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Three-year Economic Plan versus Devaluation

By Dr Edward Ellenberg, Tel Aviv

What has been, for a long time already, an open secret, known but hush-hushed by everybody, now emerged into public discussion. This is due to the fact that the two personalities, whose main responsibility it is to deal with the recovery of Israel's economy and finances, openly clashed on future measures.

The minister of Finance, P.Sapir, number 2 in the Government, who promised that during the lifetime of the present Eshkol Government no devaluation of the Israeli pound should take place, now proposed the guidelines for an economic policy which, at most, hopes to achieve a situation in which a viable economic policy can be carried out in a few years.

The Minister of Commerce and Industry H. Zadok, although fully agreeing with his colleague on the need to prepare for the future, wants as well to take a look at the present, and by adopting some specific measures to help raise exports.

There are also economists—those who have no government responsibility and position to defend—who consider extricating the economy from its chronic inability to overcome its huge trade deficit, by a new and substantial devaluation of the I£, as the only way out from today's Israel economic difficulties. In their theoretical views such a devaluation would make Israel exports much more competitive, earnings from the export market much more attractive to local producers, while making imports more expensive and thus less attractive. However, these economists seem to forget that the Israel economy is bedevilled by two main factors which make it extremely difficult to carry out any stable economic policy. One of these factors is the economy's high degree of dependence on capital imports. The second one is the institutional inflexibility, dominating the economic as well as the political life of Israel.

Both these factors are responsible for the failure of the February 1962 devaluation of the Israeli pound, the purpose of which was to give a substantial encouragement to exports, while discouraging imports. The failure of the 1962 devaluation of the I£ is now generally admitted even in Government economic circles and everybody agrees that the rate of I£ 3 to the US dollar, set at that time, was too low to provide sufficient incentive to exports—despite the fact that the low exchange rate was chosen primarily in order to avoid attracting an inflow of unrequited foreign exchange, that could have set off a runaway inflation.

On the other hand, the fact that wages, rents loans and other payments were so tightly linked either to the dollar or to the Cost-of-Living index, triggered a corresponding change in incomes throughout the whole economy. By recognising this, Mr Sapir, the Treasurer, decided to and succeeded in eliminating nearly all linkages to the dollar. Wishing to go further he now intends to eliminate as well the effects of the link to the Index, and this is why he worked out his three-year program.

The Treasurer already succeeded in avoiding—much to the dislike of many members of the coalition and the leaders of the forceful Confederation of Labour—payment of an increased Cost-of-Living allowance in July. He also succeeded in convincing most of the circles involved in rising the percentage required to increase this allowance next year, in July, and in freezing the index for the next two years. Mr Sapir seems to work hard towards preventing any allowance increases in the future, probably with the aim of making the whole system become an anachronism. And since the bulk of personal restitution payments from Germany should have been received by 1969, the Minister of Finance believes that the inflow of unrequited capital will be substantially lessened by then.

Mr Sapir estimates that by 1970 Israel will reach an annual industrial export figure of $ 750 million, and this without any payment of direct export premiums, because he considers it a form of quasi-devaluation. Mr Zadok, his colleague in the Ministry of Commerce and Industry, considers that a maximum of $ 665 million could be attained by 1970 and this only on condition that industry receives some form of major Government assistance for its exports. Both ministers agree that industrial exports cannot be expected to rise at the present rate of exchange—unrealistic as far as the export industries are concerned—and at present levels of domestic wages, productivity and overhead charges. The two ministers disagree when it comes to proposing the form of inducements to be offered to industrialists. Mr Sapir proposes selective assistance to export industries, giving more to those plants that export a larger fraction of their production and work in development areas. He wants these inducements to take the form of additional benefits under the Capital Investment Encouragement Law, exempting export plants from the payment of national insurance and of different social welfare payments for their employees, etc. Mr Zadok, for his part, proposes instead to do away with the complications involved in selective assistance and would like to set a uniform rate—I£ 0.60 (20 cents US) for every US dollar—of Government assistance for added value deriving from all industrial exports. He believes that the advantage of such uniform rate is that industrialists will have a known framework within which they will either have to export or go under, if the shrinking domestic market cannot take up their production.

The fight is on between the Treasury and the Trade and Industry Ministry. The first fears that by agreeing to a uniform rate of Government assistance, the present rate of exchange will be undermined and a premature devaluation of the Israeli pound could be

forced upon. At the same time, such straight across-the-board payments to industrialists could generate new wage demands from the employees, thus annihilating the Government assistance.

A third proposal, the one put forward by Dr David Horowitz, the Bank of Israel Governor, is generally supporting the three-year program of Mr Sapir, but proposes instead of blocking taxes, an overall 15 % reduction of all wages and benefits.

The discussion is still going on and a final decision is not expected very soon. And not only because of divergences between Messrs Sapir and Zadok, but as well because one of the coalition-partners, the extreme left wing Mapam party, strongly opposes the plan of Mr Sapir. Meanwhile, nobody seems to bother with the real disease of Israel's economy, preferring to look instead after different treatments for symptoms. The deep-rooted disease of the economy however is a structural one. First of all due to the fact that the great majority of local industrial plants are far too small—rather workshops—and thus unable to take advantage of large scale production economies. Secondly, because Israel economic institutions are much too rigid and overextended for the industrial base carrying them.

The belief of those realistic onlookers at the state and needs of Israel's economy is that the sooner these facts will be recognised and dealt with, by the Government and the other responsible economic factors, the easier it will be to find a way out of the present tight economic situation, worsened by the threat of growing unemployment and bankruptcy.

Indonesian Economic Problems in 1966

Professor Dr H. W. Arndt, Canberra, and Professor Dr J. Panglaykim, Djakarta *

The last months showed signs of awakening in Indonesia, awakening to the country's economic condition, and perhaps the beginning of a new era—although as yet action has largely been confined to the political sphere.

Beginning with two Statements in April by Sultan Hamenkobuwono IX, Deputy Premier in charge of Economic Affairs and one of the triumvirs of the new leadership (the other two being Lieutenant-General Suharto and Mr Adam Malik), a picture of economic breakdown has been revealed to the Indonesian people and to the world which can have few parallels in a great nation in modern times except in the immediate aftermath of war or revolution.

It remains true that this breakdown does not greatly impinge on the majority of the people who live in the villages of Java and the Outer Islands. Nor is there as yet evidence of catastrophic or even serious food shortage. Average standards of food consumption, and of living generally, are still, as far as it is possible to judge, substantially higher than, for example, in India. But economic breakdown in every other form is apparent in varying degrees.

The country is in default on a foreign debt officially estimated at $ 2,400 million. Current foreign exchange earnings in 1966 are unlikely to cover much more than one-half of foreign exchange requirements for imports and (unrevised) debt service. Tax collection has been falling ever further behind almost uncontrolled government expenditure. In consequence, inflation, as reflected both in rising money supply and rising prices, is continuing at a rate which is probably still rising. Shortage of imported raw materials and other factors have reduced industrial production to below 20 % of capacity. While rice production is seemingly well maintained, production of estate and other rural products, with few exceptions, continues to decline. Shipping, rail and road transport and all other public services are suffering from years of running-down of equipment and are operating with difficulty and intermittently. The whole elaborate system of government controls of the economy is rendered practically inoperative by evasion and corruption. The relevant laws and regulations are neither respected nor enforced.

All these features of the economic situation have been increasingly in evidence, and obvious to observers on the spot, for the past two years and more. It is only in the last few months that they have been officially acknowledged and squarely faced by the country's leaders.

Failure of "Emergency Measures"

It is now clear that the first series of economic measures taken by the old leadership in the wake of the abortive coup in late November and December 1965 was not as constructive as appeared at the time. While principles proclaimed were sound enough, the actions taken were partly—as in the case of the decision to make all foreign trade a government monopoly—merely further steps on the doctrinaire road followed in the preceding two years and partly emergency measures hastily conceived under extreme political pressures. The latter was true especially of the decisions to grant a large New Year bonus to government employees and of the December "currency reform" which was its direct outcome. It became apparent to the Central Bank that the amount of currency required for the bonus (75,000 rupiahs to each of about 4 million employees or 300,000 million rupiahs), on top of rapidly rising routine expenditure and considerable withdrawals of cash from the banks, was altogether beyond the capacity of the government printing press. Hence the decision to in-

* A detailed version of this report written in June this year in Djakarta and equipped with a great number of tables and sources has been published as "Survey of Recent Developments" in the "Bulletin of Indonesian Economic Studies"; Research School of Pacific Studies, Australian National University, Canberra, No. 4, June 1966. In its July-issue INTERECONOMICS has already published an interview on "Topical Problems of German-Indonesian Trade".