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ORIGIN/ACTION

DEPARTMENT OF STATE

AIRGRAM

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Secret

HANDLING INDICATOR

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TO : DEPARTMENT OF STATE

*Not sent
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FROM : AMEMBASSY DJAKARTA

DATE:

SUBJECT : PUBLIC FINANCE: Foreign Exchange Fragmentation

REF : A. CERP, Section D.

1. The Embassy has recently gathered from GOI officials comments as well as several bits of circumstantial evidence which indicate that foreign exchange fragmentation continues to be a problem. While it is clear that the Sultan, the Finance Minister, and top officials of the Bank Indonesia have made efforts to acquire unitary control over funds, the problem is proving intractable for political and organizational reasons. There follows a summary of recent remarks on this subject by R.A. KARTADJOEMENA, Deputy Governor of the Bank and Head of the Foreign Exchange Fund, and Selo SUMARDJAN, the Sultan's personal assistant, together with two reports of deals made to use forex available from estate exports under Agriculture Minister Frans SEDA.

2. Kartadjoemena was hesitant to talk about fragmentation some time ago, but he recently volunteered confirmation that it remains a considerable problem and that the causes are twofold: the continuing power and independence of certain Ministers, and chaos at the Bank Indonesia. Kartadjoemena confirmed what we have often heard, that Oil Minister IBNU is a major offender. Ibnu is taking an increasing amount of the GOI's profit

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In Out

FORM 4-62 DS-323

Drafted by: *[Signature]*
ECON:PMCleveland:ctb 6/22/66

Contents and Classification Approved by:
ECON:PDMcCusker

Clearances:
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Authority *NND3770*

S E C R E T

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share from oil in the form of crude and is selling it on his own, as he is indeed legally entitled to do under the oil company work contracts. The problem, said Kartadjoemena, is that Ibnu cannot be made to report to the Central Bank how he is using these funds. Seda, he added, was just as bad in his own way. Others, like the state trading companies, were not so much a problem. Independent projects like Kopelapip (aircraft industry) and the Carya Putra shipyard which previously siphoned off foreign exchange by earmarking certain export proceeds are now being postponed. Kartadjoemena's conclusion: the situation is not getting any worse at the moment; nor is it necessarily getting any better.

3. Selo Sumardjan in a conversation on June 13, 1966 was equally reserved about progress in this area. According to Sumardjan, when the Sultan took his present job, the first thing he decided on doing was to regain the central economic authority's foreign exchange control by placing it firmly in the hands of the Central Bank. Since then, the Sultan has worked closely with the new Bank Indonesia Governor, whom he himself appointed, RADIUS PRAWIRO, to sort out the chaos at the Bank, establish "conventional" foreign exchange controls, and on the basis of information picked up at the Bank to go after individuals and Ministries which have sequestered foreign exchange. Because of the demoralization and heritage of intrigue from the days of Jusuf Muda Dalam, sorting out matters at the Bank was proving difficult. As for going after the Ministries, there were many political risks, and so far the Sultan had only been able to nibble away at the small fish. Big time operators like Seda and Ibnu, as well as some Army commanders, all agreed in principle to the need for central control, but they had not wholeheartedly followed through in practice. Some regional Army commanders, especially in the outer islands, simply claimed they needed 50 percent of the export earnings from their areas for their Revolutionary Funds. *at/rode*

S E C R E T

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Sumardjan further confirmed that the independent authorities Kopelapip, Carya Putra and the Trans-Sumatran Highway were now under control. He also noted that while SUKARNO still had private sources for funds, the President was at least officially cut off from going directly to his Ministers for money. With some pride, Sumardjan claimed that the Sultan had bluntly told Sukarno to come to him in the future when the Palace needed foreign exchange. Sumardjan chortled as he acknowledged that the President had not yet come.

4. Two reports of deals arranged by Agriculture Minister Seda were described to the reporting officer in conversations with Mr. OHTAKA of the Japanese Embassy and Robert Keatley, Wall Street Journal reporter recently in Djakarta. a) Ohtaka told an interesting story of how the Japanese auto manufacturer Toyota not long ago arranged to export 1,000 cars to Seda's Plantations Ministry through the Dutch firm, Carven Continental. Carven in exchange for a high commission from Toyota, is including Toyota cars in a \$30 million shopping list of goods ordered by the Plantations Ministry. Seda is apparently paying for the list with estate products. From all indications, he has not obtained approval of the central financial authorities for these transactions. b) Keatley reports Land Communications Minister Brig. General Utomo UTOJO as saying that \$21 million was needed for refurbishing the state railroads. When Keatley asked where the money was coming from, Utojo, who has a record of frankness, said: I've been made a member of Frans Seda's Club. Seda is going to give me \$7 million of his foreign exchange, if I use it on the railroads serving plantations in Sumatra which come under Seda's control.

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5. COMMENT: While there appear to be strong indications that such people as Seda, Ibnu and certain Army officers continue to operate sectors of the economy under their purview as personal fiefdoms, it is difficult without access to Central Bank records to establish the extent of their personal authority. The Embassy believes that one of the key tasks that the forthcoming IMF mission could perform would be a thorough examination of the extent of foreign exchange fragmentation. An objective analysis of this question by the IMF would not only help clarify the situation for the creditor nations, but could also be useful to the Sultan in formulating a strategy designed to harness the independent economic forces under the unitary control of the central economic authorities.

GREEN

S E C R E T

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MEMORANDUM OF CONVERSATION

PARTICIPANTS: Tadashi Ohtaka, First Secretary,
Japanese Embassy
Paul M. Cleveland, Economic Officer

DATE: June 10, 1966

SUBJECT: Foreign Exchange Fragmentation

The reporting officer described the questions regarding foreign exchange fragmentation to Ohtaka several weeks ago. Ohtaka had been unaware of the problem, but immediately comprehended its significance and said he would check among his contacts for evidences of it. On June 10 he came back with the following tale.

The Japanese auto manufacturer Toyota was holding five thousand cars in its godowns for Indonesia ever since Japanese exports to Indonesia were stopped last December. When Toyota recently learned that it could not hope to obtain a part of the Sultan-negotiated \$30 million credit to cover shipment of the cars, it began looking for other ways to unload the cars. It sold 1,000 to Australia. Toyota then managed to make a deal with Carven Continental, a large Dutch firm with banking connections and connections with the Indonesian Plantations Ministry, to sell 1,000 more cars (\$2.4 million worth) through Carven to the Plantations Ministry. When the deal finally goes through Carven will receive a large commission from Toyota.

Through Toyota's man in Djakarta, who is exceedingly nervous about this deal, and through other contacts, Ohtaka has learned that Carven Continental has in fact got a list of \$30 million worth of goods it is trading with the Plantations Ministry in exchange for Ministry products. Most of the goods listed are for agricultural uses. Ohtaka believes, but is checking further, that the proceeds from the Plantation Ministry's exports are deposited directly into Carven's banks in Holland and are then used to pay Carven for the goods ordered by the Plantations Ministry.

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Ohtaka acknowledged that there was nothing in his story to establish beyond all doubt that Seda and his Ministry are acting without central bank authority. However, he believes circumstances point in this direction: (1) the deal has been very confidential (Ohtaka said he pointedly made no mention of it in a conversation he had with a central bank official about foreign exchange fragmentation /see below/); (2) Toyota only turned to making a deal with and paying a high commission to Carven, after it failed to get coverage of the export under the \$30 million credit negotiated by the central economic authorities; (3) Toyota is nervous about the whole deal. All these things, says Ohtaka, point to the conclusion that the deal has so far been undertaken without the knowledge of central authorities and in the belief that the central authorities might not approve it if they had a chance to block it. What need for all the mystery, said Ohtaka, had the central authorities already given their approval?

To obtain additional confirmation of these suspicions Ohtaka said he talked in a general way about fragmentation with Sonneville, a high level official at the Bank Negara. Sonneville said it was indeed very hard to control the Plantations Ministry. He said that the Ministry did open the letters of credit for many of its purchases through the Bank. He went on to say however, that this approval came after the deals were made and was not proving an effective way to control the Plantations Ministry use of foreign exchange.

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MEMORANDUM OF CONVERSATION

PARTICIPANTS: Mr. Robert Keatley, Wall Street Journal
Paul M. Cleveland, Economic Officer

SUBJECT: Foreign Exchange Fragmentation

DATE: June 3, 1966

Mr. Keatley reported on a late May conversation he had had with Brigadier General Utojo Utomo, Deputy Minister for Land Communication. Utojo said that he needed \$21 million for refurbishing the railroads in Indonesia. When Keatley asked where the money was coming from, the General replied: I've been made a member of Franz Seda's (Agriculture Minister) Club. Seda is going to give me \$7 million of his foreign exchange, if I use it on the railroads serving the plantations in Sumatra which came under Seda's control.

COMMENT: This would appear to be another bit of evidence that Mr. Seda is running his own private economy.

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John

John • UNITED STATES GOVERNMENT

DATE: May 30, 1966

McCusker
Cleveland

Fragmentation.

Director of the Central Foreign Exchange
hesitant to talk about fragmentation
foreign exchange two months ago, but
he volunteered several remarks to indi-
cating that fragmentation is still a considerable problem.
Fragmentation are twofold, he said: the
dependence of certain ministers and chaos

steps

General IBNU is a major problem. Confirming Howard CRAWFORD's suspicions (raised in a conversation May 24 with the Ambassador), Kartadjoemena said that Ibnu is taking a large amount of the GOI's profit share from oil in the form of crude which he then sells, mostly in Japan. This is perfectly legal, in keeping with the Work Contracts, and the companies don't mind. However, Ibnu does not obtain central bank or higher approval for spending the foreign exchange proceeds from these sales and does not even report to the bank what he spends these earnings on. Kartadjoemena allowed as how the Oil Ministry has always been independent in this regard, but he felt Ibnu had usurped power he should not have.

I asked about others. Was SEDA doing this kind of thing? Who else? According to Kartadjoemena, Seda is just as bad as Ibnu. Also, the independent projects like Kopelapip (the aircraft industry project) and the Carya Putra shipyard siphon off foreign exchange. Teams have now been organized to clean up these organizations (Karno Barka, head of the Indonesian equivalent of our FAA, told me a week ago he had just been appointed to the Kopelapip Team).

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K.M.
We should try to give see
this further + if this is
confirmed we should
immediately inform
the Dept. As you know,
we have given the Dept
an impression that the
System is gaining control
of force. John

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Office Memorandum • UNITED STATES GOVERNMENT

TO : DCM - Mr. Lydman
THROUGH : ECON - Paul D. McCusker
FROM : ECON - Paul M. Cleveland

DATE: May 30, 1966

SUBJECT: Foreign Exchange Fragmentation.

KARTADJOEMENA, Director of the Central Foreign Exchange Fund (BLLD), was hesitant to talk about fragmentation of Indonesia's foreign exchange two months ago, but two nights ago he volunteered several remarks to indicate that fragmentation is still a considerable problem. The causes of fragmentation are twofold, he said: the power and independence of certain ministers and chaos at the bank.

Independent Ministers

General IBNU is a major problem. Confirming Howard CRAWFORD's suspicions (raised in a conversation May 24 with the Ambassador), Kartadjoemena said that Ibnu is taking a large amount of the GOI's profit share from oil in the form of crude which he then sells, mostly in Japan. This is perfectly legal, in keeping with the Work Contracts, and the companies don't mind. However, Ibnu does not obtain central bank or higher approval for spending the foreign exchange proceeds from these sales and does not even report to the bank what he spends these earnings on. Kartadjoemena allowed as how the Oil Ministry has always been independent in this regard, but he felt Ibnu had usurped power he should not have.

I asked about others. Was SEDA doing this kind of thing? Who else? According to Kartadjoemena, Seda is just as bad as Ibnu. Also, the independent projects like Kopelapip (the aircraft industry project) and the Carya Putra shipyard siphon off foreign exchange. Teams have now been organized to clean up these organizations (Karno Barka, head of the Indonesian equivalent of our FAA, told me a week ago he had just been appointed to the Kopelapip Team).

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On the other hand, the Niagas, according to Kartadjoemena, are not so bad when it comes to squirreling away foreign exchange earnings. Nor could he blame the outer island governments for wanting more control over their foreign exchange earnings. Giving the outer islands more control over earnings as has been done recently will give them more incentive to export.

When I asked if fragmentation were getting worse, Kartadjoemena replied no. He added that it wasn't getting any better either.

The Bank

Kartadjoemena confirmed what we have heard elsewhere, that the bank is thoroughly disorganized and demoralized. This was a major factor in the central authorities' inability to deal with foreign exchange fragmentation. Kartadjoemena seemed doubtful about the possibility of the IMF assisting the Bank. We are not members of the IMF, and I don't think we can afford the hard currency portion of the subscription fee, he said.

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MEMORANDUM OF CONVERSATION

PARTICIPANTS: Selo Sumardjan, Office of Sultan Hamengkobuwono
Paul Gardner, Political Section
Paul Cleveland, Economic Section

SUBJECT: Foreign Exchange Fragmentation

DATE: June 13, 1966

In a good discussion with Selo Semardjan, the Sultan's personal assistant, the reporting officer used the opportunity to raise the subject of foreign exchange fragmentation. This is what Sumardjan had to say:

1. When the Sultan took his present job, he asked himself: What should I do? The very first thing to get started on, he concluded, was the regaining of control over foreign exchange, so that the government could control expenditures for recovery and development. His plan was and is to start working with the help of Radius Prawiro at the Bank Negara to centralize control in the Bank.
2. The Sultan and Radius have begun by trying to re-establish conventional controls within the Bank itself. While this work is well underway, it is by no means finished and has proved difficult because of the heritage of chaos and intrigue left by Jusuf Muda Dalam and his friends. First, conventional controls have to be established; then, even more difficult, they have to be implemented, said Sumardjan.
3. The Sultan has also now begun, by using information gained at the Bank, to regain control over independent foreign exchange funds held by some of the lesser offenders in the government. This has proved difficult for the somewhat different reason that the Sultan cannot afford politically to move against too many people at once. He is nibbling away at them one by one. As for the bigtime operators, SEDA, IBNU, and a variety of folks in the Army, the Sultan was having to proceed even more cautiously. Sumardjan handled this subject carefully, but nonetheless made it clear that, while "absolutely everyone recognizes the need for central control in principle," the big foreign

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exchange earners are not yet following through wholeheartedly. When we asked if the Sultan could afford to move against the major holdouts following the MPRS, when his political base might be stronger, Sumardjan said that the Sultan could then move "faster", but that he still would not be able to do all he wished in one fell swoop.

4. Sumardjan was obviously reluctant to go into specifics such as who is involved in squirreling away funds and how they squirrel them away, and how much. He did, however, in a general way, clearly implicate the Army along with Seda and Ibnu. He said that much of the foreign exchange gathering was done quite openly by Army officers who claim they need 50 percent of all earnings for their Revolutionary Funds. Some foreign exchange was accumulated and spent independently by Ministers simply because the Bank did not yet have an adequate control system. Some of it was ferreted into foreign accounts through such practices as false documentation. In the case of oil, he said that the Oil Ministry funds had always been handled separately and that the Oil Ministry was in a strong position to dictate their use. He admitted he did not know why this was. In answer to a question, he said it might just be historical precedent from the time when Chaerul SALEH was oil czar. But there he re-emphasized that the Ministry still retained strong control over how oil earnings were used.

5. Sumardjan did not make much of a distinction between foreign exchange sequestered legally (amounts above the check price) and that obtained illegally. The main point he thought was to establish clear and conventional controls so that all funds could be allocated in accordance with the central authorities' list of import priorities, not in accordance with some minister's list of personal needs. We did not get into the subject of whether direct or indirect controls should be established.

6. Addenda: a) The Sultan has cancelled the rights of the independent agencies, Carya Putra, Kopelapip, and the Trans-Sumatran Highway Authority, to certain foreign exchange earnings which formerly could be spent as these agencies wished. Sumardjan also gave confirmation to the suspicion that at least some of Kopelapip's foreign exchange earnings were to be used for political purposes rather than purchase of Fokker Friendship aircraft as the GOI claimed. An investigation of their (PKI-infiltrated)

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organization was now underway, he said. b) The Sultan went to Sukarno and told him that he knew the President had projects requiring foreign exchange, that he (the Sultan) didn't care what they were, but that the President should henceforth come to the Sultan when he needed money, not to other ministers. The President, said Sumardjan, had not yet come, but might have to come soon. Sukarno had just sold two cars apparently to get some cash. (This checks, as we know that the President drove unescorted to his birthday party at Madam Dewi's the other evening in a Jeep.)

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MEMORANDUM OF CONVERSATION

FILE

PARTICIPANTS: Tadashi Ohtaka, First Secretary,
Japanese Embassy

Paul M. Cleveland, Economic Officer

DATE: June 10, 1966

SUBJECT: Foreign Exchange Fragmentation

The reporting officer described the questions regarding foreign exchange fragmentation to Ohtaka several weeks ago. Ohtaka had been unaware of the problem, but immediately comprehended its significance and said he would check among his contacts for evidences of it. On June 10 he came back with the following tale.

The Japanese auto manufacturer Toyota was holding five thousand cars in its godowns for Indonesia ever since Japanese exports to Indonesia were stopped last December. When Toyota recently learned that it could not hope to obtain a part of the Sultan-negotiated \$30 million credit to cover shipment of the cars, it began looking for other ways to unload the cars. It sold 1,000 to Australia. Toyota then managed to make a deal with Carven Continental, a large Dutch firm with banking connections and connections with the Indonesian Plantations Ministry, to sell 1,000 more cars (\$2.4 million worth) through Carven to the Plantations Ministry. When the deal finally goes through Carven will receive a large commission from Toyota.

Through Toyota's man in Djakarta, who is exceedingly nervous about this deal, and through other contacts, Ohtaka has learned that Carven Continental has in fact got a list of \$30 million worth of goods it is trading with the Plantations Ministry in exchange for Ministry products. Most of the goods listed are for agricultural uses. Ohtaka believes, but is checking further, that the proceeds from the Plantation Ministry's exports are deposited directly into Carven's banks in Holland and are then used to pay Carven for the goods ordered by the Plantations Ministry.

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Ohtaka acknowledged that there was nothing in his story to establish beyond all doubt that Seda and his Ministry are acting without central bank authority. However, he believes circumstances point in this direction: (1) the deal has been very confidential (Ohtaka said he pointedly made no mention of it in a conversation he had with a central bank official about foreign exchange fragmentation [see below]); (2) Toyota only turned to making a deal with and paying a high commission to Carven, after it failed to get coverage of the export under the \$30 million credit negotiated by the central economic authorities; (3) Toyota is nervous about the whole deal. All these things, says Ohtaka, point to the conclusion that the deal has so far been undertaken without the knowledge of central authorities and in the belief that the central authorities might not approve it if they had a chance to block it. What need for all the mystery, said Ohtaka, had the central authorities already given their approval?

To obtain additional confirmation of these suspicions Ohtaka said he talked in a general way about fragmentation with Sonnevile, a high level official at the Bank Negara. Sonnevile said it was indeed very hard to control the Plantations Ministry. He said that the Ministry did open the letters of credit for many of its purchases through the Bank. He went on to say however, that this approval came after the deals were made and was not proving an effective way to control the Plantations Ministry use of foreign exchange.

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Paul M. Cleveland, Economic Officer

SUBJECT: Foreign Exchange Fragmentation

DATE: June 3, 1966

FILE

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COMMENT: This would appear to be another bit of evidence that Mr. Seda is running his own private economy.

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DCM - Mr. Lydman

May 30, 1966

ACJGH : ECON - Paul D. McCusker

ECON - Paul M. Cleveland

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MEMORANDUM OF CONVERSATION

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