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Indonesia can ill-afford the adverse impact that association with extremism and terror will have on its image and on the perception of potential buyers and investors. Hence, attention to measures to combat extremism and terrorist groups coupled with strenuous reforms will be essential for strengthening the ability of Indonesian producers to compete in the international markets.

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Indonesia's External Trade and Competitiveness: Assessing the Economic Costs of Terrorism

William E. James*

I. Introduction.

There is little doubt that the events of September 11, 2001 and apprehensions regarding the security situation in Indonesia in the wake of the terrorist attacks and the launching of allied military operations in Afghanistan have had a negative impact on Indonesia's trade and competitive position. The quantitative analysis of the economic costs of terrorism is a complex task that goes well beyond the scope of this paper. The fact that recessions had already begun in both of Indonesia's major export markets before the attacks took place makes it extremely difficult to infer the extent to which each of these events is to blame for the subsequent downturn in exports (and imports). The volatility of exchange rates and world prices of commodities that Indonesia exports further muddy the water. Hence, rather than attempting to quantify or isolate the impact of the particular events that have occurred, an attempt is made to qualitatively assess how the terrorist attacks and related events may have influenced the external trade and competitiveness of Indonesia using the most recent available data.

The deterioration of the external economic situation facing Indonesia in the year 2001 compared with 2000 was apparent even prior to the 9-11 attacks. The United States' decision to strike back at the culprits and to launch a more general global campaign against terrorism put Indonesia in a delicate position. Indonesia was presented with a clear political choice in responding to these events in an already difficult economic environment. The

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choice to actively join or not to join in the fight against terrorism carried weighty economic consequences for Indonesia. The decision to respond positively, if tentatively at first, to the call to combat global terrorism was welcomed by the United States and, generally, by the international community. Economics clearly played an important role in Indonesia's decision, but this is not to suggest that only economics was the driving factor.

The economic consequences of a failure to respond as Indonesia did would have been quite serious. By choosing as it did, the government of Indonesia has subsequently been able to successfully negotiate debt rescheduling under the generous terms of the Paris Club III with positive implications for the fiscal budget. The improving fiscal situation, brought about by reduced subsidies on fuel, electricity, basic telephone services and public transportation, coupled with successful asset sales (Bank Central Asia in particular) has helped to reduce upward pressure on interest rates and reverse downward pressures on the exchange rate. In turn, stock prices have rebounded and, although year-on-year inflation is still running high through April (13.3% year-on-year), the rate of inflation rate has finally eased after accelerating in the first two months of 2002. Whether or not one thinks the inflation target of 9-10 per cent for CY2002 is obtainable, base money growth has decelerated and is well below the indicative target. The macroeconomic economic situation has begun to turn for the better. This improvement would have been almost inconceivable if Indonesia had made the choice not to participate in the global campaign against terror.

Indeed, if Indonesia had chosen to turn its back on the global alliance to combat terrorism, it is very conceivable that the macro situation would have worsened. And it remains conceivable that unless Indonesia takes the path of strengthening its commitment to

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using the IMF period average exchange rate. The views expressed herein are those of the author and not necessarily those of USAID or the Indonesian government.

the global effort to eradicate terrorism, there could be negative near term impacts on exports, investment, tourism, the exchange rate, prices and the budget.[1]

In this paper, section II examines the impact of the world economic downturn, particularly the recessions in the US and Japan, on Indonesian trade in a comparative perspective. Section III addresses the US economy's recovery prospects and the prospects for recovery of world economic activity in 2002 and the implications for Indonesia. Section IV identifies new challenges facing Indonesia and the implications of Indonesia's stance on the fight against terror in withstanding these challenges and Section V concludes with some policy implications for Indonesia.

II. The Global Slowdown, September 11 and Export Performance in 2001.

Major markets for Indonesian products experienced deteriorating growth as the year 2001 progressed. The entry of the US, Japan and European countries such as Germany into a synchronized recession had sharply reduced global demand for Indonesian exports. Japan, the number one market for overall exports and the second largest market for non-oil exports, reported first quarter growth of just 0.2 per cent, revised second quarter growth is –0.7 per cent, with third quarter growth estimated to be –0.5 per cent. In the fourth quarter, GDP fell again so that growth for the year 2001 was –0.5 per cent.[2] Japan's third recession in a decade is the most serious as GDP had never before contracted for three consecutive quarters since Japan revised its method of calculating GDP in 1980.

[1] The question of how events will influence world oil prices is of obvious importance in determining the outcome for Indonesia as a net oil exporter. However, the focus of this paper will be on the non-oil economy, leaving the oil price issue to other analysts at the seminar.

[2] Note that economic growth rates are calculated based on gross domestic product in constant local currency prices whereas trade growth rates are calculated on the basis of exports and imports of goods in current US dollar prices. Hence, one cannot infer income elasticity of demand from these data.

In the United States GDP growth fell to 0.3 per cent in the second quarter (revised upward from 0.2 per cent) from 1.3 per cent in the first quarter, and growth in the third quarter became negative (-1.3 per cent), the weakest performance in ten years.[3]

The impact of the recessions on the non-oil export data from the Central Statistical Agency of Indonesia in the table below is clear:

Table 1

Indonesia: Non-Oil Exports to Japan and USA

(mil. US $)

	Q1	Q2	Q3	Q4	Q1-Q4
Japan	1,917.1	1,736.3	1,617.3	1,352.8	6,623.5
% Change*	13.42	-4.95	-13.51	-32.8	-10.48
USA	1,880.0	1,972.3	1,929.1	1,444.7	7,226.1
% Change*	7.31	-5.45	-14.97	-9.2	-8.10

*Year-on-year growth comparing the period in 2001 with the same period in 2000. These data are all in current prices.

Source: BPS, Buletin Ringkas and Berita Resmi Statistik, various issues.

As income growth has become negative in Japan and the US, and stagnates in the EU, the outlook is bleak across Indonesia's main export destinations. The downturn in the economies of the US and Japan had a severe impact on non-oil/gas exports in 2001 in both key markets. In order to obtain a complete and accurate picture of the downturn's impact, comparison of import data from the two main Indonesian markets with data in Table 1 above is instructive.[4]

[3] The National Bureau for Economic Research (NBER), announced that the US economy entered recession in March 2001, based upon somewhat different criteria than the standard two quarters of zero or negative growth. The NBER assessment is based upon rising unemployment, declining industrial production, personal income and wholesale and retail trade.

[4] For a variety of reasons, import data from partner economies may differ from the export data of the source country. For Indonesia, one of the most important differences arises from the use of Singapore (and to a much lesser extent, Hong Kong) as a transshipment center. Indonesian statistics do not distinguish between exports retained by Singapore and re-exports and Singapore does not publish its trade statistics with Indonesia.

The growth of non-oil/gas imports from Indonesia in the US and Japan sharply deteriorates as the year 2001 progresses mirroring the Indonesian export data although the magnitude of decline is smaller using the import data. Growth rates, calculated for each quarter of 2001 and for the year based on official import data from US and Japanese sources, provide a clear picture of the impact of the recessions (table 2). Weakness in consumer demand in the US and Japanese economies began to take its toll in the second quarter of 2001. U.S. import statistics present a picture that is broadly consistent with the Indonesian export data.[5] Growth in demand for Indonesian products has taken a turn for the worse: 11 per cent growth in the first quarter, -1.0 per cent growth in the second quarter, -7.8 per cent growth in the third quarter and –10.8 per cent growth in the fourth quarter.[6] Import data from Japan (converted into US dollars) reveal a similar picture: 10.4 per cent growth in the first quarter, -0.5 per cent in the second quarter, -3.8 per cent in the third quarter and –21.1 per cent in the fourth quarter. The third and fourth quarter declines in imports from the rest of ASEAN in the US and Japan was sharper than Indonesia. However, imports from China held up much better in the final two quarters in both the US and Japan.

It is important to note that the composition of imports from Indonesia in the US and Japan differ considerably.

[5] As Indonesian export data become available in detail, the author will check their consistency with US import data.
[6] Data compiled by PEG consultant Peter Minor from US sources.

Table 2

Growth Rates of US and Japanese Imports from Indonesia

(2001 vs. 2000, quarterly and annual growth in per cent)

	Q1-Q1	Q2-Q2	Q3-Q3	Q4-Q4	Annual 2001
US	11.0	-1.0	-7.8	-10.8	-2.7
Japan	10.4	-0.5	-3.3	-21.1	-4.4

Growth Rates of US and Japanese Imports from China

(2001 vs. 2000, quarterly and annual growth in per cent)

	Q1-Q1	Q2-Q2	Q3-Q3	Q4-Q4	Annual 2001
US	12.8	2.1	-1.3	0.3	2.7
Japan	15.8	7.5	1.8	-6.8	3.8

Growth Rates of US and Japanese Imports from ASEAN (ex. Indonesia)

(2001 vs. 2000, quarterly and annual growth in per cent)

	Q1-Q1	Q2-Q2	Q3-Q3	Q4-Q4	Annual 2001
US	1.3	-12.1	-24.3	-19.7	-14.6
Japan	7.3	-4.9	-16.5	-26.2	-10.8

Source: *US Department of Commerce Imports of Merchandise Trade CD-ROM; Japan, Ministry of Finance homepage:* http://www.mof.go.jp/english/1c015fle.htm

In Japan, a much higher proportion of imports (nearly 60 per cent) are primary products and processed resource-based industrial goods. In 2000, base metal and ores, wood and wood products and fishery products alone accounted for 50 per cent of Japan's imports

from Indonesia.[7] In contrast, in the United States, primary products and those of resource-based industries comprised less than 20 per cent of imports from Indonesia in 2000.

Manufactured products, chiefly in labor-intensive industries, accounted for the lions' share of imports. Textiles & apparel (24%) and footwear (7%) were among the largest US imports from Indonesia in 2000. The implication of this difference is that Indonesia faces much greater competition from a broader range of producers for its products in the US market than it does in Japan. Any developing country with abundant labor may compete with Indonesia in the US market in labor-intensive manufactured products, however, only a few countries possess similar stocks of diverse natural resource wealth as Indonesia and so there are fewer competitors facing Indonesian products exported to Japan.

The unprecedented events of September 11 in the United States have had a strong negative impact on demand for Indonesian products. Buyers have reportedly been unwilling to travel to Indonesia and have begun to source purchases elsewhere in the region. In part, this is a result of the perception that foreigners, particularly Americans, may be targets of extremists and the issuance of threats against American interests has reinforced this negative image of Indonesia. Indirect evidence of the negative impact of the September 11 attacks is seen in the fact that growth rates of US imports of nine of the ten top labor-intensive product groups from Indonesia were negative in the fourth quarter of 2001. In seven of nine cases, growth became negative, or if already negative, worsened in the fourth quarter compared with the third quarter of the year. These products include apparel items (5 SITC 3-digit product groups), footwear, and toys and sporting goods.[8] The downside of the terrorist attacks of September 11 are likely to be magnified should Indonesia be unable to respond effectively to reverse these negative perceptions in the US.

[7] These figures are derived from official sources. See William E. James, "The Competitiveness of Indonesian Non-Oil Products in Major Markets: Market Shares in the United States and Japan," Partnership for Economic Growth, Jakarta, March 2002.

Germany technically entered a recession, with contractions in the second through the fourth quarter. Growth for the year 2001 as a whole was a paltry 0.5 per cent. In other countries of Europe such as the UK, growth has also begun to slow. Growth in Italy and France became negative in the fourth quarter of the year compared with the previous quarter. Overall, growth in countries in the Euro Zone was estimated to be 1.5 per cent in 2001.[9]

Hong Kong, Taiwan and Singapore recorded negative real economic growth in 2001. Taiwan's recession is the deepest it has ever experienced, with three consecutive quarters of negative year-on-year growth beginning with the second quarter of 2001. Hong Kong had negative growth year-on-year in both the third and fourth quarters of 2001. In Singapore, GDP contracted by 2.2 per cent in 2001. Korea managed to record 2.8 per cent positive GDP growth for 2001, but the outlook for 2002 remains clouded with uncertainty.

Revised global economic growth forecasts reflect the expectation of a prolonged recession. For example, the IMF forecast was revised downward in October 2001 from that of May and indicated that world income will grow by less than 3.0 per cent in 2001 and by only 2.4 per cent in 2002.[10] Slower growth in world income would result in further weakening of demand for Indonesian exports with potentially serious impacts on economic growth in 2002. The forecast for growth of real GDP in developing countries is 4.4 per cent in 2002, led by Asia with a respectable 5.6 per cent growth (led by China and India).

Overall, Indonesian exports (including oil and gas) growth in the year 2001 fell by 9.8 per cent compared with the year 2000 (US$56.04 billion vs. US$62.12 billion).[11] Non-oil/gas exports declined by 9.1 per cent during 2001 compared with 2000 (US$43.41 billion vs. US$47.76 billion). The growth in oil and gas exports was –12.09 per cent 2001. Both

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[8] James, *ibid.*

[9] Data for the 15 member countries of the EU trade with Indonesia have not been compiled as of the time of writing of this paper.

[10] The revised IMF projection of US growth in 2002 is 0.7 per cent, indicating that the recession was expected to continue into the first two quarters of 2002.

[11] Exports are on an FOB basis, while imports are on a CIF basis unless otherwise noted.

agricultural (-9.3 per cent) and manufacturing (-11.1 per cent) exports have declined while mining exports have risen sharply (18.7 per cent) during the year. Indonesia's export performance has held up better than a number of other East and Southeast Asian economies (see the Table 3 below). One reason for this is that Indonesia is less dependent on electronics for exports than many of the neigh boring countries. For example, in Taiwan, electrical machinery and equipment made up 56 per cent of merchandise exports in 2000 and exports in this sector alone declined by almost 20 per cent in 2001. There is also heavy dependence on electrical machinery and equipment in Singapore, Malaysia, the Philippines, and Korea where export growth contracted sharply during the year.

National statistical agency's reports around the region reflect the deepening economic slowdown. For example, a comparison of the January-December period compared with the earlier months of the year finds that in all cases export growth fell in the nine economies reported upon in the table 3 below.[12]

In Hong Kong, growth of domestic exports was -11 per cent over the calendar year of 2001 compared with 2000. Overall export growth was helped by the fact that re-exports (mainly of goods from Mainland China) held up better than domestic exports. Despite the relatively mild contraction of re-exports over the year (-1.5 per cent), the decline became pronounced starting in September at -9.5 per cent.

[12] Two previous reports for growth during the first seven months of 2001 and the first nine months of the year may be requested from the author: "Indonesia's Export Performance and the Global Economic Slowdown: A Comparison with other East and Southeast Asian Economies," September 14, 2001 and "Indonesia's Export Performance and the Global Economic Slowdown: An Update for the Period January-September 2001," November 14, 2001.

Table 3

Comparison of Indonesian Export Performance with Asian Economies

Country/Territory	Export Growth 2001 (year on year, % change)	Period
Hong Kong	-2.6 (-11.0*)	Jan.-Dec. 2001
China, Mainland	6.3	Jan.-Dec. 2001
Indonesia	-9.8	Jan.-Dec. 2001
Korea	-13.0	Jan.-Dec. 2001
Malaysia	-10.0	Jan.-Dec. 2001
Philippines	-15.6	Jan.-Dec. 2001
Singapore	-11.8 (-16.2*)	Jan.-Dec. 2001
Thailand	-6.4	Jan.-Dec. 2001
Taiwan	-17.1	Jan.-Dec. 2001

*Domestic exports (excluding petroleum in the case of Singapore).
Sources: Author's compilations from national statistical agency home pages for Taiwan, Singapore and the Philippines, from national trade ministries for Korea, Malaysia, Thailand and Hong Kong and from the US-China Business Council for Mainland China. For Indonesia data are from the Central Statistical Agency home page, *Berita Resmi Statistik*, January 1, 2002 and Ministry of Industry and Trade.

In the region, China stands out as the only country that has sustained positive export growth in 2001, although indications (such as the decline in re-exports in Hong Kong noted above) are that growth there slowed significantly as the year progressed. For example, China's export growth slowed from almost 15 per cent in the first quarter to 8.8 per cent for January-June and 6.1 per cent for January-September. However, surprisingly, growth for

January-December was 6.3 per cent, indicating fourth quarter performance was relatively good.

In markets in the region, with the exception of the Republic of Korea, there has been a decline in demand for Indonesia's non-oil exports in 2001. Although some Asian countries are moving to fiscal stimulus, including Taiwan, Malaysia, Singapore and Thailand, this may not be enough to lift demand for imports in these markets until the second half of 2002.

Table 4

Comparison of Import Growth in Asian Economies

Country/Territory	Import Growth 2001 (year on year, %)	Period
Hong Kong	-5.4	Jan.-Dec. 2001
China, Mainland	8.6	Jan.-Nov. 2001
Indonesia	-8.1	Jan.-Dec. 2001
Korea	-12.0	Jan.-Dec. 2001
Malaysia	-9.9	Jan.-Dec. 2001
Philippines	-5.9	Jan.-Dec. 2001
Singapore	-14.4*	Jan.-Dec. 2001
Thailand	-0.6	Jan.-Dec. 2001
Taiwan	-23.4	Jan.-Dec. 2001

*Non-oil imports.

Sources: author's compilations from national statistical agencies' home pages.

China's positive export growth performance matched positive import growth during the year (see Table 4 above). However, Indonesian non-oil/gas exports to China recorded –9.4 per cent growth in 2001 (year-on-year).[13]

Imports in the East Asian region have started to follow exports with the downturn (Table 4). Growth of imports started to deteriorate sharply in the second quarter of 2001 and this trend appears to be worsening with the latest reports in the third and fourth quarters showing double-digit negative import growth across much of East Asia. For example, import growth for the month of September 2001 (compared with the same period in 2000) was -34.1 per cent in Taiwan and -12 per cent in Korea. In October, negative growth in imports of -21 per cent in Taiwan and -18 per cent in Korea reflect weakening demand as well. In November 2001, import growth was -19 per cent in Korea and -34 per cent in Taiwan. Finally, in December imports growth (year on year) was -14 per cent in Korea and -18 per cent in Taiwan.

Additional analysis of Indonesia's export performance may shed some light on the vulnerability of non-oil/gas exports to the global slowdown. With the deteriorating external environment, one expects that the decline in export growth may accelerate. Indonesia's export performance clearly deteriorated over the course of the year as income growth has declined in major markets. Second quarter growth of total exports dropped to –5.1 per cent compared with positive 5.1 per cent growth in the first quarter as external demand continued to weaken. For non-oil/gas exports the growth also became negative in the second quarter (-7.4 per cent) after posting positive 3.6 per cent growth in the first quarter. In the third quarter non-oil/gas exports grew (year-on-year) by -12.6 per cent and in the final quarter by -18.9 per cent. Underlying the declining growth performance is weakness in prices of the

[13] BPS reports a fall in non-oil/gas exports to Singapore in the first nine months of 2001 with a drop in value of over 17 per cent. As Singapore does not publish data on trade with Indonesia, it is not possible to sort out the actual amounts that have Singapore as the ultimate destination of goods exported from Indonesia.

products Indonesia exports rather than falling volumes, though there is substantial variance between industries and commodity groups. The diversity of Indonesian exports (including some that are relatively demand inelastic) helped sustain overall performance. Certainly, the lower reliance on electronics as an export in Indonesia relative to neighboring countries has shielded it from a more severe downturn. Consumers in markets for basic commodities may substitute away from expensive brands and items to less expensive ones as their expected real income falls and this may create some opportunities for Indonesian producers to increase their market share.

Indeed a new study of market share of the top 50 Indonesian products in the two major markets of Japan and the United States for the year 2001 indicates this may be the case. In the US, despite contraction in imports in 28 of the 50 product groups, Indonesia increased its share of US imports in 24 cases, had no change in 8 product groups and lost market share in 18. In Japan, there was also a decline in import demand in 28 of the 50 product groups. Indonesia gained market share in 30 product groups, had no change in 4 and lost market share in 16 product groups. Although these data are partially reassuring, there are signs that competitive pressures are mounting on key Indonesian industries, including footwear, apparel, textiles, and wood products. Among the top competitors are China and countries with which the US has entered into free trade agreements, particularly Mexico and Canada.[14]

As was the case with exports, Indonesia's growth in imports is slowing as the year progressed and was much lower in the second quarter compared with the first three months of the year. In part, import growth in the first half of the year reflected the recovery and pent-up demand resulting from the crisis in previous years. One can see the drop off in import growth rates from strong growth in the first two quarters to sharply negative growth

by the third quarter. In the fourth quarter imports have contracted by over 40 per cent compared with the same period in the previous year.

Table 5

Indonesia: Export and Import Performance in 2001:Quarterly Data in Current Prices

	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
	(US$, bil.)				(% Change)			
Total Exports	14.87	14.43	14.37	12.29	5.1	-5.1	-14.2	-23.3
Non-Oil/Gas	11.18	11.15	11.30	9.72	3.6	-7.4	-12.6	-18.9
Oil & Gas	3.75	3.29	3.07	2.58	10.0	3.4	-19.2	-36.0
Total Imports	9.21	8.54	7.00	6.04	40.5	17.8	-25.3	-41.9
Non-Oil/Gas	8.02	7.20	5.29	4.92	51.6	23.9	-29.6	-44.5
Oil & Gas	1.20	1.33	1.71	1.52	-5.7	-3.5	-8.1	-0.7

Growth rates are calculated as year-on-year changes, i.e., Jan-Mar of 2001 compared with Jan-Mar 2000.

Source: Ministry of Industry and Trade and Central Statistical Agency.

III. Prospects for Recovery in the United States: A "Mini" Recession?

Growth in the October-December quarter of 2001, initially estimated to be 0.2 per cent, actually was a surprising 1.4 per cent. There are other signs that the US economy is entering into a recovery phase, including continued high productivity growth (3.5 per cent in the fourth quarter and around 1.7 per cent for the year). Inflation remains muted and the US dollar has strengthened against the Euro and the Yen. Aside from some risk of a "double-dip" recession, however, evidence of a recovery is mounting.

[14] William E. James, "The Competitiveness of Indonesian Non-Oil Products in Major Markets: Market Shares in the United States and Japan," March 11, 2002, Jakarta: Partnership for Economic Growth.

Interest rate cuts and tax reductions in the US helped to stimulate consumer demand and to cushion the pressure of firms and industries as they reduced inventories and cut back production. US consumer confidence, already down because of the stock market correction and rising unemployment, was severely shaken by the September 11 attacks. However, confidence appears to have begun to recover according to surveys of consumers conducted by the University of Michigan. The latest survey for March reports a higher than expected index of confidence and reflects the 5th increase in the past six months. Consumer spending has held up with purchases of autos and housing rising. Another reason for consumer resilience in the US market is that inflation has been falling steadily from an annualised rate of 3.2 per cent in June of 2001 to just 1.1 per cent in January of 2002. This has helped sustain real incomes despite the job losses and adverse wealth effects of the stock market declines.

IV. Outlook for 2002

For the year 2002, a number of countries in the region had projected negative growth of exports and imports during the first two quarters, but expected second half growth to rise sharply. This pattern based, in part, upon the expected pattern of recovery in the United States, may be unduly pessimistic. Most of the negative growth in current dollar amounts has been due to falling commodity prices, export volumes have actually been increasing. The expectation of a continuation of the US recession into the first and second quarter of the year appears to have been mistaken. Federal Reserve officials and others, including Fed Chairman Alan Greenspan have acknowledged that the economy is already entering the recovery phase. Recent data confirm that industrial output rose by 0.2 per cent in January 2002 and by 0.4 per cent in February (compared with the previous month). Industrial output still remained over 4 per cent below last year's level in 2002 in the first two months, but the month-on-month increases indicate recovery is at hand.

The first quarter of 2002 GDP numbers were very good at 5.8 per cent year on year growth. The surge in production was caused in large part by inventory investment as firms began to restock after running down inventory levels during 2001. This recovery may not be as robust as previous recoveries, with growth at about 3 per cent only in the second half of 2002. Typically, recoveries usually achieve around 5 or 6 per cent growth during the first year, but it is unlikely that the first quarter performance will be sustained unless private capital formation accelerates rapidly for the rest of the year.

Prospects for Indonesian exports in the New Year improve with the early recovery in the US, but diminish with the expectation that the recovery will be sluggish after the first quarter. The likelihood that Japan will not soon escape from its economic difficulty, and more intensive competition from producers seeking to aggressively increase exports and penetrate markets also cloud prospects for Indonesia.

There are some possible signs of "bottoming out" as domestic exports of Singapore (-4.1 per cent in January of 2002) declined by less than expected and was less than the -16.7 per cent recorded in December of 2001. Similarly, in Korea the January 2002 contraction in exports (-8.9 per cent) was less than expected and lower than the actual decline of -19.6 per cent in December of 2001. This was also the case for Taiwan where exports (-1.4 per cent) also fell less than expected and less than in the previous month. However, fourth quarter trade figures are not reassuring and indicate a continuation in the downward trend. For example, export growth in Korea was -20 per cent in December of 2001 and import growth was -14 per cent. And while January export data came in better than expected for Korea, exports for the month of February 2002 performed poorly, indicating that it is advisable to await first quarter numbers before reaching any conclusions.[15]

[15] The first two months of the year provide an unsatisfactory basis for making any firm statements about export recovery because of strong seasonal factors, particularly the shortened number of workdays due to New Year holidays in these months.

China's export growth accelerated in January-February 2002, up by 14.1 per cent year-on-year. In the case of the US market, China's exports rose by 18 per cent during this period. Hence, it is likely that China will continue to set the pace in Asia in terms of export performance in the coming year, particularly given the improved market access it is starting to enjoy as a WTO member.

The outlook is further complicated by three factors: 1) the sharp depreciation of the yen against the US dollar; 2) the entry of China into the WTO; and 3) the initiation of discriminatory preferential free trade agreements by many of Indonesia's most important trading partners.

Assessing the impact of each of these three factors is rather complex. For example, the yen's decline results in reduced import demand in Japan but also lowers the cost of imported Japanese components used in Indonesian export industries.

In the case of China's WTO entry, there are also complexities in the sense that China will open its markets for agricultural commodities and manufactures of interest to Indonesia but will also enjoy better terms of market access in key sectors in both the United States and the EU. For example, in textiles and apparel China’s export growth was constrained in volume to 1 per cent quota growth in the US market until January 1, 2002. From now on, however, China will receive full benefits from the quota liberalization in the US and EU under the Uruguay Agreement on Textiles and Textile Products.

In assessing the impact of new free trade agreements one must distinguish trade creation effects from those of trade diversion--an inherently difficult task *ex ante.* The best way to assure the minimization of trade diversion is to push forward multilateral negotiations for overall trade liberalization in the WTO Doha Round.

In addition to the uncertainties in the international economy, Indonesia faces many domestic problems and challenges that may influence its ability to produce and compete in

the international market place. One problem in this regard is that Indonesia is an outlier in terms of domestic price inflation and this will undermine Indonesian products competitiveness, all other things equal, in foreign markets.

Inflation appears to be closely associated with growth in base money and also with depreciation of the currency. Administered prices of items such as fuel, electricity, public transportation, and volatility in food prices add to inflationary pressures. However, studies by Bank Indonesia and by the IMF show that even after stripping away these volatile elements, so-called “core inflation” remained in double digits in 2001 and in the first quarter of 2002.

Table 6

Consumer Price Inflation in East Asian Economies

(% change, Year-on-Year)

Country/Region	2000	2001
Hong Kong	-3.8	-1.6
China	0.4	1.1 (Jan.-Jun. 2001)
Korea	2.3	4.1
Indonesia	9.4	12.6
Malaysia	1.6	1.4
Philippines	4.4	6.0
Thailand	1.6	1.6
Taiwan	1.3	0.0

Source: Compiled by the author using national statistical agencies' publications and home pages.

V. Conclusion.

Trade data for the first quarter of 2002 show a mixed picture in the region. For example, in Hong Kong exports recorded 2.2 per cent growth in March 2002, marking the first increase in 13 months. In Korea, first quarter growth of exports was negative, though March exports declined by far less (-5.7%) than in the first two months (-12.9%) and recorded growth of 9.3% in April. In Thailand and Vietnam, export growth was also negative in the first quarter. However, the negative growth reflects declining world prices of commodities rather than declining volumes of exports.

Indonesian export data from the Central Statistical Agency for the first quarter of 2002 indicate negative growth (year on year) for total exports (-13.9%) and for non-oil exports (-9.6%). However, growth in non-oil exports in the first quarter of 2002 compared with the fourth quarter of 2001 reached 3.4% and for total exports was 1.3%, indicating a turnaround is likely. Data on imports, however, are cause for concern if the numbers are correct.[16] Import data for the first quarter of 2002 indicate year on year growth of –30.7% (total) and for non-oil products of –36.8%. These numbers are hardly consistent with an economy growing at a real rate of over 3%! However, quarter on quarter growth of non-oil imports is 5.2% and for total imports is 5.8% (comparing the first quarter of 2002 with the final quarter of 2001). Import data for capital goods for the first quarter of 2002 compared with the same period in 2001 indicate growth of –37.5%. These figures do not provide much optimistic news about capital formation.

Inflation data (CPI) for April (-0.24% compared with the previous month) and 13.3% year on year for the first four months of 2002 compared with the same period in 2001. Inflation is decelerating, reflecting slower growth in base money since the second half of 2001, and the recent appreciation against the US dollar will also help moderate inflationary pressure. On the other hand, increases in fuel prices will add somewhat to headline inflation measures during the course of the year. The positive effects of reducing fuel subsidies on the budget over the course of the year will have enormous benefits in keeping the deficit within bounds.

Progress in asset disposal, along with the Paris Club III rescheduling, will also reduce budgetary pressures. The combination of a stronger currency, reduced budget deficit and moderating CPI inflation indicate that macroeconomic conditions are improving. Thus,

[16] The existence of rampant smuggling, under-invoicing and false classification of imports may lead to gross understatement of the level of imports. Reconciliation of Indonesian import figures with export figures of

cautious optimism is warranted, provided the government can continue to make progress in legal reform and in institutional reform (such as in cleaning up the Customs and Tax Departments).

On the trade front, Indonesia will face the challenge of coping with the great changes that are taking place in the global trading system. For Indonesia, the most immediate challenge comes from China's entry into the WTO. Particularly, in textiles and textile products (Indonesia's most important export industry in terms of employment, non-oil exports and manufacturing production), the China challenge appears to be huge. Data from the US, where China is no longer constrained to 1 per cent quota growth per annum, indicate huge leaps in China's market share relative to other competitors, including Indonesia. The reasons underlying the shifts in market share in textiles and textile products (apparel) in the US, Japan and Europe should be carefully analysed in order to rectify any shortcomings in present policies.

All in all, Indonesia can ill-afford the adverse impact that association with extremism and terror will have on its image and on the perception of potential buyers and investors. Hence, attention to measures to combat extremism and terrorist groups coupled with strenuous reforms will be essential for strengthening the ability of Indonesian producers to compete in the international markets.

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partners is difficult, as Singapore, the third largest trading partner, does not publish statistics on trade with Indonesia.