

EXCHANGE RATE STRATEGY IN INDONESIA :
AN ANALYSIS OF 1978 DEVALUATION.

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by
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ABSTRACT.

Even though the oil-boom in Indonesia eliminated the shortage of foreign exchange, it created new problems in expanding employment opportunities in Indonesia. The boom reduced the competitiveness of Indonesia's tradeable goods in international markets.

The 1978 devaluation was aimed at improving the ability of the tradeable goods industries to compete in international markets. The 1978 devaluation, however, seemed to have no impact on Indonesia's exports. The failure of 1978 devaluation can be attributed to the fact that the supply of some main exports is inelastic to price changes. Moreover, the increasing domestic demand for exportables reduced the exportable surplus. In addition, several government measures, i.e. price controls and quotas, undermined the positive effects of devaluation. Finally, world recession contributed to the decline in Indonesia's exports.

Although the 1978 devaluation, as an instrument for stimulating non-oil exports, seems to have been largely a failure, it might have been responsible for the growth in both domestic and foreign investment, which in turn may contribute to the expansion of economic activity in the long run. Certainly, foreign investment grew very rapidly during the post devaluation period and a strong domestic demand for investment after devaluation indicates the beginning of a new investment boom.

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