	114.0	106.7	116.3	85.5	67.4
DOD/GNP	27.1	33.5	25.8	27.4	27.7	26.4	26.6	27.1	21.6
TDS/XGS	6.9	6.3	3.9	7.5	8.7	11.5	18.2	13.5	7.9
TDS/GNP	.9	1.3	1.2	1.8	2.1	2.9	4.2	4.3	2.5
Proportion of DOD which:									
Is concessionary	78.0	75.3	71.3	60.8	53.4	52.2	53.2	51.5	50.2
Bears variable i-rates	.0	4.5	6.8	19.4	20.7	18.7	15.0	14.5	16.8
Is from private creditors	11.6	23.2	27.4	37.4	40.9	39.3	36.2	35.9	36.5
Memo items									
Proportion of debt service paid to private creditors	51.6	55.3	57.8	74.3	75.4	78.1	79.2	73.1	64.1
Central Bank net foreign assets	55.6	800.0	1,494.0	−691.6	−159.0	1,108.4	1,312.0	3,282.3	5,868.4

Note: Central Bank assets position calculated from *International Financial Statistics* data prior to February 1987, using series 11 and 16c. Bank Indonesia changed its valuation procedures in February 1987. The new procedures caused net asset position to improve quite substantially.

[a]Debt reported is end of period, in millions of U.S. dollars.

[b]XGS = export of goods and services.

debt/export ratio fell from 206 percent to 67 percent, and the debt/GNP ratio fell from 27 percent to 22 percent. The eagerness of the banks to extend credit appears to have been matched by the eagerness of the Indonesian public sector to borrow. It was quite normal for Indonesia to contract additional loan commitments even when it was unable to spend these funds quickly enough. The ratio of funds drawn to the total committed was 61 percent in 1980 compared to 83 percent in 1970.

It must be mentioned at this point that there is no paradox in why in 1970–80 the debt-service/export and debt-service/GNP ratios went up as the debt/export and debt/GNP ratios moved down. The rise in the former two ratios was a good sign in this case because it meant that Indonesia had regained access to the private capital market. The increase in the DSRs was inevitable for two reasons. First, Indonesia was now borrowing an increasing proportion of its loans at market interest rates rather than at concessionary IGGI rates. Only 50 percent of the outstanding long-term Indonesian debt in 1980 was concessionary compared with 78 percent in 1970. Second, private credit generally has a shorter maturity than official credit. In 1970 only 11 percent of total debt was owed to private creditors compared with 37 percent in 1980. So it is not that the Indonesian DSRs in 1980 were high, but that these ratios were unusually low in 1970. The low 1970 DSRs were the result of Indonesia being shut off from the private credit market and of IGGI having to forward emergency loans at 3 percent to help the Soeharto government weather its inherited financial crisis. The point is that the higher DSRs in 1980 were the result of an economic situation superior to that in 1970.

On consumption-smoothing grounds, readmission into the external credit market resulted in a net gain to Indonesian national welfare. This welfare gain was not without its price, however, as Indonesia was now exposed to two new risks. The first risk is systemic in nature and threatens every country with external debts. An example of such a systemic risk is the simultaneous collapse of a debtor's export earnings and a large increase in the real rate of interest.

The second new risk is the possibility of imprudent borrowing by Indonesia. This danger was realized in February 1975 when Pertamina could not roll over a $400 million short-term loan and defaulted. The government bailed Pertamina out by guaranteeing repayment of all of its debts. The enormity of the Pertamina rescue operation is clearly indicated by the jump in the principal ratios in table 7.2. The debt/export ratio jumped from 85 percent in 1974 to 114 percent in 1975, and it returned to the 85 percent level only in 1979. By taking over Pertamina's debts, the proportion of private credit to total credit jumped by 10 percentage points—a magnitude unprecedented and not repeated. It is clear that most of Pertamina's debt bore variable interest rates because the percentage of variable interest rate loans almost trebled from 1974 to 1975 (see table 7.1).

7.4 The Pertamina Debt Crisis

Pertamina, on the eve of the crisis, was more than an oil company.[2] It was an extremely diversified conglomerate with the distinction of being the largest corporation in Asia outside of Japan. Table 7.3 gives a partial listing of the range of businesses engaged in by Pertamina.

As discussed earlier, one of Soeharto's key operating styles is to appoint a "dynamiser" to solve problems of industrial development and to grant him broad discretion in achieving the goals. General Ibnu Sutowo, who became chairman of the National Oil Committee in 1966 and president-director of Pertamina in 1968, lived up to the "dynamiser" image. Oil production rose from less than half a million barrels a day in 1966 to 1.4 million barrels a day in 1973. Furthermore, it was widely accepted that General Sutowo had driven a hard bargain with the oil companies, receiving terms which were more favorable than those received by the Saudis (Hunter 1967). His innovative "production-sharing" scheme avoided many of the monitoring difficulties of the "posted price" approach adopted by the Gulf states.

Table 7.3 Pertamina Subsidiaries and Joint Ventures

Company and Status	Functions
Wholly owned subsidiaries in Indonesia	
PT Electronika Nusantara (Elnusa)	Services for marine, land, and offshore operations
PT Palembang Rice Estate	Large-scale rice project in South Sumatra
PT Patra Jasa	Providing facilities to oil and service contractors (offices, housing, and land transport)
PT Pelita Air Service	Air services
Pertamina Gulf Industrial Processing	Packaging of fertilizer and other chemical products
PT Pertamina Tongkang	Operating non-vessel tankers
Wholly owned subsidiaries outside Indonesia	
Ocean Petrol Ltd. (Hong Kong)	Operating and managing ocean-going tankers
Joint ventures in Indonesia	
PT Arun Natural Gas Liquefaction Co. (Pertamina 55%; Mobil 30%; Jilco 15%)	Processing and sale of LNG produced in Aceh
PT Badak Natural Gas Liquefaction Co. (Pertamina 55%; Huffco 30%; Jilco 15%)	Processing and sale of LNG produced in East Kalimantan
PT Brown and Root Indonesia (Pertamina 20%; Brown & Root USA 80%)	Manufacture of components and appurtenances for offshore constructions; concrete coating of steel pipes; design and construction of processing plants and engineering works for oil and gas; procurement and storage of materials
PT Chicago Bridge and Iron Indonesia (Pertamina 51%; Chicago Bridge and Iron Co., USA 49%)	To furnish metal plate structure, process facilities equipment, and construction services throughout Indonesia for government agencies of Indonesia and companies operating in Indonesia

Table 7.3 (continued)

Company and Status	Functions
PT Dresser Magcobar (Pertamina 10%; Dresser Magcobar, USA 90%)	Mud for drilling
PT Indonesia Chemical Co. (Pertamina 60%; PT Sempurna 10%; Teijin Ltd and Toyo Menka 30%)	To produce annually 100,000 tons of peravele and 120,000 tons of dimethyl telethalate (DMT) in South Sumatra
PT Krakatau Steel (infrastructure; on behalf of the GOI, $6 million)	To rehabilitate and operate the abandoned Soviet steel mill project at Cilegon
PT Kuda Laut Batam Island (Pertamina 50%; Interagencies Hong Kong 50%)	Supply frozen and dry foodstuffs
PT Nippon Steel Construction (Nisconi) (Pertamina 10%; Nippon Steel Japan 90%)	To provide support for oil and gas industry including: fabrication, assembling, and construction of steel structures; coating of gas and oil pipes; supply storage and servicing
PT Patra Vickers Batam (Pertamina 50%; Vickers Ruwolt Australia 50%)	Heavy engineering facilities to service the oil, mineral processing extraction, and other manufacturing industries.
PT Permiko Engineering and Construction (Pertamina 10%; Nippon Kokan KK and Mitsubishi 90%)	Fabrication, coating, assembly, installation, and construction of pipelines and steel structures for oil and gas exploration drilling; production and distribution; supply of services including design, inspection, testing, repairing, and surveying for gas and oil; storage and lease of goods and equipment related to these
PT Pertafenikki (Pertamina 30%; Japan Gasoline 60%; Far East Trading Co. 10%)	Consulting engineering
Pexa Oil Co. (Pertamina 25%; Pexa Oil Co. 75%)	Oil exploration onshore South and East Kalimantan
PT Burna Bina Indonesia (Pertamina 51%; Bechtel Inc. 49%)	Engineering consulting
PT Sankyu International (Pertamina 10%; Sankyu Tokyo 90%)	Fabrication, assembling, installation, and construction of pipelines and steel structures
PT Toyo Kanetsu (Pertamina 51%; Toyo Kanetsu 35%; Nissho Iwai 14%)	Engineering consulting
Joint ventures outside Indonesia	
Far East Oil Trading Co. Ltd. (Japan) (Pertamina 50%; various Japanese companies 50%)	Marketing of crude oil in Japan
Indonesian Enterprises Ltd., USA (Pertamina 50%; various companies 50%)	Promotion of tourism in the USA
Japan-Indonesia LNG Import Co. (Jilco) (Pertamina 15% through Far East Oil Trading Co.; five Japanese companies 51%; Tokyo Electric and Tokyo Gas 4%; Industrial Bank of Japan 6%; Nisano Iwai 15%; other trading companies 9%)	
Japan Indonesian Oil Kabushiki (Pertamina 50%; Toyota Motor Sales Co., The Tokyo Electric Power Co., The Kansai Electric Power Co., The Chuba Electric Power Co., Maruzen Oil Co., Daikyo Oil Co., Idemitsu Kosan Co., total 50%)	To supply the low sulphur crude oil produced in Indonesia to Japan, and other associated matters
Perta Oil Co., USA (Pertamina 50%; United States International Investment Corp. 50%)	Transport and marketing of Indonesian crude oil
Tugu Insurance Co. Ltd., Hong Kong (Pertamina 40%; private investors 60%)	Insurance

Source: Bulletin of Indonesian Economic Studies (July 1974)

Sutowo's ability to get things done, albeit many times by paying a high premium,[3] resulted in him being asked by the president to take over lagging projects. The biggest of such projects was the completion of the Krakatau Steel Mill for which Pertamina had assumed responsibility in 1970 and which had been abandoned uncompleted by the Soviet Union in 1966. Partly by allowing itself to be volunteered to take over the management of more and more state projects, and partly because of Sutowo's desire to play a pioneering role in Indonesian economic development, Pertamina developed into an autonomous development agency independent of the control of the technocrats at BAPPENAS. Pertamina improved harbors, developed residential and commercial estates, and built roads and hospitals.

Although these expanded activities of Pertamina intruded upon the economic policymaking turf of the technocrats, there was not much domestic pressure which they could bring to reverse this state of affairs. There were good reasons why the president chose to maintain the status quo with Pertamina. An obvious one was that criticisms of a success story were hard to make stick, especially when Pertamina's largess had won it many supporters in the president's circle. An equally important reason could be that General Ibnu Sutowo had come to epitomize the kind of economic nationalism favored by a large segment of the military and the intellectuals. As explained in chapter 3, one thorny problem of Indonesian economic development has been the disproportionate economic power of the Indonesian Chinese community. General Sutowo's much heralded success as a big-time businessman was a source of considerable ethnic pride. It was widely held in some intellectual circles that the only effective containment of Chinese economic strength was to allow the small number of capable *pribumi* entrepreneurs to each head a gigantic state enterprise modelled after the Japanese *zaibatsu*. It was believed that only such gigantic enterprises could reap the economies of scale and sustain the short-term losses of an infant industry.

What was really alarming to the technocrats who had gone through the trials of rescheduling Soekarno's debts was that this new independent development agency was now borrowing heavily in the international credit market to finance its nonoil activities. In March 1972 the minister of finance chose to enter into another standby agreement with the IMF, even after the IMF had concluded that a balance-of-payments crisis was unlikely. The standby agreement set a ceiling of $14 million on medium-term external borrowing for 1972/73. Given this ceiling, a decree was issued requiring all state bodies to seek approval from the Ministry of Finance before contracting foreign borrowing.

Pertamina ignored this decree, borrowing $350 million in short-and medium-term debt in 1972 without informing the Ministry of Finance. When this transgression came to the attention of the United States, the biggest aid donor, American economic aid was suspended. And in February 1973 U.S.

Vice President Spiro Agnew raised the issue of Pertamina's borrowing with President Soeharto. The president's reaction was very much in line with his belief that a talented problem-solver like Sutowo ought to be given free rein. Soeharto "delivered a vigorous defense of Ibnu Sutowo, saying he had personally charged him with important national projects and trusted the oil chief to find his own finance" (McDonald 1980, 155). Nevertheless, when U.S. aid resumed, Pertamina stopped borrowing in the medium-term market and started financing its long-term projects with short-term loans.

It was this borrowing in the short-term market which precipitated the Pertamina crisis. Short rates rose dramatically after the OPEC-1 price increase because central banks in the industrialized countries began tightening their monetary policies to dampen aggregate demand to offset the price pressures from the supply side. At the end of 1974, the discount rate was 7.8 percent in the United States and 9 percent in Japan, compared with their respective 1972 discount rates of 4.5 percent and 4.3 percent. It was also at this time that the international banking community was shocked into greater cautiousness by the failures of the Franklin National Bank in the United States and the Herstatt Bank in Germany due to foreign exchange speculation. The result was that the banks took a harder look at Pertamina's borrowing.

They were alarmed that they had extended so much credit (it turned out to be $10.5 billion) to Pertamina without any one of them having seen a full statement of Pertamina's finances. While it was true that the future of the oil industry looked very promising in 1975, bankers were troubled because significant proportion of the borrowing was for nonoil projects, the debt was not guaranteed by the Indonesian government, and Pertamina was showing increasing signs of mismanagement. In the face of these reservations, the banks refused to automatically roll over existing debts unless they were given more information about Pertamina's financial position. The upshot was that Pertamina defaulted on 20 February 1975 when it could not meet a $400 million payment to the Republic National Bank of Dallas.

The Indonesian government announced that it would assume responsibility for Pertamina's debt, of which $1.5 billion was in short-term loans. The rescue operation obligated the Indonesian government to undertake its first major borrowing in the external credit market since it had been readmitted into the private credit market. The Pertamina crisis was solved by a combination of repayment, rolling over part of the existing debt into longer term instruments, and cancellation of contracts. Even with access to the international financial market, Indonesian resources were still stretched thin. The net foreign reserve position of Bank Indonesia fell from $1.5 billion at the end of 1974 to a deficit of $0.7 billion at the end of 1975.

An indication of the magnitude of money involved in the rescue operation can be obtained from table 7.4 in which the long-term publicly-guaranteed debt is divided between the government sector and the public enterprise

Table 7.4 **Distribution of External Sovereign Debt[a] by Sectors, FY1973 to FY1986**

	73/74	74/75	75/76	76/77	77/78	78/79	79/80	80/81	81/82	82/83	83/84	84/85	85/86	86/87
Government sector														
Net drawings	562.0	571.0	1,918.0	1,657.0	1,345.0	1,425.0	1,263.0	1,381.0	2,271.0	3,226.0	3,883.0	4,710.0	1,678.0	3,134.0
Adjustment						571.0	−975.0	−62.0	−787.0	5.0	−471.0	−2,038.0	4,487.0	3,603.0
Outstanding debt	3,979.0	4,550.0	6,468.0	8,125.0	9,470.0	11,466.0	11,754.0	13,073.0	14,557.0	17,788.0	21,103.0	21,179.0	27,344.0	34,081.0
Public enterprises														
Net drawings	352.6	555.2	−109.3	50.7	−327.1	−10.0	−73.0	49.0	683.0	1,017.0	77.0	−408.0	−325.0	−383.0
Adjustments						.0	−17.0	18.0	−5.0	−122.0	54.0	77.0	41.0	18.0
Outstanding debt	1,665.5	2,220.7	2,111.4	2,162.1	1,835.0	1,825.0	1,735.0	1,802.0	2,480.0	3,375.0	3,506.0	3,175.0	2,891.0	2,526.0
Unattributable drawings or adjustments during 1973–77	−118.3	−3.6	−83.5	128.0	726.1									
Total public sector														
Net drawings	914.6	1,126.2	1,808.7	1,707.7	1,017.9	1,415.0	1,190.0	1,430.0	2,954.0	4,243.0	3,960.0	4,302.0	1,353.0	2,751.0
Adjustment plus unattributed sums	−118.3	−3.6	−83.5	128.0	726.1	571.0	−992.0	−44.0	−792.0	−117.0	−417.0	−1,961.0	4,528.0	3,621.0
Outstanding debt	5,526.2	6,767.1	8,495.9	10,415.1	12,031.1	13,291.0	13,489.0	14,875.0	17,037.0	21,163.0	24,609.0	24,354.0	30,235.0	36,607.0
Memo item														
Government borrowing for budget	491.3	559.0	1,184.6	1,888.7	1,863.6	2,105.1	2,204.1	2,382.5	2,685.0	2,877.9	3,947.9	3,314.0	3,189.3	2,544.4
Government borrowing from balance of payments	643.0	660.0	1,995.0	1,823.0	2,106.0	2,208.0	2,690.0	2,684.0	3,521.0	5,011.0	5,793.0	3,519.0	3,432.0	5,296.0
Ratio of public enterprise to total public sector debt (%)	30.1	32.8	24.9	20.8	15.3	13.7	12.9	12.1	14.6	15.9	14.2	13.0	9.6	6.9

Note: Figures for 1978/79 onward are from an IMF document. For the earlier years, net drawing of public sector is from the World Bank's *World Debt Tables* and net drawing of government sector is from the balance of payments. The difference between the two numbers is attributed to net drawing by public enterprises. The difference between the cumulated flows and the stocks in the *World Debt Tables* is reported in the "Unattributable drawings" item.

[a]Debt reported is end of period, in U.S. dollars.

sector. The debt flow of 1975/76 was extraordinary compared with the preceding two years—the $1.9 billion increase in the long-term debt of the government sector was more than three times that in 1973/74 and 1974/75. Four reasons have been advanced for this large increase. The first two reasons are the conversion of part of the $1.5 billion short-term obligations into long-term debt and the amortization of Pertamina's long-term debt. The third reason is that by 1975 the government had been convinced by the 1973 oil price increase that the future income stream of the economy had been markedly increased. It decided, therefore, to embark on an expanded program of development spending to be financed by external borrowing. The fourth reason is that development expenditure in 1975 overshot its targeted level by $313 million, requiring the government to undertake additional borrowing.

Since detailed data on the Pertamina rescue operation have not been released, any estimates of how much of the $2.0 billion worth of public borrowing, as shown in the balance-of-payments account, is Pertamina-related is necessarily speculative. It could be argued that the Pertamina affair accounted for only 40 percent of the borrowing because $1.2 billion was required to finance the budget. On the other hand, one has to take into account that Pertamina had collected $819 million in oil taxes on behalf of the Ministry of Finance, which it had kept for its own use. If this oil revenue had been forwarded to the government, only $365.6 million would have been needed for budgetary reasons. This meant that more than 80 percent of the large external borrowing in 1975/76 was caused by the mismanagement of Pertamina.[4]

For the next several years, Pertamina continued to be a drain on the budget and obliged the government to undertake additional external borrowing. In 1976/77 the government budget showed a debt-service transfer of $75 million to Pertamina; in 1977/78 the debt-service transfer was $208 million; and in 1979/80 the government extended a subsidy of $77 million to Pertamina.

7.5 Economic and Political Effects of the Pertamina Crisis

Since the 4.9 percent real GDP growth rate in 1975 was the lowest in the thirteen-year period from 1968 to 1981, one may be tempted to attribute the drop in aggregate demand to the across-the-board cancellation of Pertamina's numerous investments. We do not think so, however. Instead, we believe that the large plunge of the 1975 real GDP growth rate from the rates of 9 percent in 1972, 11 percent in 1973, and 8 percent in 1974, was largely the result of the 1975 global recession induced by high oil prices. Decomposition of the sources of growth in 1975 revealed that it was external, not internal, factors which were responsible for the low growth rate: real domestic absorption increased by 17 percent, while real exports fell by 18 percent and real imports rose 8 percent.

The level of real government expenditure did grow more slowly in 1976/77 and 1977/78 because the technocrats deemed it prudent to lower the growth of external debt and, hence, diverted domestic revenue to keep Pertamina afloat. If one is looking for a silver lining in the Pertamina crisis, it could be argued that the fiscal conservatism of this period was a desirable outcome because inflation has been above 18 percent since 1973 and economic growth has picked up again.[5]

The Pertamina debacle was a major setback to the military advisors who favored the nationalist *zaibatsu* approach to economic management. The technocrats at the BAPPENAS and Ministry of Finance were once again unchallenged in the sphere of economic policymaking. The technocrats were asked to oversee the reorganization of the Pertamina empire and were granted real control over all external borrowing (short- and long-term) by state enterprises.

There is no doubt that the technocrats immediately used this new authority not only to sharply curtail foreign borrowing by the state enterprises but also to reduce their outstanding debt. At the time of the Pertamina crisis, not counting short-term debt, the long-term publicly-guaranteed external debt of state enterprises stood at $2.2 billion, which was 33 percent of the total outstanding public debt. By the end of March 1979, the debt of the state enterprises was reduced to $1.7 billion, which was only 13 percent of the total. The days of Pertamina-style borrowing by public enterprises were clearly over.

It could be cogently argued that the Pertamina crisis was a blessing in disguise. By reminding the Indonesian government of the importance of being prudent in external borrowing, it could be the reason why Indonesia did not experience a debt crisis in 1982. The timing of the Pertamina crisis could not have been better. The real price of oil was at an all-time high, so the international credit markets were willing to roll over the now-guaranteed debts; and the real interest rate was low, so the debt burden was not increased disproportionately.

If Pertamina had not been prevented from further borrowing in the medium-term credit market and had, therefore, over-reached itself in the short-term credit market, it could have accumulated by 1982 a foreign debt at least as big as the $20 billion debt of PEMEX, the Mexican state oil company. After all, in February 1975 Pertamina already had $10.5 billion in loans (including undisbursed), and the 1979 OPEC-2 price increase would have further expanded its ability to borrow. The failure of an unchecked Pertamina in 1982 would have had cataclysmic effects on the economy. Not only would the record high real interest rates of 1982 have made the debt service painful, but the lower oil prices would have forced the implementation of more draconian austerity policies. By denying all state-owned enterprises direct access to the external credit market after the Pertamina embarrassment, Indonesia did not have as large a debt as it otherwise would have had when it entered 1982. With the benefit of hindsight, the Pertamina debacle could certainly be viewed as a vaccination against excessive borrowing.

It is important to note that the Pertamina crisis did not reduce the role of the army in the management of state and private enterprises. The doctrine of *dwifungsi* remained intact. For example, even though the technocrats were asked to reorganize Pertamina, it was an army man, General Piet Haryono, not a civilian administrator, who was appointed to replace General Ibnu Sutowo. And it was another army man who succeeded General Haryono in 1981. The point is that it is vital for the army to control key sectors of the economy, partly because of the political need to channel resources to retain the support of the military and partly because of the president's belief that a "dynamiser" should have discretionary funds available for off-budget development projects. The legacy of the Pertamina crisis is that these extrabudgetary allocations are now unlikely to lead to an external debt crisis.

7.6 External Debt in the 1980s

The Pertamina crisis also resulted in major changes in the way in which the external debt is managed. As a commitment to prudent debt management, the government now eschews short-term loans in its borrowing. Furthermore, all external borrowing by the government, government agencies, and state-owned enterprises must be approved, negotiated, and administered by the Ministry of Finance and Bank Indonesia. By law, private Indonesian enterprises are required to report all their external borrowing and to hand over the administration of these debts to Bank Indonesia. In practice, the government has control only over official borrowing. This state of affairs is due in small part to underreporting by the private sector and in large part to the Indonesian government's pledge of maintaining an open capital account.

There is close collaboration between the Ministry of Finance and Bank Indonesia in managing the external debt.[6] In addition to monthly and detailed quarterly reports on changes in the external debt, Bank Indonesia also submits a weekly report of its external-debt-related activities to the Ministry of Finance. Before any payment of principal and interest can be made, Bank Indonesia must request approval from the Ministry of Finance which would then recalculate the debt service using its own records. The slow computerization of external debt information unduly increased the difficulties of debt management in the early 1980s when Latin American countries were slipping into debt crises. Manual handling and careful recalculations meant that as late as 1984, "late payments [were] frequent, resulting in late payment penalties and even defaults" (Haryono 1985, 229). The manual handling of the debt records meant that it was almost impossible to generate debt-service scenarios under different refinancing schemes to change the maturity structure and under different assumptions about foreign interest rate and exchange rate developments.

While the Pertamina crisis was a deep one, it was still manageable. Real interest rates were low and Indonesian exports were in high demand. The collapse of oil prices in early 1982 and the subsequent collapse of commodity prices have produced a situation which is more ominous. In 1985 public long-term debt-service ratio went above 20 percent for the first time, rising from a "comfortable" 15 percent in 1984 (see table 7.5). The significant rise in the DSR occurred despite a 38 percent devaluation of the rupiah in March 1983, and the large-scale postponement of public investment projects in fiscal 1983 which saved $10 billion in foreign exchange (World Bank 1987b, 24–25).

External debt management in the 1980s has also been made more difficult by capital flight. The (net) errors and omissions item (which contains all private portfolio flows) in the balance-of-payments accounts shows a cumulative deficit of $6.3 billion for 1980–85 compared to one of $1.4 billion for 1969–79. Without the loss of reserves from the 1980–85 capital flight, the DSR in 1985 may have been 15 percent instead of 20 percent.

Two events occurred in 1986 which worsened the debt situation dramatically. The price of oil dropped precipitously from $28 per barrel in January to $10 in August (World Bank 1987b, 24–25). The yen, in which more than a third of Indonesian public external debt is denominated, appreciated 21 percent against the dollar. The result was that the public debt-service ratio shot up to 29 percent at the end of 1986. (If external credits for the expansion of LNG production are included, the ratio stood at 32 percent.)

The Indonesian government has shown itself to be prepared to make significant policy changes to ward off an external debt crisis. The rupiah was devalued by 31 percent in September 1986, and, in October 1986 and January 1987, the input costs to the export sector were lowered with the abolition of a substantial number of import restrictions. Nominal state expenditure for fiscal 1986 was cut 6 percent from the previous year (see table 4.3). In fact, real government expenditure has been steadily reduced since fiscal 1983. Real expenditure has declined more than the drop in real revenue, reducing the amount of real borrowing (in 1980 prices) from Rp 2.8 billion in 1983 to Rp 2.1 billion in 1986. Mobilization of domestic resources was also undertaken to slash foreign borrowing—a value-added tax was introduced in April 1985, followed by a more comprehensive land tax in June 1986. These tax increases, however, have not been able to make up for the fall in oil royalties. Nominal revenue in 1986 was Rp 1.4 billion lower than in 1985.

Table 7.5 **External Debt[a] of Indonesia, 1980–86**

	1980	1981	1982	1983	1984	1985	1986
(a) External public and publicly-guaranteed long-term debt							
Debt outstanding and undisbursed	24,451.9	27,211.0	32,216.0	35,492.0	36,922.8	41,872.6	48,712.0
Debt outstanding and disbursed (DOD)	14,971.3	15,870.3	18,515.0	21,689.5	22,861.9	26,624.6	32,119.0
Private creditors	5,464.9	5,812.5	7,403.4	9,649.6	10,048.6	11,667.9	14,556.0
Total debt service (TDS)	1,758.5	2,047.2	2,246.6	2,550.8	3,251.0	4,015.1	4,401.0
Private creditors	1,127.6	1,336.4	1,374.3	1,526.8	2,069.9	2,631.7	2,549.0
Principal ratios(%)							
DOD/XGS[b]	67.4	63.7	87.1	108.8	103.2	133.0	212.8
DOD/GNP	21.6	19.2	21.2	28.0	26.5	33.4	48.2
TDS/ XGS	7.9	8.2	10.6	12.8	14.7	20.1	29.3
TDS/GNP	2.5	2.5	2.6	3.4	3.8	5.0	6.6
Proportion of DOD which:							
Is concessionary	50.2	48.5	42.7	37.3	34.9	35.1	NA
Bears variable i-rates	16.8	17.8	20.0	22.7	23.7	21.7	NA
Is from private creditors	36.5	36.6	40.0	44.5	43.9	43.6	45.3
Proportion of public debt service paid to private creditors	64.1	65.3	61.2	59.9	63.6	65.5	57.9
(b) External private nonguaranteed long-term debt							
Debt outstanding and disbursed	3,142.0	3,579.0	3,200.0	3,400.0	3,800.0	3,810.0	3,800.0
Total debt service	1,051.0	1,173.0	1,260.0	1,116.0	960.0	1,036.0	800.0
(c) External short-term debt	2,775.0	3,274.0	4,787.0	4,639.0	5,384.0	5,280.0	5,000.0
Total external debt	20,888.3	22,723.3	26,502.0	29,728.5	32,045.9	35,714.6	40,919.0
Memo							
XGS	22,208.0	24,926.3	21,262.1	19,932.6	22,163.8	20,014.5	15,094.0

Source: The World Bank's *World Debt Tables* and Country Reports. Figures do not include LNG expansion credits.

[a]Debt reported is end of period, in millions of U.S. dollars.

[b]XGS = export of goods and services.