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FORM OF DOCUMENT	CORRESPONDENTS OR TITLE	DATE	RESTRICTION
#104 memo	Walt Rostow for the President <i>open 10-14-82 in NLJ 82-196</i> Confidential 2 p.	8/8/67	A
# 106 memo	Walt Rostow for the President <i>open 10-14-82 in NLJ 82-196</i> Confidential 3 p.	8/8/67	A
# 110 memo	Freeman and Gaud for the President <i>open 4-24-87 NLJ 82-197</i> Confidential 3 p.	8/8/67	A
# 112 summary report	Summary of report on Indonesia Secret 3 p. <i>sanitized 12-13-82 in NLJ 82-198 OPEN 9/6/02</i>	8/8/67	A
# 113 report	Report on Indonesia Secret 9 p. <i>sanitized 12-13-82 in NLJ 82-198 OPEN 9/6/02 per F.R.S. Vol. XXVI, # 24</i>	n.d.	A

FILE LOCATION

Meeting Notes File, Box 1

DCH 10/81

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MEMORANDUM

THE WHITE HOUSE
WASHINGTON

Wednesday, August 9, 1967
9:45 a. m.

MR. PRESIDENT:

Here are the essential numbers for the NSC meeting this morning.

Present PL-480 set-aside from 1967 U. S. rice crop: 670,000 tons

150,000 tons to be delivered to Vietnam in fourth quarter 1967

400,000 tons to be delivered to Vietnam first and second
quarters 1968

100,000 tons for Indonesia

650,000 tons

But calendar 1968 Vietnam rice requirements could run as high as
800-950,000 tons of imports. The above figures provide only 400,000 tons
through PL-480. If Vietnam reserves hold up, we would hope to finance
most or all of the rest through cash sales. But if they are strapped and
we have to provide more through PL-480, where could the balance of
400-550,000 tons come from?

Thailand-Taiwan 100,000

From 1968 rice crop to be
delivered to Vietnam in last
quarter 1968 200,000

300,000 tons

Possible deficit: 100-250,000 tons

Deficit could be met by:

- bigger than now estimated 1967 U. S. rice harvest (with normal
PL-480 set-aside)
- normal crop, but enlarged PL-480 set-aside in November
- Vietnamese dollar purchases to draw down reserves.

Walt R.

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MEMORANDUM

THE WHITE HOUSE

WASHINGTON

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Tuesday, August 8, 1967 -- 6:10 p.m.

Mr. President:

The NSC meeting is on Indonesia; but, because the heart of our Indonesian aid program for the remainder of this year is 100,000 tons of rice, I am submitting to you the attached action documents on the PL 480 rice programs for Viet Nam and Indonesia. (Tab A) Because there are domestic implications, we are inviting Orville Freeman to the meeting.

The NSC meeting need not -- and in my view should not -- be the occasion for your deciding on the rice question; but it is a good occasion for debate and cross-examination.

I suggest the following procedure for the meeting itself.

I. Introduction. You should state that the progress made by Indonesia in the last year is heartening. Within the possibilities of our resources, you want us to do our share in an Indonesian aid program which brings the Suharto government forward to stability and success.

II. You might then ask Under Secretary Katzenbach to review briefly what has been accomplished since our last NSC meeting a year ago (see Tab B for State paper on top of which is a summary we have prepared).

III. Under Secretary Katzenbach will ask Bill Bundy to amplify and define major action problems now before us.

IV. You may then wish to go round the table and get comments from:

- Gaud on the development picture and prospects in Indonesia;
- Freeman on the domestic rice prospects and PL 480 set aside.

V. You may then wish to put these questions:

- What are the 1968 prospects for assistance from all sources for Indonesia?
- How do we plan now to meet our share of the common effort to generate and maintain momentum in Indonesia?

Bill Bundy and Bill Gaud might be asked to speak to these questions.

Author: JWS 6/22/75
By: JWS 10/16/82

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VI. (FYI: The World Bank and the Asian Development Bank, as well as a number of private enterprises, will be examining Indonesian development possibilities in the months ahead.) You may wish to conclude by asking that a development program for 1968 and beyond be prepared and submitted to you by, say, October 31, including:

- major Indonesian efforts;
- contributions by other governments and international institutions;
- contributions by foreign private enterprise;
- the U.S. contribution.

W. Rostow
W. Rostow

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MEMORANDUM

THE WHITE HOUSE

WASHINGTON

Tuesday, August 8, 1967 -- 4:00 PM

MEMORANDUM FOR THE PRESIDENT

DECLASSIFIED
Authority NLJ 82-196
Date 10-14-82

SUBJECT: PL-480 Rice for Vietnam and Indonesia

Attached are two memoranda which, taken together, cover virtually all of the rice we can deliver through PL 480 from this year's crop:

- At Tab ¹A, Bill Leonhart recommends a Vietnam program totalling 650,000 - 750,000 tons, of which at least 550,000 tons would be provided through PL 480. (All or part of the remainder may be cash sales if the Vietnamese foreign exchange situation remains as favorable as it is now.)
- At Tab ²B, Freeman and Gaud recommend immediate agreement to provide Indonesia with 100,000 tons as part of our consortium commitment this year.

The relevant agencies are unanimous in support of both recommendations.

The Rice Calendar

The U.S. rice crop will begin coming in in October. By November 1 -- but not until then -- we will have an accurate estimate of (1) how large the total U.S. crop is going to be, and (2) how much of it we can set aside for PL 480. However, there are excellent reasons, set out below and in detail in the attached memoranda, why it is clearly to our foreign policy advantage to make these decisions now. Thus, we are asking you now to authorize allocations of PL 480 rice from this year's crop which may add up to more than we will have in the normal PL 480 set-aside when the crop is all in. If you make this decision, the contingencies line up as follows:

1. If we get a very big U.S. rice crop -- which Agriculture thinks is possible but not certain -- we will have enough in the PL 480 set-aside to handle all the rice we now expect to need for Vietnam, Indonesia, and the very small amount we are committed to supply to Africa.
2. If our rice crop is smaller, we will need to ask you to choose in November between:
 - increasing the amount of our rice crop set-aside for PL 480 (thereby probably displacing some commercial exports); or
 - cutting back PL 480 shipments to Vietnam, replacing them with dollar sales (if the Vietnamese foreign exchange situation can stand it).

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The Indonesia case is also very strong, in my judgment. Suharto is making a hard try at making something of Indonesia which could be very good for us and the world. He is operating very close to the edge in economic terms. He needs every dollar of the consortium commitment. If we are to come through with out share, I see no way around the 100,000 tons of rice. On balance, I would advise you to take the risk that there will be heat later -- partly because of a feeling in my bones that Agriculture is underestimating the size of this year's U.S. rice crop.

W. Rostow Rostow

Approve Leonhart memo on
Vietnam (Tab A) _____

No _____

Speak to me _____

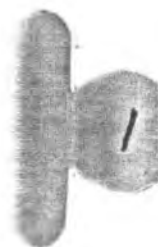
Approve Gaud/Freeman memo on
Indonesia (Tab B) _____

No _____

Speak to me _____

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MEMORANDUM

THE WHITE HOUSE

WASHINGTON

August 7, 1967

MEMORANDUM FOR THE PRESIDENT

SUBJECT: PL-480 Rice and Foreign Exchange Negotiations with Vietnam

1. 1967-68 Requirements. We request your approval to commit, by a PL-480 agreement with Vietnam, 500,000 tons of rice from the current crop. This 500,000 tons (plus 50,000 previously agreed which will also come from this year's crop) will meet Vietnam's rice imports needs from September 1967 to about June 1968. We need early authorization in order to negotiate this agreement with the present GVN and to keep the pipeline prudently filled.

2. We do not ask for your decision now on the balance of CY 1968:

a. The Saigon Mission estimates the year's needs at 800-950,000 tons. If you approve the present request, we plan to ship 150,000 tons in CY 1967. We would have 400,000 tons left for CY 1968. If Vietnam buys, as expected, 100,000 tons from Thailand and Taiwan, and we take about 200,000 tons from next year's crop late in CY 1968, we will have an unfilled requirement of 100-250,000 tons.

b. We plan to deal with this problem in November, when we have better estimates of the size of the US harvest, PL-480 availabilities, Vietnam's rice needs and the GVN foreign exchange position. At that time we will propose to you a rice program for the rest of 1968 -- balancing PL-480 against cash sale rice. Your Vietnam decisions can then be taken in the light of your determinations on the total PL-480 share of the current crop and on rice acreage for the 1968-69 season.

3. I believe this formula protects the flexibility needed to meet Vietnam's requirements and have thus concurred in a separate proposal to you to send 100,000 tons of PL-480 rice to Indonesia from this year's crop.

4. Attachment A has the background for these calculations and an outline of a rice production strategy in support of pacification. Its statistical table shows what has happened on the rice front over the 1964-67 period and our best estimates of what is likely in 1968.

5. The Forthcoming PL-480 Rice Agreement Negotiations. GVN foreign exchange reserves have grown in two years from about \$200 million to an all-time present high of about \$350 million. They are

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continuing to rise. This reserve build-up has been the direct result of US purchases of piasters at the "official rate" of P80/\$, instead of the P118/\$ rate applicable to virtually all other transactions. The build-up represents a direct US balance of payments cost. It has already attracted Congressional attention (McClellan and Moss Committees). And it is potential ammunition for critics to charge that the Vietnamese are enriching themselves from our efforts in their behalf.

6. My memorandum to you of June 30, 1967 outlined a general proposal to deal with the GVN foreign exchange question in the context of PL-480 negotiations (copy at Attachment B). I have discussed this with our people in Saigon during my last visit and have the concurrence of the interested Departments and Agencies to its terms and to the opening of negotiations with the present GVN. We should use the leverage with them that we now have. Thus, we propose offering the GVN a PL-480 agreement for 500,000 tons of rice (\$80-\$90 million worth depending on the price) if they will agree to unify the exchange rate at P118/\$.

-- If they agree to change the rate now, we will retain only 20 percent of the piaster counterpart proceeds for US uses. We would thus provide rice on concessional terms in return for a rate change which would save us about \$20 million between now and the end of 1967 and about \$90-\$100 million in 1968.

-- If they commit themselves to change the exchange rate after the election - say, January 1, 1968 - but are unwilling to do so now for political reasons, we will write the PL-480 agreement for 100 percent US uses piasters. This will save us from having to buy about \$95-\$105 million worth of piasters at the P80/\$ rate -- it will cost the GVN more than the rate change over the next twelve months. We would then exchange a side letter stating that we will change the agreement to 20 percent US uses as soon as the exchange rate is unified.

-- If the present GVN refuses to consider the exchange rate question, we will sign an agreement for only enough rice to carry them for the next few months (50-100,000 tons) at 100 percent US uses, and put the subject of a rate change to the new GVN as soon as it is organized and operational.

7. In sum, our negotiating aim will be to make exchange rate unification at P118/\$ more attractive to the GVN than continuing under the old P80/\$ rate with 100 percent US uses on PL-480 rice.

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8. Consequences for AID. Changing the exchange rate will reduce GVN foreign exchange earnings. To get the GVN to accept the change, therefore, it will be necessary to show that there will be enough dollars to finance Vietnam's future import requirements. This will mean AID financed imports of about \$190 million out of FY 1968 funds, which is \$40 million less than we asked from Congress. We will, of course, make no formal commitment to the GVN until the Foreign Aid Appropriations bill is passed.

9. Recommendation. The Departments of State, Defense, Agriculture, and Treasury and AID and the Bureau of the Budget have concurred in these proposals. (Agriculture wishes to limit monthly shipments to 50,000 tons through the end of 1967, and this is agreeable.) I recommend that you approve negotiating instructions for 500,000 tons of PL-480 rice:

- (a) along the strategy lines outlined above, but
- (b) with flexibility on timing to permit Ambassador Bunker to act in the light of his assessment of relevant political factors.

Approve _____

Disapprove _____

See me _____


William Leonhart

Attachments:

A - Rice situation report.

B - Copy memo June 30.

cc: Walt Rostow

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ATTACHMENT A

VIETNAM RICE SITUATION

1. The table which follows details the Vietnam rice situation. From 1962 through 1965, Vietnam's rice production varied between about 3.1 and 3.2 million tons (milled rice equivalent). But the 1966 crop, the first sown after intensification of the war, yielded only about 2.9 million tons, and the 1967 crop dropped to about 2.6 million tons. The Mission does not count on the forthcoming crop's being any larger.

2. The production fall-off has been the direct result of the intensification of the war:

- Intense fighting in the rice deficit provinces north of Saigon has widened the difference between local production and consumption there.

- Recently increased military operations in the rice-rich delta have discouraged farming in insecure or contested areas.

- Land and farm labor have been diverted from rice to more profitable perishable crops such as vegetables, which are consumed in large quantities by the US troops.

- Farm laborers are being attracted to higher paying jobs in urban areas, recruited for RD programs, and drafted into the ARVN.

3. In the past three years, war-related production fall-offs plus increased consumption due to population growth have changed Vietnam from a small net exporter of rice (averaging about 150,000 tons per year from 1961 through 1964) to a large net importer (probably 800-950,000 tons in 1968).

4. Rice Strategy and Pacification Progress. The fall-offs in Vietnam's rice production reflect both the intensification of the war and the cost of necessary shifts of manpower to support our primary objectives in Vietnam. From the standpoint of US interests we cannot afford either to ignore the substantial number of people in the countryside who depend heavily upon rice farming for their livelihood, or to view our capacity to provide imported rice to Vietnam as unlimited. Thus we have two strategic aims in rice production in Vietnam in the midst of war. Over the next year we should:

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a. Increase rice productivity by better fertilizer utilization, more mechanization, etc. but without attracting labor away from critical occupations to rice farming. Our prime needs are for Vietnamese manpower for their armed forces, RD teams, police and security organizations.

b. Insure that GVN rice pricing policy does not squeeze rice farmer's real incomes but also does not create undue inflationary pressure. (Over the past year rice farmers have done relatively well as wholesale rice prices have about doubled - increasing half again as much as the Saigon cost of living. This spread of prosperity to rural areas is an important element in maintaining the momentum of pacification.)

5. We will include provisions in the next PL-480 agreements committing the GVN to these objectives and practical means for achieving them.

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VIETNAM RICE SITUATION

(thousands of metric tons of rice)

<u>Year</u>	<u>Vietnam Delta Surplus (shipments to rice deficit areas)</u>	<u>Imports from U.S.</u>	<u>Imports from other countries</u>	<u>Rice deficit area re- quirements*</u>	<u>Year end Security Stocks</u>
1964	500	0	0	410	90
1965	450	130	0	620	50
1966	310	260	180	750	50
1967 (est)	220	740	100	970	140
1968 (est)	220	700-850	100	1020-1170	140

*Deficit area requirements = total consumption minus local production.

6. At this point my preference for strategy follows:

a. Make clear to Thieu and Ky that we wish maximum progress before the election but that we expect the new GVN to take early and comprehensive steps to solve the reserve problem.

b. Press hard for a change of the DOD P 80/\$ official exchange rate to the personal purchase rate of P 118/\$ no later than January 1, 1968. This alone would cut GVN dollar earnings on US account by almost one-third, check reserve build-up, and defuse a domestic political issue.

c. Negotiate for a supplementary arrangement to use letters of credit tied to US exports in payment for some official piaster purchases. We can only go so far on this route - perhaps half way - since Vietnam has a legitimate need for dollar exchange for some non-US trade and transactions.

d. Vary the US counterpart share of PL-480, upward from 20 percent, to fine tune the reserve level. We may need to ship at least 650,000 tons of rice again in 1968. Earlier this year we negotiated an agreement for 100 percent US uses for 300,000 tons of total rice shipments. This gave us about \$74 million worth of piasters for about \$50 million worth of rice.

e. Use larger amounts of counterpart generated by the Commercial Import Program for US piaster expenses in Vietnam.

f. Urge the GVN to provide piasters for DOD local expenses as a burden-sharing contribution.

7. Given the political sensitivity of the reserve question over the next 6-12 months, we will probably have to live with piecemeal combinations of the lines listed above. This means keeping our choices open. In particular we should reserve our freedom of action on the US usage share of PL-480 counterpart and the size of the AID-financed CIP until we have agreement on the DOD official exchange rate.

8. Unless you see objections, I plan to use this approach in discussing the problem next week in Saigon as the first step in developing a forward strategy package for your approval. Are there additional points that you would like me to take up?


William Leonhart

cc: Walt Rostow

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MEMORANDUM

ATTACHMENT BTHE WHITE HOUSE
WASHINGTON

June 30, 1967

MEMORANDUM FOR THE PRESIDENT

1. US Economic Strategy and GVN Foreign Exchange Holdings.
The combination of a continued build-up in GVN reserves and large DOD dollar balance of payments leakages at the official exchange rate will leave us very vulnerable to Congressional and public criticism in the months ahead.
2. GVN reserves are now in the \$350 million range - up \$50 million since January - and increasing. The build-up is primarily the result of DOD purchases of piasters with dollars for troop support costs at the P 80/\$ rate (about \$260 million this FY). US personal purchases are made at the P 118/\$ rate (about \$140 million this FY). In effect the DOD is paying \$1.47 for each dollar's worth of official purchases. We have both a balance of payments drain and a potential source of domestic political embarrassment.
3. We have put considerable pressure on the GVN for a solution. Since Honolulu when we first raised the problem, we have convinced them to:
 - a. Pay for more of their imports with their foreign exchange (their rate of import financing doubled between the first and fourth quarters of 1966).
 - b. Hold \$120 million of their reserves in long-term US assets, which are a plus in our balance of payments.
 - c. Deposit \$50 million more of their reserves in the US, tied to US procurement for postwar projects.
4. Yet GVN reserves continue to build. It is not an easy problem, since the reserve level is as politically sensitive in Vietnam as in the US. Neither the Ky regime - in the midst of an election campaign - nor its successor can afford to yield too readily on an issue regarded as a measure of national wealth and economic independence.
5. But in our own interest we need to bring the problem under greater control. What we can do will necessarily be a function of US troop levels and deployments, GVN spending, AID appropriations, and US rice crop availabilities. All of these are still largely undetermined variables. We should aim to combine them in ways which will take into account GVN political problems and our own needs.

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DEPARTMENT OF STATE
AGENCY FOR INTERNATIONAL DEVELOPMENT
WASHINGTON

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August 8, 1967

OFFICE OF
THE ADMINISTRATOR

MEMORANDUM FOR THE PRESIDENT

SUBJECT: Economic Assistance to Indonesia

Helping the Suharto Government get its economic house in order involves two separable problems:

- (1) How to fulfill the U.S. share of the Inter-Governmental Group support of the Indonesia stabilization program for Calendar Year 1967, on which we are still \$27 million short of the \$65 million U.S. commitment; and
- (2) How to help stimulate rapid enough developmental progress in Indonesia to sustain public and army support of the promising new trend in Indonesian political orientation and leadership without loosening the economic stabilization discipline which is essential to long run solution of Indonesia's problems.

The second of these two matters will be the subject of studies being undertaken by the World Bank and Asian Development Bank, which will not be available even in preliminary outline until about the end of this year.

This memorandum deals with the first item. A.I.D., with the concurrence of State, proposes to meet the U.S. commitment this year in the following way:

Actions already taken:

A.I.D. loans \$30 million
P.L. 480 cotton credit \$8 million

Actions proposed:

P.L. 480 rice credit \$20 million
P.L. 480 tobacco credit up to \$2 million
(P.L. 480 terms to be dollar-repayable loans - 40-year maturity, 1% interest during 10-year grace period, 2-1/2% thereafter).

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E.O. 12356, Sec. 3.4

NIJ 82-197

By 28, NARA, Date 4-8-87

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The balance of \$5 - \$7 million, to be covered in November by either P.L. 480 cotton credit (if demand for raw cotton has by then revived) or by an A.I.D. loan.

Agriculture concurs in the rice component of this package if it is decided as a matter of policy that Indonesia is of sufficiently high priority to risk diversion of rice from cash exports. Whether such diversion will actually be necessary depends on the size of this Fall's U.S. rice harvest, the trend in Vietnam rice requirements and the behavior of the world rice market. With a bumper U.S. crop, we might get by without any visible diversion at all. But if we didn't - and if the diversion were fairly obvious - we could expect criticism on the Hill. Secretary Freeman is prepared to take the risk if you concur with the State/AID proposition that Indonesia is important enough to be worth it.

Specifically, this package requires your approval to commit 100,000 tons of P.L. 480 rice to Indonesia, as a priority claim on a supply which otherwise could be fully absorbed in Vietnam, Africa, and in commercial exports. This would not mean a rice shortage in Vietnam. It would still permit providing Vietnam 550,000 tons under P.L. 480 from the current U.S. crop. In addition, we would still be able in the Spring to provide an additional 100,000 to 200,000 tons to Vietnam from the current crop (to be divided between P.L. 480 and cash sales, depending on the Vietnamese foreign exchange situation), plus small amounts to fulfill outstanding commitments to the Congo, Ghana and Liberia.

However, the above allocation totals more than the minimum of 670,000 tons Agriculture now expects to be available for P.L. 480 from this year's crop. Although our crop may turn out to be large enough to cover it, we won't know until October. But it makes very good foreign policy sense to let the Indonesians know now. The price of telling them now is that if our crop is not any larger than the low end of Agriculture's range, we will have to choose between lowering P.L. 480 rice shipments to Vietnam and cutting into U.S. commercial rice exports.

Even with a very large U.S. crop, this rice commitment to Indonesia would probably foreclose the possibility of meeting 100,000 tons of Vietnam rice requirements from the United States, and cause Vietnam to turn to Thailand or Taiwan for purchases with Vietnamese-owned foreign exchange for that amount. We believe this will cause minimum domestic political difficulty here if the commitment to Indonesia is made at the beginning of the U.S. crop, i.e., this month, and any further Vietnamese purchases are made from Thailand/Taiwan next spring when the U.S. exportable surplus of rice is fully committed elsewhere.

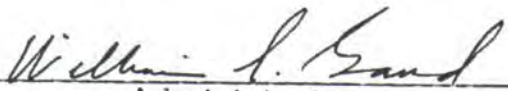
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The extreme tightness of U. S. rice availabilities, despite a record crop, and the growing shortage of rice in Southeast Asia to meet the world demand indicate need for reconsideration of existing restraints on U. S. rice acreage allocations for the future. This question will be addressed by the Department of Agriculture, State, Budget Bureau and A.I.D. in the near future looking toward budget decisions affecting the 1968-69 crop year.

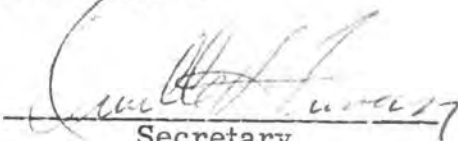
We may need to return to you later concerning the \$7 million of our 1967 commitment which will remain to be met beyond this 100,000 tons of rice. This will have to be put together through some combination of non-grain PL 480 and A.I.D. loans. But you need not make that decision now.

RECOMMENDATION

That you approve a priority claim of Indonesia for 100,000 tons of the PL 480 rice program, on the terms proposed above, subject to the development of an agricultural self-help commitment by the Indonesians satisfactory to Secretary Freeman and Administrator Gaud.



Administrator
Agency for International Development



Secretary
Department of Agriculture

Approve: _____

Disapprove: _____



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August 8, 1967

Summary of Report on Indonesia for NSC Meeting of August 9th

Following is a summary of the attached report on Indonesia:

I. BACKGROUND

Political

Sukarno has been eliminated as a political force. Suharto has given deft but undramatic leadership. There is some tension between civilian and military elements in the new leadership. Next major election likely in late 1969 or early 1970.

On the international scene, Indonesia has: rejoined the UN and associated agencies, settled its quarrel with Malaysia, supported regional cooperation.

Economic

More progress than expected. Tough stabilization program imposed and runaway inflation checked. Suharto government has given maximum play to market forces and has cut bureaucratic controls. A new investment law encourages foreign investment. A small group of young, foreign-educated economists had led the effort; they are our natural allies. Corruption and smuggling remain problems.

International Response

The U.S. and others rescheduled Indonesia's staggering debt load. IMF played a key role in stabilization program. International group pledged \$200 million to meet Jakarta's estimated foreign exchange shortfall in CY 1967 (U.S. share: \$65 million). World Bank is surveying development needs; so is Asian Development Bank.

II. ACTION PROGRAM

We want to see the present government succeed.

Our basic strategy includes:

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- (1) encouraging international agencies (IMF, IBRD, ADB, etc.) to play a central role;
- (2) given Indonesia's immense needs, a multilateral approach is desirable and necessary;
- (3) encouraging an environment favorable to foreign investment;
- (4) supporting Indonesia's able young modernizers;
- (5) putting the U.S. in a supporting rather than central role;
- (6) continuing modest but useful bilateral programs.

III. U.S. ACTIONS

A. Debt rescheduling - U.S. and other debtors will meet in Paris in October to reschedule Indonesian debts coming due after January 1, 1968. In the short run, Jakarta will not be able to reduce its growing debt (now more than \$2-1/2 billion).

B. New aid - Donor countries will meet in the Netherlands in November. Our share will be at least \$65 million, may run as high as \$100 million.

C. Bilateral programs - We should continue small programs of MAP (civic action programs such as roads, irrigation, flood control), technical training for military and civilians, food for work, technical assistance, and educational exchange.

IV. ANTICIPATED PROBLEMS

A. Unreasonable requests for aid -- we can expect, but will discourage, random, uncoordinated requests for large U.S. aid programs.

B. Population control -- a major problem but a sensitive issue.

C. Volume and nature of our assistance

-- major AID cuts on the Hill will reduce the amount we can lend Indonesia;

--Indonesia needs rice, but there will be some competition with Viet-Nam's requirements;

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-- if its broken-down textile industry can be restored, Indonesia will need cotton through PL-480.

D. Multilateralism -- as Indonesia moves from stabilization to development, its needs will increase. Other sources of aid (Japan, Western Europe) may not be able to increase their help significantly. We may have to reconsider the one-third aid formula.

E. Inadequate resources -- it is almost certain that we will not be able to meet from expected resources our one-third share of Indonesia's 1968 needs. A request to Congress for supplemental funds may be necessary. Congressional consultation has indicated a favorable attitude toward aid to Indonesia and our multilateral approach.

The report concludes:

"The Indonesians are performing on their side of the bargain, and the U.S. and other countries of the Free World are confronted with the challenge of dealing not with a failure, but with a prospective success. We should not fail them."

A table of support pledges from the U.S. and others in CY 1967 is attached to the report.

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INDONESIA

I. BACKGROUND

Introduction

1. On August 4, 1966, the National Security Council considered a paper on Indonesia which made cautiously hopeful forecasts for the coming year. These forecasts have proved realistic. Economic and political progress was perhaps slightly better than expected a year ago, and the contributions made by the United States and other major Free World countries to economic stabilization followed the predicted pattern.

2. This paper reviews the current situation, projects a program of action, and looks ahead to the prospects for the coming year.

Political

3. Sukarno has been eliminated as a political force. The "New Order" led by General Suharto is well established in power, and is neutralizing gradually "Old Order" hold-outs in the police, marine corps, and parts of Central and East Java. Suharto and his associates showed sophistication and a fine sense of timing in managing the transition. The thread of legitimacy was never broken. Sukarno was denied martyrdom. Instead, the pernicious irrelevance of his leadership was gradually exposed, and the hollow shell of rhetoric and revolutionary romanticism allowed to crumble of its own weight. "Engineer" Sukarno now lives in internal exile in Bogor, a pathetic old man transformed in eighteen months from the incarnation of the Indonesian State into a historical relic.

4. This process of political transition was completed only in March of this year, and a post-Sukarno political structure has not yet emerged. Suharto keeps his own counsel, and is inclined to caution and gradualism. He is feeling his way among the conflicting pressures of New Order activists advocating rapid, wholesale change, and entrenched traditional political leaders defending the status quo. Military-civilian distrust and suspicions add another element of stress. There is some public criticism of the slow pace of change, but

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FRUS, Vol. XXVI, #241

8-23-02

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SERVICES

Suharto has shown in the past a good sense of timing and an ability to recognize and exploit a developing national consensus. The new election law is not yet passed and, with a minimum of eighteen months lead time between passage and elections, it is unlikely that the Indonesians will go to the polls before late 1969 or 1970.

5. The past year has been one of solid accomplishment in the international field. Indonesia settled its quarrel with Malaysia and rejoined the United Nations and its associated organizations and agencies. It has supported the concept of regional cooperation, and will be meeting with its neighbors in the coming weeks to create a new Southeast Asian regional organization. It has continued to adhere to a non-aligned policy, and has maintained correct relations with the Soviet Union and the States of Eastern Europe. Its relations with Peking, however, are under severe strain, but both the Chinese and Indonesian Governments appear desirous of avoiding a complete break.

Economic

6. Progress in domestic economic reform has been considerably greater than was anticipated in August of last year. An ambitious and reasonably effective stabilization program was put into effect. The pace of wild inflation has been checked. Prices on major consumer items leveled off. A stultifying jungle of licenses and controls was swept away and replaced by a system that relies in large measure on free market forces to determine import priorities. Government corporations were cut off the dole and told to produce effectively or perish. Budgetary stringency was introduced, and the military share of the budget cut in half. Political risks were faced and highly subsidized prices for gasoline, electricity and rail travel were raised to meet the costs of production. The Central Bank, which under Sukarno was a fiscal mockery of that term, is now beginning to exercise control of foreign exchange earnings and domestic credit. A new investment law designed to attract foreign capital was passed.

7. These accomplishments are largely the results of the leadership of a group of young economists from the University of Indonesia trained at the University of California at Berkeley, MIT and Harvard. These men have not only been responsible for determining economic policy and overseeing its execution, they have also participated in the international negotiations leading to debt rescheduling and

new aid. Most important of all, these economists have won the unqualified support of General Suharto who has backed them without reservation in the politically painful belt tightening of the stabilization program.

8. These gains were achieved from a degree of economic collapse unparalleled for a major nation in modern times, and much still remains to be done. A substantial volume of trade still moves in irregular channels. Government revenue is overly dependent on taxation of foreign trade, and tax collection as a percentage of gross national product is the smallest in Southeast Asia. Corruption and influence peddling continue at all levels of government. The Suharto regime, however, acknowledges the seriousness of these problems, and spurred by strong pressures inside and outside the government, is moving to deal with them.

Psychological

9. With these political and economic changes have also come important changes in attitudes and values. The baby boom of the 1950's has produced a new post-revolutionary generation, a stranger to both the heroics of the independence struggle and the spiritual indignities of colonialism. This generation has taken the lead in a general rejection of the slogans and ideology of the Sukarno period, and pragmatism, rationalism, and performance have become the new watchwords. A sober, objective judgment of national self-interest is now more often the basis for decisions, and Indonesian actions, if not always satisfactory, have at least become more predictable.

International Response

10. Moving in response to the steps taken by Indonesia to put its house in order, the United States and other friendly countries of the non-Communist world cooperated in a joint effort to help Indonesia. They agreed in Paris in December to reschedule somewhat over \$300 million in debts in arrears and falling due in the 18-month period ending December 31, 1967. They later agreed in Amsterdam to provide \$200 million of new assistance in CY 1967 to meet the foreign exchange gap estimated by the IMF staff. The United States committed itself to provide one-third of the total requirement if Indonesia continued to make reasonable progress in its stabilization performance and if the other donor countries made up the remaining two-thirds. The meeting in The Hague in June announced the successful pledging of the full amount (attached table sets forth the specific contributions). The Japanese contribution of approximately one-third is noteworthy.

11. The Soviet Union refused to participate in these conferences, but Indonesia reached, through bilateral negotiations, a preliminary understanding that would lead to rescheduling, under approximately the same terms, the debt due the USSR and other Communist states. However, the Soviet Union and the countries of Eastern Europe have thus far made no contribution of new aid.

12. The International Monetary Fund has played a central role in advising the Indonesian Government on its stabilization program. It maintains a representative in Djakarta, and has taken part in all of the international meetings on debts and new aid. The International Bank for Reconstruction and Development made a preliminary survey of Indonesian priority import requirements for CY 1967 and, at the Indonesian Government's request, has a mission now in Indonesia studying the question of transition from stabilization to the development phase. Both the United Nations Development Program and the newly formed Asian Development Bank have dispatched missions of experts to advise the Indonesian Government on critical development efforts.

II. ACTION PROGRAM

U.S. Objectives

13. We seek the development of a politically stable Indonesia, responsive to the needs of its citizens, and playing a responsible and constructive role in Southeast Asia and the world. This objective coincides with the goal of the present Government of Indonesia.

U.S. Strategy for the Future

14. Our strategy contains the following major elements:

A. Central Role of the International Agencies

The international agencies must continue to play a central role in Indonesia's economic recovery. The IMF has made an invaluable contribution in the areas of stabilization planning, debt re-scheduling, and mobilization of new aid. The IBRD is now moving in to advise Indonesia on reconstruction and development planning. The Asian Development Bank appears certain to become an important contributor to the development effort. These organizations provide Indonesia

with sound professional advice, act as a clearing house of economic information, and serve both as impartial judges of achievement and as politically insulated forces for encouraging minimum standards of performance.

B. Maximum International Participation

Indonesia's needs for foreign assistance are so great that only the pooled resources of many nations can provide the necessary help. Indonesia's continuing debt problem can be dealt with only on an international basis. A multi-national approach is therefore both desirable and necessary. All the major trading nations of the world have a stake in the economic recovery of a nation with abundant natural resources and a political economy of over 100 million people. We should ensure that they bear their fair share of the burden, and avoid a division of labor in which, in effect, we feed the cow and they milk it.

C. Maximum Role for Private Investment

Private investment from all of the developed countries must play an important role in Indonesia's transition from the stabilization to the phase of rehabilitation and development. We should continue to encourage Indonesia to maintain a favorable environment for foreign investment.

D. Support of "Modernizers"

One of Indonesia's greatest assets is the cadre of young men trained in American and Western European universities. These are the people that form the cutting edge of Indonesia's drive to develop its economy and its political institutions. They are our allies and our actions should support them.

E. "Low Profile"

The United States must make a major contribution to Indonesian recovery. The principal elements of our strategy -- international agency involvement and multi-national participation -- require, however, that we play a supporting rather than a central role.

F. Bilateral Program

While making our major contribution in the multinational context, we should also continue small, intensive bilateral programs.

III. U.S. ACTIONS

15. A. Debt Rescheduling

The United States will join other creditor countries in Paris in October to deal with the problem of Indonesia's debts falling due after January 1, 1968. We should build upon understandings already established in past reschedulings and, in determining changes, take due account of Indonesia's capacity to service its debts. Whatever the outcome, the fact will remain that Indonesia in the near term will have no resources to devote to the reduction of a growing external debt of over \$2-1/2 billion.

B. New Aid

The donor countries will meet in Amsterdam in November to consider the IMF's estimate of Indonesia's requirements for new assistance during CY 1968, and to discuss the IBRD report on development planning. We can reasonably expect to be called on to contribute at least the \$65 million pledged for CY 1967 and possibly one-half again that amount.

C. Bilateral Programs

We plan to continue to provide non-combat equipment under MAP for the civic mission program of the Indonesian armed forces. This assistance permits the Army to strengthen its ties with the civilian sector, and at the same time provides high priority services in the field of road construction, flood control and irrigation system maintenance. The training of Indonesian officers in our Service schools in economically beneficial management and technical skills will continue. On the civilian side, we intend to support under PL-480, Title II, food for work programs which increase agricultural production. We intend also to provide technical assistance, and a program of educational exchange has been resumed and will be expanded.

IV. ANTICIPATED PROBLEMS

Unreasonable Requests for Aid

16. While the Indonesian Government accepts and supports the concept of a multi-national approach to Indonesia's economic problems, there has been in the past a tendency, particularly on the military side, to look for easy solutions in an outpouring of large quantities of American assistance. The new Indonesian leaders have gained, during the past year, a more realistic understanding of U.S. capabilities and aid procedures. We must anticipate, nevertheless, some further random, uncoordinated requests for substantial bilateral assistance.

Population Control

17. Two-thirds of the population of Indonesia live on one-fourteenth of its land area. Economic recovery and political stability cannot in the long run be achieved without population control and family planning on the central island of Java. The Indonesian leaders are beginning to turn in a tentative fashion to face this problem. This is a sensitive issue on which heavy-handed pressure would be self-defeating, but we should be quietly persistent in encouraging a vigorous program of family planning.

Volume and Nature of Our Assistance

18. The most difficult problem confronting the United States during the coming year will be providing the volume and type of assistance to meet our fair share of Indonesia's needs. The principal elements of this problem are:

A. Meshing Capacity With Needs

If major cuts in the A.I.D. appropriation are made this year, the amount which we can lend to Indonesia will be reduced. Indonesia needs rice, but must compete with the preemptive requirements of Viet-Nam. Cotton, through PL-480, could be a major element in our aid, but Indonesia's broken down textile industry has not been able to compete with cheap Hong Kong imports. When idle capacity is restored, Indonesia can absorb increasing amounts of our raw cotton.

B. Multilateralism

As a member of a group working on a common problem, we are under special obligation not only to carry our share of the burden, but also to make our assistance available on terms no less generous than those offered by other countries. In addition, as Indonesia moves from the stabilization to the development phase its needs will increase. Japan and Western Europe may find it difficult to increase significantly their current levels of assistance to Indonesia, and we may be unable to limit our share to one-third or to achieve a rigid matching formula.

C. Inadequate Resources

Even assuming the best possible AID-PL480 mix, it is almost certain that we will not be able to meet from anticipated resources one-third of Indonesia's 1968 requirements. It may therefore be necessary to go to Congress early next year for supplementary funds. We have been in close touch with key members of Congress on the Indonesian situation, and have found them favorably disposed both towards assistance to the Suharto government and to our multi-national method of approach.

19. Indonesia has been led to believe that if it faced up to its economic problems, took the politically difficult steps to stabilize its economy, and adopted sensible policies of self-help, it could expect support from the world community. Indonesia's leaders have started down this difficult road, and for them there is no turning back. The pace of change must be maintained. We have seen at home and abroad how improving conditions create expectations which become explosive if not fulfilled. The Indonesians are performing on their side of the bargain, and the United States and other countries of the Free World are confronted with the challenge of dealing not with a failure, but with a prospective success. We should not fail them.

INDONESIA'S CY 1967 ASSISTANCE REQUIREMENTS

Pledged or Furnished
in Millions U.S. Dollars

United States	\$65
Japan	\$60
Netherlands	\$28
Germany	\$29
India	\$13
Others (Australia, Canada, UK)	\$ 2

Total	\$197
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