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Trade: The Future Engine
of Growth for Indonesia

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TRADE: THE FUTURE ENGINE OF GROWTH FOR INDONESIA

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INTRODUCTION

Indonesia's economic performance over the past twenty-five years has been impressive, with real gross domestic product (GDP) increasing at an annual rate of about 6.5 percent each year. As a result of this robust growth, per capita income has increased ninefold from only US\$75 in the mid-1960s (i.e., at the onset of the New Order) to US\$620 in 1991.

In addition to this growth, the economy has undergone significant structural changes. The agricultural sector's contribution to the country's GDP has declined from more than one-half in the 1960s to 18 percent in recent years. At the same time, the importance of the manufacturing sector has increased with its share of GDP rising from less than 9 percent to more than 20 percent over the same period. Thus, the source of growth in the Indonesian economy has shifted from agriculture to manufacturing.

AN OVERVIEW OF THE ROLE OF TRADE IN INDONESIA

International trade has played a vital role in the growth and development of the Indonesian economy. After the establishment of the New Order in the mid-1960s, Indonesian exports consisted largely of primary commodities and raw materials. With the surge in oil prices in the 1970s and early 1980s, the significance of oil in Indonesia's total exports skyrocketed, accounting for about three-fourths of total exports. At that time, the trade regime was characterized by an inward orientation with development based on an import-substitution strategy,¹ a strategy that was primarily financed by revenues generated from the oil boom. Moreover, because of Indonesia's huge domestic market and abundance of natural re-

sources, the country was able to follow this import-substitution strategy for a long period of time without significant impacts being felt on the economy's growth.

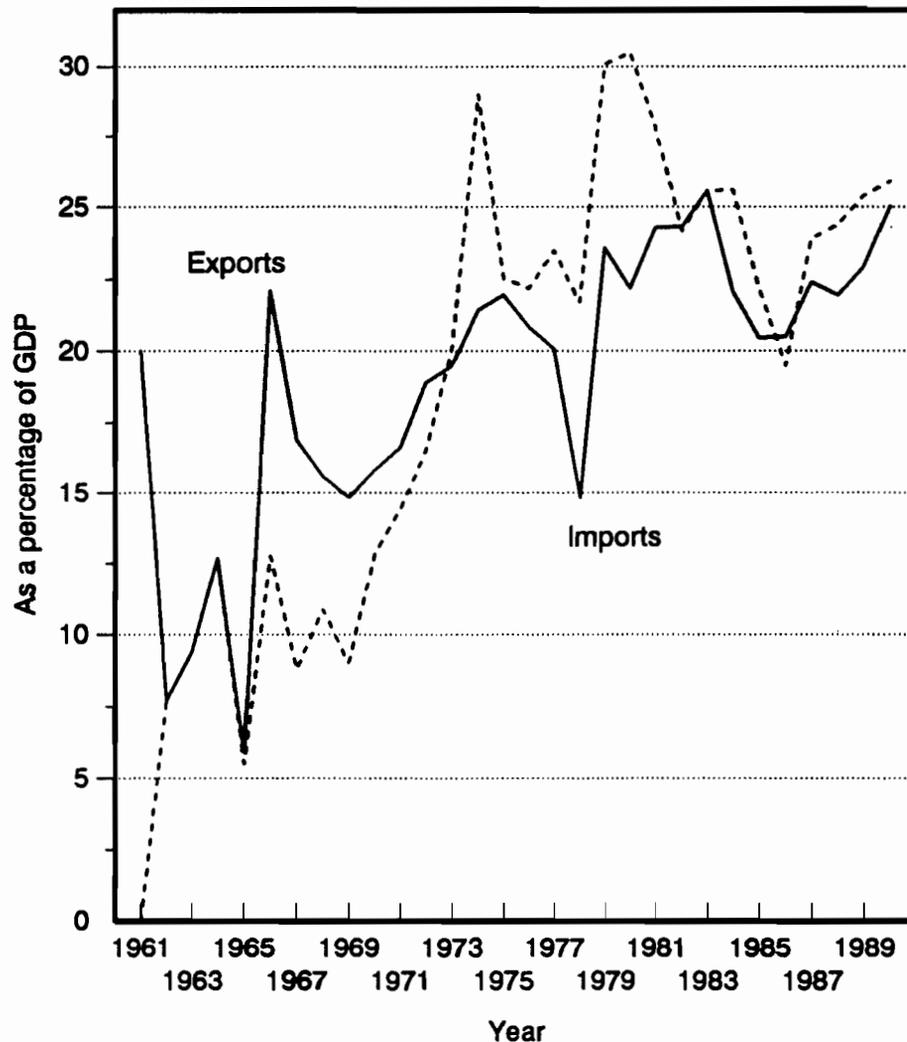
The low ratios of exports and imports of goods and services to GDP reflect this relatively inward-looking development strategy (Figure 1). In the 1960s, these ratios were 7.7 percent for both exports and imports, and even as late as 1970, the ratios were 12.8 and 15.8 percent. However, primarily as a result of the rise in the price of oil in the early 1970s, the value of Indonesia's exports climbed to 22 percent in 1978. By 1980, Indonesia's merchandise exports—the majority of which was made up of petroleum and primary commodities—amounted to more than 30 percent of the country's gross domestic output. Imports also increased over the decade, and in 1980, the import-to-GDP ratio was 22 percent. Today, the export and import ratios are slightly lower, reflecting to some extent the decline in prices of commodities and petroleum. In 1991, the ratios of exports and imports to gross domestic output were 25 percent and 20 percent, respectively.

The Structural Transformation of Indonesian Trade

Perhaps most striking in reviewing Indonesia's trade trends is the general long-term shift in exports from oil and primary commodities to manufactured goods. Exports of manufactured goods were practically non-existent in Indonesia in 1970. However, since that time and most notably in the past decade, the structure of trade has changed dramatically (Figure 2). Although mineral fuels continue to dominate Indonesia's exports as the single most significant item, there has been substantial growth in exports of manufactured products. While total merchandise

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Figure 1
Ratio of Exports and Imports, Indonesia



Sources: International Monetary Fund, International Financial Statistics (various years).

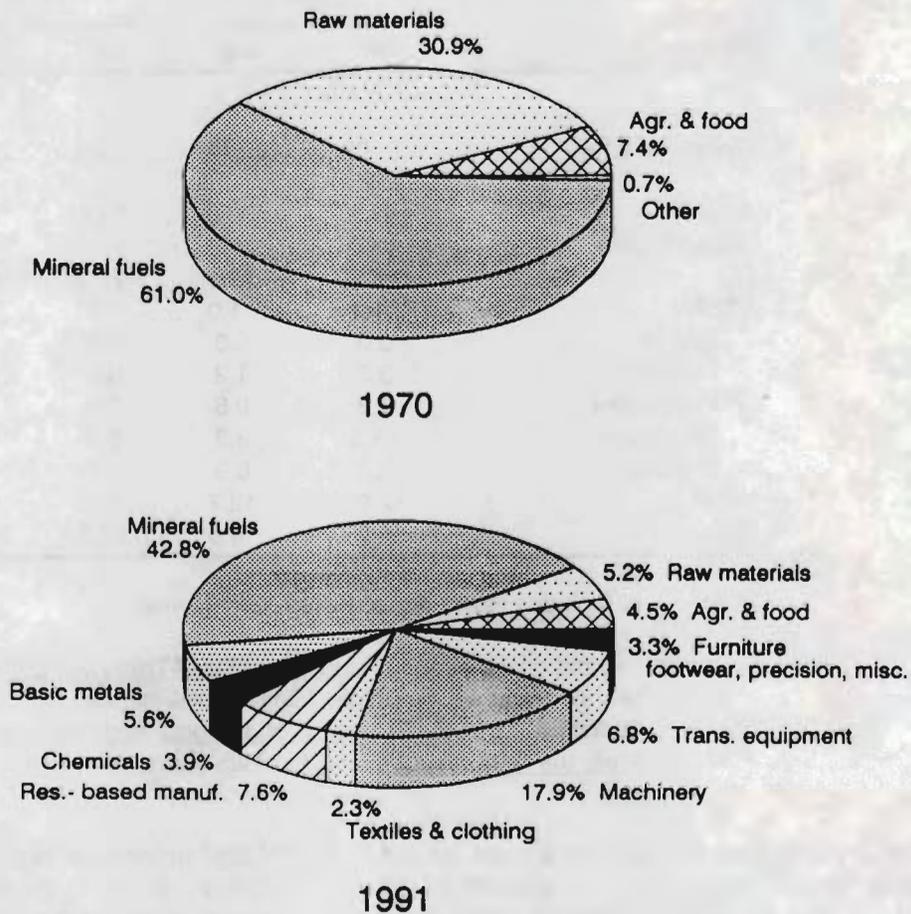
exports over the 1970–1991 period increased at an annual rate of 18.0 percent, growth in the value of manufactured exports over the same period was explosive at 39.5 percent on an annual basis.

Because of this phenomenal growth in manufactured exports, the share of manufactured goods in Indonesia's total value of merchandise exports has risen from less than 2 percent throughout most of the 1970s to 12.9 percent in

1985. Following the reforms in the mid-1980s which emphasized export expansion and diversification, the share of manufactured exports rose even further. In 1990 and 1991, the share of manufactured exports was 34.5 percent and 39.8 percent, respectively.

Among manufactured exports, the most significant are resource-based manufactures which made up more than 14.1 percent of total merchandise exports in 1991. Clothing is the next

Figure 2
Structure of Indonesian Trade



Source: United Nations, Commodity Trade Statistics (various years).

largest industry with an export share of 8.0 percent. This is followed by textiles with a share of 6.2 percent. Exports of footwear have made significant strides in recent years, and in 1991, its share of total exports was 3.4 percent. The share of chemicals, which has been 2-3 percent in recent years, is also significantly higher than before (in 1975 and 1980, the share of chemicals was less than 0.4 percent).

Contrary to the shifting structure of exports, the change in the structure of imports to Indo-

nesia is not as dramatic. In 1970, the bulk of imports to Indonesia were manufactured items, with nonelectrical machinery (16.8 percent), chemicals (12.8 percent), textiles (11.8 percent), and transport equipment (11.6 percent) making up the largest shares. Imports of primary commodities (including agricultural and food products, raw materials, and basic metals) amounted to about 29 percent.

In the 1990s, manufactured products continue to dominate Indonesian imports. Nonelectrical

Table 1 Direction of Indonesian Trade, 1970 and 1991 (percentage)

Trading Partner	Exports		Imports	
	1970	1991	1970	1991
World (US\$ m)	1,108	29,142	1,002	25,869
Japan	40.8	37.0	29.4	24.5
United States	13.0	12.0	17.8	13.1
EC	14.9	12.8	21.6	18.2
ASEAN	21.1	11.0	7.6	9.5
Brunei	0.0	0.0	0.0	0.0
Malaysia	3.3	1.2	0.6	1.6
Philippines	2.3	0.6	0.2	0.3
Singapore	15.5	8.3	5.7	6.6
Thailand	0.0	0.9	1.1	1.1
NIEs ^a	2.0	12.7	5.8	11.6
Other	8.2	14.5	17.8	23.1

Note: a. Includes Hong Kong, Korea, and Taiwan.

Sources: International Monetary Fund, Direction of Trade Statistics (various years); Republic of China, Ministry of Finance, Department of Statistics, Monthly Statistics of Exports and Imports, Taiwan Area, the Republic of China (various years).

machinery remains by far the largest import product group, making up 27.3 percent of the country's total merchandise imports. Imports of chemicals, which had a share of 13.6 percent in 1991, also remain significant. The next three largest import shares belong to transport equipment (9.2 percent), electrical machinery (8.2 percent), and resource-based manufactures (5.5 percent). Imports of agricultural and food products, raw materials, and basic metals in 1991 amounted to a little more than 29 percent.

Direction of Trade

Indonesia's major trading partners have been and continue to be Japan, the United States, the countries of the European Community (EC), and its ASEAN neighbors, particularly Singapore (Table 1). Together, these countries accounted for almost 90 and 70 percent of Indonesia's exports and imports in 1970. In the following two decades, Indonesian trade with these countries increased in absolute terms although their share

of total Indonesian exports and imports declined slightly. In 1991, the proportion of Indonesian exports destined for these countries was 73.2 percent while the share of Indonesian imports from these countries was 65.3 percent. Nevertheless, these ratios are relatively high, suggesting that these countries remain important trading partners for Indonesia.

Japan has been and still is the single most important trading partner of Indonesia. In 1991, Japan received more than US\$10.7 billion of Indonesia's exports (or 37.1 percent of Indonesia's total exports). The bulk of exports to Japan are mineral fuels (67.3 percent), although other primary commodities—agricultural and food products, 7.0 percent; raw materials, 7.3 percent—are also important export items (see Appendix Table 1). Resource-based manufactures were the most important manufactured exports making up about 10.2 percent of Indonesia's total exports to Japan.

Indonesian imports from Japan are also significant, amounting to US\$6.3 billion in 1991 or 24.5 percent of total Indonesian imports. Most significant are Japanese imports of nonelectrical machinery and transport equipment which make up more than 40 percent and 18 percent, respectively, of all of Indonesia's imports from Japan. Other significant import products from Japan include basic metals (11.1 percent), chemicals (9.9 percent), and electrical machinery (7.2 percent).

The United States is Indonesia's second most important trading partner. Like Japan, the single most important export item from Indonesia to the United States is mineral fuels (22.1 percent) and the shares of agricultural and food products and raw materials are also significant at 11.9 percent and 14.1 percent, respectively. However, the structure of manufactured exports from Indonesia to the United States is more diverse. Indonesian exports of clothing make up 16.9 percent of total Indonesian exports to the United States. Other significant shares are found for resource-based manufactured goods (11.8 percent) and furniture, footwear, precision instruments, and other miscellaneous manufactures (16.4 percent). A small but rapidly growing export group to the United States is textiles for which the share has increased from less than 0.10 percent in the 1970s and early 1980s to more than 2 percent in recent years.

The United States is also an important source country for Indonesian imports. In 1991, the total value of imports from the United States was US\$3.4 billion, representing 13.1 percent of Indonesian imports from the world. Similar to imports from Japan, Indonesian imports from the United States are concentrated in manufactured goods with the largest value of imports in the nonelectrical machinery sector (28.5 percent). This is followed by chemicals (15.1 percent), transport equipment (14.2 percent), and electrical machinery (9.3 percent). The share of raw materials imports from the United States was also significant at 12.5 percent.

The European Community is another important destination for Indonesian exports and source of Indonesian imports. As a group, its share of total Indonesian exports (12.8 percent or US\$3.7 billion) and imports (18.2 percent or US\$4.7 billion) exceeded that of the United States. However, the structure of Indonesian exports to the EC is markedly different from its exports to

Japan and the United States with agricultural and food products making up 23.2 percent of Indonesia's total exports to these European countries. Other significant export shares are exhibited in clothing (22.3 percent), resource-based manufactures (13.4 percent), and textiles (12.3 percent).

Indonesian imports from the European Community, on the other hand, exhibit a similar pattern to its imports from Japan and the United States with manufactured items making up the lion's share. Notable among Indonesian imports from the EC are nonelectrical machinery (36.8 percent), chemicals (15.7 percent), electrical machinery (15.2 percent), and transport equipment (11.7 percent).

Indonesia's ASEAN neighbors as a group rank as the fourth most important trading partner. Exports to and imports from the other five ASEAN countries amounted to US\$3.1 billion and US\$2.5 billion in 1991, or 10.5 percent and 9.5 percent of Indonesia's total exports and imports, respectively, with the world. By far, primary commodities—including agricultural and food products (16.7 percent), raw materials (12.0 percent), and mineral fuels (8.6 percent)—are the most significant Indonesian exports to ASEAN. However, several manufactured products exhibited high shares as well; they include textiles (20.2 percent), chemicals (9.6 percent), and resource-based manufactures (8.8 percent).

Indonesia's single largest import item from its ASEAN neighbors is mineral fuels (40.8 percent), reflecting the fact that Singapore is the center of petroleum refining in the region. Chemicals (16.4 percent), nonelectrical machinery (12.6 percent), and agricultural and food products (8.3 percent) are other important imports from the ASEAN countries to Indonesia (see Box 1: Indonesia's Trade with its ASEAN Neighbors).

INDONESIA'S TRADE POLICY REGIME

Although Indonesia has a commercial code that dates back to 1847, the country has no basic trade law in its books. Proposals that impact on trade policy are formulated within the Ministry of Trade and submitted to the Coordinating Minister (EKUIN) who discusses the proposals with relevant government institutions. The outcome of these discussions are implemented as decrees from the Ministry of Trade. Other than the Minis-

Box 1: Indonesia's Trade with its ASEAN Neighbors

Singapore is by far the most important trading partner among the ASEAN countries for Indonesia with exports and imports of US\$2.3 and US\$1.70 billion in 1991. Of nonmanufactured goods, raw materials, which comprised more than 80 percent of total Indonesian exports to Singapore in 1970, accounted for 13.7 percent of total exports in 1991; mineral fuels accounted for 13.9 percent. The single most important manufactured export to Singapore is textiles, accounting for 23.5 percent. Other significant exports are resource-based manufactures (8.5 percent), chemicals (8.3 percent), and clothing (8.1 percent).

In terms of Indonesian imports from Singapore, mineral fuels account for the largest share at 46.1 percent. Manufactured goods also comprise a large share of imports from Singapore with the most important products being chemicals (15.4 percent), nonelectrical machinery (13.1 percent), and electrical machinery (8.5 percent).

Malaysia and Thailand are Indonesia's next most important ASEAN trading partners. For both of these countries, agricultural and food items are the most important products accounting for a little more than 30 percent of Indonesia's total exports to these countries. Mineral fuels account for 10–18 percent. Of manufactured exports, resource-based manufactures, textiles, chemicals, and basic metals were the most significant. The majority of imports from Malaysia were mineral fuels (54.2 percent). In terms of manufactures, nonelectrical machinery and chemicals were also important Indonesian imports from both of these countries.

Indonesia's trade with the Philippines is not as large, and the structure differs somewhat from the other large ASEAN countries. Chemicals are the most significant export item, accounting for 31 percent of total Indonesian exports to this country. At the same time, the same product group makes up an enormous 78 percent of total Indonesian imports from the Philippines.

try of Trade, Indonesia has no permanent advisory body to advise the President of Indonesia on trade matters. However, since 1985, a Deregulation Team—which consists of representatives from the Ministry of State for Administration Reform, the Ministry of Trade, the Ministry of Industry, and ECUIN—has played a major role in the formulation of the recent reform packages. In addition, a Tariff Team and a Technical Team assess requests for tariff amendments from industries.

Historical Overview of Indonesian Trade Policy and Recent Reforms

Until the mid-1980s, the country's tariff structure and regulations on exports and imports were heavily biased to protect industries producing for the domestic market. This strategy was necessary in order to support the Indonesian govern-

ment's development strategy at that time which was based on import-substitution industrialization (see Box 2: Changes in Policy Direction and Economic Conditions). Studies have shown that in the 1970s, the nominal and effective rates of protection for manufacturing were generally higher for Indonesia than for any other ASEAN country.²

In the early and mid-1980s, however, the Indonesian economy was forced to cope with a series of external shocks. A decline in the prices of Indonesia's major exports—including oil, gas, and primary commodities—led to a deterioration in the country's terms of trade. Exacerbating this problem was the worldwide recession which had a negative impact on developed countries' demand for imports, including Indonesian goods.

The combination resulted in a stagnation in the growth of Indonesia's economy, and in 1982, real

Box 2: Changes in Policy Direction and Economic Conditions

	1967-1972 Rehabilitation and Stabilization	1973-1981 Oil Boom	1982-1985 Initial Oil Price Decline	1986-Present Rapid Oil Price Decline
GDP	High growth 10%	Moderately- high growth	Slow growth 3-5%	Slow growth 3-5%
Industrial Policy	Initial phase import substitution (final goods)	Continued import substitution intermediate and capital goods	Continued IS industrial deepening: localization and beginning of export orientation	Export-oriented growth with strong promotion of non-oil exports
Trade Policy	Beginning of protection	Increased protection (mainly through high tariffs)	Increased protection through NTBs	Decline in protection with strong export promotion

Source: Pangestu, Mari. 1991. *Managing Economic Policy Reforms in Indonesia*. In *Authority and Academic Scribblers*, Sylvia Ostry, ed. San Francisco: International Center for Economic Growth.

GDP growth registered a dismal 2.2 percent. Still another blow to the Indonesian economy was the depreciation of the U.S. dollar. Because much of Indonesian debt was denominated in yen, the appreciation of the yen meant a swelling of Indonesia's debt service repayments. At the same time, the inflation rate had begun to reach double-digit levels, peaking at 11.7 percent in 1984.

It soon became apparent to the Indonesian government that policy adjustments were sorely needed to cope with the stresses on the economy. In 1983, a series of market-oriented deregulation packages designed to improve economic efficiency and stimulate economic growth were introduced. Included in this program was a devaluation of the rupiah from Rp 703 to Rp 907 to the U.S. dollar or 27.5 percent. In addition,

credit markets were deregulated through the abolishment of credit ceilings for all banks and a deregulation of interest rates.

In early 1984, reforms in the Indonesian tax structure and in the administration of taxes were implemented in an attempt to increase nonoil tax revenues.³ Later in that year, a value added tax (VAT) on goods and services and a sales tax on luxury goods were introduced. The 10 percent VAT covered most products and a number of services as well.

However, oil prices continued to slide and it became clear that further reforms were required. In April 1985, a new import tariff schedule was introduced. Ad valorem tariff ceilings were reduced from 225 percent to 60 percent, and the number of tariff categories was reduced from 25 to 11. In addition, with Presidential instruction

(INPRES) No. 4, the country's customs, shipping, and port operations were reorganized to reduce handling and transport costs for exports and to simplify the administrative procedures governing interisland and foreign trade.

However, it is the reform package of May 1986 that is most notable in that the reforms instituted by the package effectively revoked the import-substitution policies the country had followed in the past. Instead, export industries were promoted through such measures as the exemption from duty on imported inputs by enterprises exporting at least 85 percent of their output. Another part of this shift in development strategy was the promotion of export diversification (i.e., growth of nonoil exports) and growth of manufactured exports, in particular. Among the principal measures taken to facilitate growth of nonoil exports were (1) the lifting of foreign exchange controls and requirements for foreign exchange earnings to be sold to the Bank of Indonesia; and (2) the broadening of export credit guarantees and insurance facilities that were offered at relatively low interest rates through banks and rediscount facilities. It was thus clear that the Indonesian government had shifted towards an export-oriented growth strategy. Nevertheless, while the import bias of the protective Indonesian system had been reduced, it was not done uniformly across sectors and goods.

In the fall of 1986, the rupiah was once again devalued by 31 percent against the U.S. dollar, dropping from Rp 1,134 to Rp 1,644. In addition, import procedures for certain items such as electrical and electronic products, chemicals, metal products, equipment machinery, and vehicle spare parts were simplified, and import licensing requirements on 329 items were made less restrictive. Nominal tariffs on inputs that were not domestically produced were also reduced.

The reform of the trade regime continued in early 1987 with the easing of procedures to import raw materials, and the simplification of administrative procedures affecting such industries as textiles, steel, motor vehicles, and specific machinery. A major deregulation of the import licensing system affecting 616 items was also announced. Devaluations of the rupiah occurred periodically in the first few months of the year.

Later in that year, additional measures to reduce the anti-export bias were announced. For example, export procedures were simplified with

Minister of Trade Decree No. 331/KP/XII/87 (enacted in December 1987) which revoked the requirement for an Exporter Identification Number (APE) and a Limited Exporter Identification Number (APET), making only a trading license necessary for most enterprises to export goods. In addition, the minimum export requirement to qualify for duty-free imports (as specified in the May 1986 reforms) was reduced from 85 percent to 65 percent (except for garment producers). Other fiscal incentives, such as exemptions on value added taxes, were also made available to exporting companies. Nontariff barriers were eliminated on 111 items including some food and beverages, electrical products, chemicals, and heavy equipment, but the bulk of the barriers lifted impacted steel and aluminum products. Tariffs were reduced on 65 goods, but at the same time were increased on 91 items.

In November 1988, another major liberalization import policy was introduced. The Minister of Trade Decree No. 375/Kp/XI/1988 substituted nontariff barriers with tariffs on 301 items and lowered tariffs on 17 items.⁴ In addition, import duties and surcharges on 86 items essential to the production of domestic manufactures were reduced to improve international competitiveness of domestic manufacturers. However, at the same time, import duties and surcharges for other items (72 items in total) were increased.⁵

In January 1989, a new system of trade classification was introduced whereby specific tariff rates were converted to ad valorem rates. At the same time, however, the application of import surcharges increased to compensate domestic producers for the easing of certain import licensing restrictions (which implied a reduction in the level of protection). In fact, studies have indicated that as a result of the conversion to the new classification system, the unweighted average tariff rate (inclusive of import surcharges) actually increased from 24 to 27 percent.⁶

The May 1990 reform package, which as noted earlier signalled the switch from an import-substitution strategy to an export-oriented approach, is notable in terms of its scope and extent. A general reduction in nominal tariffs on 2,363 items was announced and tariffs on 125 items were eliminated. While the number of goods subject to tariffs or import surcharges was increased, a large part of the increase reflected the switching from nontariff barriers to tariffs.⁷

Import bans on radio telephones and television receivers were abolished, and regulations on imports of pharmaceuticals, vegetables, fruit, fish, candies, dredging vessels, and steel were eased.

In mid-1991, the deregulation of the trade regime continued with the Indonesian government announcing a general reduction of import tariffs including the abolition of outright bans on imports of cold-rolled steel coils. The export quota system for palm oil and copra was also abolished, and there was a further reduction in the extent of nontariff barriers. However, the government also introduced an import quota system on built-up commercial vehicles.

More recently, in July 1992, a reduction of tariffs on 44 items was announced. Import surcharges on 81 items were lowered, and surcharges on 184 other items such as steel pipes, nail wire, and products in 27 food and beverage categories, 19 tire categories, and 51 metal goods categories were abolished. Also included in the July 1992 package was a reduction in the scope of nontariff barriers, particularly in products such as batik cloth, agricultural products, mineral water, metal goods, and electricity transformers. It has been estimated that with these latest steps in reducing NTBs, NTBs currently impact only 8 percent of total imports (as opposed to 43 percent in 1986), and the relative proportion of domestic production protected by NTBs has declined from 41 percent to 22 percent over the same period.⁸ Further, to improve the competitiveness of the Indonesian manufacturing sector, import restrictions on certain intermediate inputs that are used in the production of manufactured goods were made more flexible.

THE CURRENT TRADE SCENARIO

The recent liberalization of the trade regime appears to have met with a modicum of success in terms of improving the export competitiveness of Indonesian goods and the efficiency and growth of the Indonesian economy. Average most-favored-nation (MFN) tariffs have been lowered and Indonesia has made significant strides in diversifying exports away from oil and agricultural commodities and towards manufactured goods in the past few years.

However, despite the progress made by the Indonesian government to reform its trade frame-

work, Indonesia is far from being an open economy. Although the average MFN tariff rate of 22 percent in 1990 does not at first glance appear to be very high, the Indonesian economy is characterized by a number of impediments to trade which serve to effectively shield the domestic market from foreign competition. A variety of measures are imposed directly on imports, and exports as well, of goods and services.

For imports, the most apparent instrument is the Indonesian tariff structure. However, there are numerous other mechanisms at work which impede the free flow of goods into the country. These include import surcharges which act like tariffs, and nontariff barriers such as taxes, tax and duty exemptions, counterpurchasing agreements, and local content schemes. Exports of Indonesian goods also face obstacles in certain sectors. Export duties and bans, as well as minimum standard requirements, act to restrict the ability of exporters to sell their goods abroad. Still other measures, such as input subsidies, indirectly affect Indonesian trade. Clearly, the complexity of the Indonesian trade regime will not be recognized by a mere inspection of the country's tariff structure. To this end, the more detailed discussion of the various impediments to trade which follows can be helpful.

Tariffs and Import Surcharges

With the exception of the preferential treatment given to its ASEAN neighbors for products that qualify under the ASEAN Preferential Trading Arrangement, tariffs are applied to all imports on an MFN basis; that is, the imposition of a tariff does not depend on the source of the imports. Moreover, all tariffs are presently ad valorem rates, which thereby increases the transparency of the Indonesian tariff regime. Alternate tariffs, seasonal tariffs, or variable levies on imported goods which are measures that have been used by other countries have not been employed in this country.

Since the mid-1980s, the average tariff rate has declined steadily with each successive reform package (Table 2). From 37 percent prior to 1985, the average tariff rate fell to 27 percent in 1985 and 24 percent in 1988. In January 1989, when Indonesia switched from the CCCN Nomenclature of classifying imports and exports to the Harmonized Commodity Description and Coding System (HS)⁹, the average tariff jumped back to

Table 2 Changes in the Tariff Schedule Since 1985

	Pre-1985	1985	1988	1989	1990	1991	July 1992
Average tariff rate (%)							
Unweighted	37	27	24	27	22	20	22
Weighted							
by import value	22	13	15	12	11	10	9
by domestic product	29	19	18	19	17	15	13
Index of dispersion ^a	62	108	90	93	89	83	83

Note: a. Index of dispersion is defined as the coefficient of variation (i.e., standard deviation over the mean) of the unweighted average tariff plus the surcharge.

Source: Confidential report by the World Bank, May 25, 1993.

Table 3 Nominal Rates of Protection (NRP) in the Manufacturing Sector Before and After the May 1990 Reform

Sectors	NRP Before	NRP After
Food, beverages, and tobacco	20.0	19.4
Textiles, clothing, and footwear	22.8	13.3
Wood products	-8.1	-8.8
Paper products	13.4	13.1
Chemicals	12.5	12.1
Oil and gas	0.0	0.0
Nonmetallic products	22.0	17.6
Basic metals	6.8	6.8
Engineering	38.7	36.7
Other manufacturing	29.3	27.1
Nonoil manufacturing	17.9	16.0

Source: Ministry of Industry.

27 percent. The dispersion of tariffs, which was already high to begin with, also increased with the conversion to the HS scheme. However, with the May 1990 reform package, the average tariff rate fell once again to 22 percent and within manufacturing, the decline in nominal tariffs was most marked in the textiles, clothing, and footwear sectors, as well as nonmetallic products (Table 3). Following the June 1991 and July 1992 reforms the average tariff rate declined further to 20 percent while the dispersion of tariffs also fell.

Presently, only about 9 percent of Indonesia's tariff lines are bound under the General Agreement on Trade and Tariffs (GATT). While this may suggest that Indonesia's trade regime is relatively protected, the bound rates exceed the current duties levied¹⁰ by a significant margin for almost all products.¹¹ That is, the actual protection afforded by tariffs is, in fact, much lower than the rates the Indonesian government has committed itself to under the GATT.

However, in addition to tariffs, the Indonesian government also imposes import surcharges on goods imported into the country. These surcharges are ad valorem rates of duty that affect the price of imports in the same way as do tariffs in that the surcharges raise the price of imports and allow domestic producers of import-substitutes some protection from import competition. Import surcharges were originally intended by the Indonesian government to be a less permanent means of raising tariffs to compensate domestic producers for reductions in protection resulting from the relaxation and/or removal of import licensing controls,¹² or to temporarily protect domestic infant industries from fluctuations in world prices. Although the surcharges were to be in place for no longer than one year (with extensions allowed for special cases deemed to have a valid reason), the Indonesian government did not always strictly enforce this time limit. Last year, however, as part of the July 1992 reform package, import surcharges were abolished on a large number of items. As a result, only about 3 percent of all tariff items are now subject to these surcharges.

While the ASEAN PTA scheme reduces tariffs imposed on Indonesia's imports from its ASEAN neighbors, the P4BM program waives the payment of tariffs and surcharges on raw materials, intermediate inputs, and machinery used in the production of exports.¹³ In 1990, more than

one-third of total nonoil imports were covered by the P4BM scheme. The manufacturing industries that have made use of this scheme include footwear, rubber and plastic products, electronics and electrical machinery, processed foods, chemicals, fabricated metal products, wood products, and iron and steel products. Some industries in the agricultural sector—particularly the fishing industry and rubber plantations—have also taken advantage of this scheme.

Nontariff Barriers (NTBs) to Imports:

The Hidden Obstacles

In addition to tariffs and import surcharges, other measures serve to protect domestic industries from foreign competition. A clear example of such a nontariff barrier is the Indonesian import licensing scheme which has acted to regulate imports into the country for much of Indonesia's history. (The various types of licenses that are employed in this scheme are described in Box 3: Indonesia's Trade Licensing System.) In certain cases, the import licensing scheme resulted in a virtual monopoly market for a product, while in other cases, the scheme effectively led to an implicit quota for imports of a good, where the level of the quota was determined informally between the government and the license holder.

However, the reform packages in the past seven years have reduced the restrictiveness of the import licensing system (Table 4). From 43 percent in mid-1986, the value of imports subject to import licensing steadily declined to only 15 percent following the May 1990 reform package in which a number of goods were reclassified from the more restrictive categories to the general importer category (IU or IU+). Today, only 13 percent of total imports are subject to licensing, and a majority of all tariff items can be imported by a licensed general importer (i.e., someone with a IU or IU+ license) without restriction. All other items that are catalogued in the Restricted Goods List can only be imported by holders of the license under which the commodity is classified. In certain sectors such as cement and fertilizers, impediments to increased imports remain despite the relaxation of licensing regulations.

In addition to the informal quotas that arose from the licensing scheme, quantitative restrictions on imports have been employed by Indonesia in a number of sectors. Most apparent is the quota on batik imports, the object of which is to

Box 3 : Indonesia's Trade Licensing System

The different licenses issued by the Indonesian government include the general importer license (IU or IU +), importer-trader (IT) license, the producer-importer (PI) license, the importer-producer (IP) license, and the sole agent (AT) license.

General importer licenses are issued to firms wishing to import items that do not require specific licenses or are not listed in the Restricted Goods List.

IT licenses are held by six state-owned trading companies—PT Kerta Niaga, PT Pantja Niaga, PT Mega Eltra, PT Tjipa Niaga, PT Dharma Niaga, and PT Sarinah. These licenses effectively provide these companies with monopoly power in the import of a number of finished products, including apparel and accessories, and alcoholic and nonalcoholic beverages.

Producer-importers, i.e., PI license holders, are allowed to import goods which compete with their own output. Examples of organizations holding PI licenses include (1) BULOG, the government organization in charge of the domestic production and marketing of basic foodstuffs; (2) Krakatau Steel, the state-owned enterprise producing steel products; (3) Dahana, a state-owned company which produces explosives; and (4) Pertamina, the state-owned enterprise which produces petroleum and gas products.

Importer-producer (IP) licenses are issued to firms wishing to import items that are used in their production processes but which are not available domestically. IP licenses are concentrated in the iron and steel and electrical machinery industries.

Sole agents who hold AT licenses are national distributors appointed by the government of Indonesia. Typically, enterprises in this category are national companies that are appointed as overseas principals to import, promote, distribute, and carry out after-sales service of certain goods throughout Indonesia. Thus, owners of AT licenses are in effect monopolists of their products in the Indonesian market.

preserve and protect the Indonesian batik industries. In addition, Indonesia explicitly prohibits imports of certain products such as transport equipment, certain printed matter, rice, specific pesticides and salts, and pharmaceuticals. The rationale for the import bans are to protect the domestic assembly or processing industries (this is the basic reasoning behind the bans on transport equipment), to protect national security and culture (the rationale for rice), and to protect the community's health (the ban on pesticides).

In addition to the tariffs, import surcharges, and informal and formal quotas and bans, local content schemes which require that a certain amount of components in the production of a good be sourced from domestic suppliers act as nontariff barriers to trade. In Indonesia, compo-

nents that are not on a Master List,¹⁴ i.e., deleted components, must be sourced locally. This program has been applied in the production of motor vehicles, electrical equipment and home appliances, agricultural machinery, and machine tools.

In line with its recent move towards trade liberalization, however, the Indonesian government has eased some of the local content requirements. For example, assemblers are now able to import certain previously restricted components. In addition, the methods by which domestic assemblers can fulfill local content requirements have been made more flexible by allowing the assembler to choose which local components to substitute in production provided the overall local content requirement is met. Still

Table 4 Impact of Reform Packages on Import Licensing Coverage Since 1986

	Mid-1986	End-1987	End-1988	Early 1990	May 1990	June 1991	July 1992
% of CCCN items	32	22	16	na	na	na	na
% of HS items	na	na	na	17	14	10	5
% of import value	43	25	21	17	15	13	13
% of total production value	41	38	29	28	25	22	22
Main items							
% of domestic production coverage of NTBs:							
Manufacturing	68	58	45	38	33	32	31
Agriculture	54	53	41	40	38	30	30
Mining and minerals ^a	0.2	0.2	0.2	0.24	0.24	0.2	0.2

Notes: na = not available.
a. Includes oil and gas.

Source: Confidential report by the World Bank, May 25, 1993.

another indication of the Indonesian government's seriousness in addressing this issue is that no new local content schemes have been instituted in the past six years.

A related regulation affecting imports is the existence of mixing requirements, particularly in the dairy industry. According to this scheme, milk processing firms must purchase one unit of locally produced milk for every two units of imported milk.¹⁵ This mixing requirement, which has been strictly enforced by the Ministry of Trade, implies relatively high protection of the domestic dairy industry.

Still another impediment to the free flow of trade is the set of regulations concerning government procurement and purchases. Indonesian legislation on government procurement requires that goods and services from domestic entities be used whenever possible. For contracts of Rp 20 million or less, domestic suppliers recorded on a List of Capable Suppliers are awarded the contracts. Contracts in excess of Rp 20 million but less than 500 million must go out for bid, but in most cases, only domestic suppliers are invited to participate in the bidding process. Only for contracts in excess of Rp 500 million are foreign suppliers eligible, and only on the condition that the supplier agree to purchase certain amounts of Indonesia's nonoil and nongas exports, i.e., a

counterpurchase. The value of the counterpurchase must be equal to the value of the contract, less the value of Indonesian labor and services input, and duties and taxes paid. In addition, the counterpurchase must be over and above the level of Indonesian exports that would have been purchased by the foreign firm had the contract not been awarded. Indonesian exports benefiting from this scheme have customarily been in traditional products such as rubber, coffee, tea, cocoa, palm oil, aluminum, coal, pepper, shrimp, palm oil, and textiles. More recently, counterpurchase arrangements have been used to promote Indonesian exports of aircraft components.¹⁶

Still other instruments that act as nontariff barriers to trade are special excise taxes and technical and safety standards. Although an excise tax is levied on certain products—in particular, sugar, specific artificial sweeteners, and cigarettes—only for cigarettes do the excise duties discriminate against imported goods. In addition, an extensive system of technical and safety and health standards impact on imports of fertilizers, pesticides, and insecticides; most agricultural products; livestock; cosmetics and toiletries; and pharmaceuticals. There are a few cases in which Indonesian regulations result in administrative delays and special registration.¹⁷

Table 5 Production Coverage of NTBs Before and After the May 1990 Reform

Description	Production (Rp Min)	Production Weight	Coverage of NTBs		Contribution to Average Coverage	
			Before	After	Before	After
Food crops	15,823,832	0.15	64.65	64.65	9.75	9.75
Estate and other crops	6,210,371	0.06	25.72	25.72	1.52	1.52
Livestock	5,318,252	0.05	7.31	7.31	0.37	0.37
Forestry	2,111,200	0.02	0	0	0.00	0.00
Fishing	2,526,958	0.02	23.03	0	0.55	0.00
Mining and quarrying	17,394,195	0.17	0.04	0.04	0.01	0.01
Food, beverages, and tobacco	18,012,942	0.17	62.94	61.58	10.80	10.57
Textiles, clothing and footwear	4,382,364	0.04	8.02	6.52	0.33	0.27
Wood products	3,657,082	0.03	0.04	0.04	.00	.00
Paper products	1,041,986	0.01	37.55	37.11	0.37	0.37
Chemicals	3,307,054	0.03	5.52	2.59	0.17	0.08
Oil and gas	12,581,002	0.12	0.52	0.52	0.06	0.06
Nonmetallic products	4,006,827	0.04	19.48	1.78	0.74	0.07
Basic metals	2,393,572	0.02	17.21	5.74	0.39	0.13
Engineering	5,904,602	0.06	49.19	36.33	2.77	2.04
Other manufacturing	302,199	.00	2.97	2.97	0.01	0.01
Total	104,974,438	1.00	27.85	25.24	27.85	25.24
Agriculture	31,990,613	0.30	40	38.18	12.19	11.64
Mining, quarrying, and oil	17,394,195	0.29	0.24	0.24	0.07	0.07
Manufacturing	55,589,630	0.41	38.06	33.05	15.60	13.55
Total	104,974,438	1.00	27.85	25.24	27.85	25.24

Source: Confidential report by the World Bank, May 25, 1993.

However, in most cases, the standards of Indonesia are less stringent than international standards and hence do not pose too great an impediment.

In summary, the reforms have reduced the extent and coverage of NTBs in Indonesian trade. Following the May 1990 reform package, for example, the average coverage of NTBs declined from 28 percent to 25 percent overall, and from 38 percent to 33 percent for manufacturing (Table 5). Although more recent estimates of the impacts of the June 1991 and July 1992 reforms on the effects of NTBs are not yet available, it is noteworthy that there has been an extensive reduction in the use of import licenses and

quotas to manage Indonesian imports. Most notable are the reduced coverage of NTBs in livestock and fishing.¹⁸

Measures Affecting Exports

Not only is the Indonesian trading system characterized by barriers to imports of goods, but measures also exist that affect Indonesian exports. These measures include export finance, export bans, licensing arrangements, quotas, and taxes. In most cases, the use of export restrictions reflects the government's attempts to increase exports of nonoil goods, conserve scarce resources, encourage greater domestic value-

added especially for natural resource-based products, and preserve the environment.

Unlike most developing countries, Indonesia does not offer export subsidies. Instead, export credits are now provided by commercial banks at interest rates determined by the banks themselves.¹⁹ However, exporters received some benefits through the Export Credit Insurance Guarantee Scheme which is funded by the government, and which protects exporters against nonpayment from overseas importers.

In addition, special bonded zones in Indonesia have been established with the goal of promoting exports. Firms that export at least 85 percent of their output may locate their operations in these zones; the benefits to a firm locating in one of these areas include duty-free imports of goods that are re-exported after processing and warehousing.

While there are incentives for exporters, at the same time, exports of a number of specific products—most notably, forest products such as logs and rattan, animal and marine products, and low value-added manufactured goods—are explicitly prohibited by the Indonesian government. In addition, for a substantial number of Indonesian goods, a license is required in order to export the good from the country. Goods that are subject to such licensing restrictions include (1) goods which are subject to international import or production quotas and (2) goods which can only be exported once domestic requirements have been met. Goods in the first category include such products as textiles (which is covered by the Multifiber Agreement), petroleum oil (which is governed by Indonesia's commitment to OPEC of which it is a member), and tapioca and tin (which is governed by Indonesia's participation in international commodity agreements). Goods in the second category include such items as rice and wheat flour, as well as fertilizers.

As in the case of imports, quotas on exports are not clearly specified in a formal framework and information on the extent and sectors to which export quotas are applied is not readily available. In most cases, quotas are informally applied as part of the export licensing system.

Some products are subject to export taxes which are generally ad valorem rates ranging from 5 to 30 percent (the exception is certain wood products which have specific export tax rates). The tax is assessed on the f.o.b. price of the

export. Products subject to these taxes are generally agricultural goods such as pepper, palm nuts, chinchona bark, natural cork, and animal hides and skins.

To improve the reputation of Indonesian products, the government has a set of minimum standards for a number of exportables. However, there are no cases where the Indonesian standards are more stringent than the standards applied internationally. Hence, the quality standards for exports are not deemed to be a measure restricting exports.

Other Measures Affecting Production and Trade

Still other measures that impact on trade and production of goods are subsidies provided by the government for inputs of certain products. In Indonesia, input subsidies are most notable in the agricultural sector. For example, there are subsidies on fertilizers and crop seeds, loans can be obtained at concessional rates by rural producers, and farmers are provided irrigation facilities at less than the true cost of operating the facilities.

The subsidy on fertilizers—which reflects the government's goal of achieving food self-sufficiency, particularly in rice—differs depending upon the type of fertilizer. Because different crops utilize different fertilizers, the benefits of the fertilizer subsidies differ across crops.²⁰ Since 1988, however, the level of fertilizer subsidies has been reduced.²¹

The subsidy on crop seeds is similar to the subsidy for fertilizers with farmers and seed suppliers sharing the benefits of the subsidy. Again there is no information regarding how the benefits of the subsidy are shared.

Still another benefit accruing to farmers is the benefit arising from access to irrigation facilities at below cost.²² The value of the benefits across different farmers is unclear for a number of reasons. First, different crops have different water requirements; hence farmers cultivating crops that require large amounts of water would benefit more than farmers cultivating less water-intensive produce. Second, the operation and maintenance of many irrigation systems rest with provincial governments. Some of these provincial governments charge service fees for using the water, while others do not. Moreover, the fees are

Table 6 Changes in the Coverage of Import Restrictions with the Recent Reforms

Type of Restrictions	Number of Items		Import coverage of NTBs (%)		Average tariff on NTBs	
	Before	After	Before	After	Before	After
IT license	1,038	732	6.3	3.8	44	34
Health	40	115	0.6	0.7	10	36
BULOG	31	31	2.4	2.5	9	9
Ban	26	52	0.0	0.7	156	126
IP license	40	79	1.6	1.2	9	11
PI license	251	130	3.0	2.5	27	17
AT license	197	149	3.5	3.6	55	52
Total	1,623	1,288	17.4	15.0	—	—

Note: — = not applicable.

Source: Confidential report by the World Bank, May 15, 1993.

generally low and do not come near to recovering the full costs.

Input subsidies for natural gas also imply benefits to users of natural gas, most notably, the fertilizer and steel industries. The price of the natural gas, and hence the amount of the subsidy, is determined on a project-by-project basis.

Because domestic prices of petroleum and fuel products are usually set below world prices, all users of these products in effect receive a subsidy on their use. As a result, the competitiveness of industries that intensively use petroleum and fuel products as inputs is improved. The largest subsidies are on kerosene and diesel fuels.

In addition to the input subsidies, fertilizer manufacturers also receive a price for their output that is well above the world price. The margin between the price paid to the fertilizer manufacturer—which is determined by the government—and the world price varies between manufacturers. For example, it has been estimated that producers of urea received between 15.0 and 40.0 above world prices, while producers of triple superphosphate and ammonium sulphate received up to two times the world price.²³

Other controls on domestic production, marketing, and pricing affect agricultural products such as sugar, soybeans, and rice. For example, farmers of these commodities are in some cases given direct production targets. In general, domestic prices of these agricultural commodities are higher than the world market prices.

The Combined Effects of Tariffs and Nontariff Barriers

With the reforms in Indonesian trade policy in recent years, the ease with which imports can be brought into the country and the export competitiveness of Indonesian goods have improved. Indonesia's average MFN tariff rate is low relative to that of other developing countries and the coverage of the licensing scheme has decreased (Table 6). At the same time, the impacts of certain nontariff barriers have increased in terms of number of items and import value. This is particularly true in the case of health regulations and outright bans on specific products.

Numerous studies have attempted to quantify the "true" or "effective" protection that is received by the various sectors in the Indonesian economy, taking into account not only the existing tariff structure but also the framework within which trade takes place. In estimating the effec-

tive protection, the impacts of tariffs on the inputs of a product, as well as the tariff on the product itself, are incorporated in the analysis.²⁴ In addition, the quantitative impacts of NTBs are also assessed in the calculations. Studies of the Indonesian trade environment in 1987, 1989, and 1990 indicate that the effective levels of protection have declined as a whole for the Indonesian economy (Appendix Table 2), and have typically been lower than that of other developing countries. However, while the general level of protection has decreased since the mid-1980s, the bias against export-competing sectors and the agricultural sector continues with effective levels of protection for these sectors being low or negative. At the same time, despite the reduction in nominal tariffs, certain sectors continue to be very highly protected due to strict licensing controls or quota arrangements. Most notable is the continued high protection of the motorcycles and motor vehicles sectors, and the dairy and wheat sectors.

TRADE-RELATED INVESTMENT IN INDONESIA

As part of its shift away from an import-substitution approach to an export-oriented industrial strategy—and in particular, exports of nonoil and manufactured goods—the Indonesian government has made a concerted effort to promote private investment, both domestic and foreign investment, especially in export-oriented manufacturing.

The data on private investment indicate that the government's initiatives in this regard have succeeded. While domestic investment approvals have declined since 1990 when it peaked at Rp 59.9 trillion, the Rp 29.3 trillion posted in 1992 is still significantly higher than the investment approvals recorded in prior years.²⁵ Foreign investment approvals, on the other hand, have shown continued strong growth in the past five years. From about Rp 4.5 trillion in 1988 and 1989, foreign investment approvals increased to 8.7 trillion in 1990 and 1991, and in 1992, foreign investment approvals rose once again to Rp 10.3 trillion.

Moreover, the orientation of these investments, especially investments by foreigners, is clearly towards export activities. In 1992, 340 of 436 approved projects by domestic investors were in export-oriented activities; the export value of these projects was US\$5.8 billion or 20 percent of

the value of all approved domestic investments. For foreign investors, the export-orientation is even more pronounced with 137 projects out of a total of 294 approved projects in export-oriented activities. The export value of these foreign investments was US\$4.5 billion, which is 44 percent of the total value of foreign investments in Indonesia in that year.

In cumulative terms, i.e., from 1968 through December 1992, the trends are similar. During this period, more than one-half of both domestic and foreign approved projects were in export-oriented activities, and the export value of these projects amounted to 32–37 percent of the total value of investment projects approved by the government.

It is also interesting to note that Indonesia's most important trading partners are also the most significant investors in the country. Japan, the United States, the EC, and the ASEAN countries together made up 42 percent of total foreign investment approvals, including joint investments, in 1992. Over the period 1968–1992, the share of these countries combined was a high 63 percent.

Foreign investment data of the United States as an investing country in Indonesia also point to the high export orientation of U.S. affiliates. In 1989, almost one-half of total sales of U.S. affiliates in Indonesia were sold as exports, and for U.S. affiliates in the electronics and trade sectors, exports made up 100 percent of total sales.²⁶ Comparable data for Japanese affiliates are not as detailed, but suggest that Japanese affiliates in Asia are also involved to a substantial degree in export activities. In 1990, almost one-half of total sales of Japanese affiliates in Asia were sold as exports.²⁷

The data above suggest that although foreign investments are less significant than domestic investments in terms of the number and value of total projects, foreign investments are more likely to be involved in export-oriented activities than are domestic operations. With respect to the stock of investments, the share of foreign investments in export activities is higher both in terms of the number of projects and the export value of the projects. Thus, the importance of foreign firms to the export drive of the Indonesian economy cannot be ignored, and, in fact, foreign investments should continue to be encouraged as part of the government's promotion of export

growth, particularly expansion of manufactured exports.

To this end, it is important for Indonesia to move forward in its reform efforts to liberalize trade and investment. Studies and surveys of foreign firms indicate that it is not the availability of generous investment incentives that is of primary concern in the decision to invest in a foreign country or not. Rather it is the overall openness and stability of the investment and macroeconomic environment that is important in making this decision. The ease with which machinery, equipment, and components can be imported are also of paramount importance. Therefore, while the Indonesian government has made significant strides on both the trade and investment front in terms of liberalizing the economy, it is imperative that this process continue.

FUTURE TRENDS IN INDONESIAN TRADE POLICY: ARE FURTHER REFORMS WARRANTED?

The trend of trade liberalization in Indonesia has come a long way, and much progress has been made in improving the trade environment of the country. Both nominal and effective rates of protection have declined over the past six years, the incidence of nontariff barriers has been reduced, and the administration of the tax and licensing systems have been streamlined.

Yet more can be done to promote development and growth of exports in this country. Licensing arrangements continue to inhibit trade and production in a number of sectors, particularly in agricultural products and raw materials. The involvement of BULOG in the production, marketing, and distribution of basic foods such as rice, sugar, and wheat is a case in point. In addition, formal and informal quotas also plague a number of sectors including the wood industries. In still other industries, such as the dairy and electronics industries, local content schemes limit the flexibility of domestic producers in sourcing their inputs, thus rendering their products less able to compete in world markets.

That these nontariff elements of the Indonesian trade framework impact on the competitiveness of Indonesian exports and hence, on the success of the country's more outward-oriented, export-based development strategy, is not going unnoticed. The keen interest of government officials in the effective levels of protection suggest that they are well aware of the impacts of nontariff barriers, such as licensing arrangements and export/import restraints, on the cost of imports and their related impacts on the competitiveness of Indonesian products in world markets. Moreover, investment policies that impact on trade activities are also coming under the scrutiny of Indonesian officials who recognize the linkages that develop between investment and trade.

NOTES

1. This strategy fulfilled two goals—one economic and the other political. On the one hand, the focus on import substitution implied an easing on the country's balance of payments as imports were replaced with domestically produced goods. At the same time, the protection of domestic manufacturers helped to strengthen the political position of the newly installed Suharto regime.
2. James, William E., Seiji Naya, and Gerald Meier. 1987. Asian Development: Economic Success and Policy Lessons. San Francisco: University of Wisconsin Press.
3. The reforms included a simplification of the tax structure, as well as the administration of all tax sources.
4. The 318 items affected were in five product categories: (1) chemicals, pharmaceuticals, and cosmetic products; (2) metal products; (3) textile products; (4) food and beverage items; and (5) raw and processed agricultural products.
5. United Nations. 1989. Traders' Manual for Asia and the Pacific: Indonesia. New York: UN.
6. When weighted by domestic production, the average tariff increased from 18 to 19 percent. In addition, the dispersion of tariff rates widened. General Agreement on Tariffs and Trade (GATT). 1991. Trade Policy Review: Indonesia 1991. Geneva: GATT Secretariat.
7. Goods for which nontariff barriers were replaced with surcharges of 10–20 percent include such items as meat and fish preparations, cocoa and cocoa preparations, plastics especially polyvinyl chloride, rubber tires, iron and steel tools, and watch straps, bands and bracelets.
8. Note, however, that these estimates may be biased as they were reported by a government-sponsored organization.
9. While the HS system is an international coding system that is harmonized at the six-digit level across all countries, individual countries typically employ a more disaggregated coding system. In the case of Indonesia, the trade and tariff data are coded at the nine-digit level. The conversion to the nine-digit HS system resulted in an increase in the number of tariff lines from just over 5,000 to more than 9,100.
10. The duties referred to are inclusive of import surcharges. This additional tax on imports is discussed in subsequent pages of this study.
11. For example, it has been reported that about 60 percent of all tariff lines subject to binding under GATT are bound at a rate that is six times or more than the rate that is currently applied. GATT, Trade Policy Review: Indonesia 1991.
12. Import surcharges were, in fact, introduced or increased on many goods with the May 1990 reform package in which import licensing regulations on numerous products were eased. One could argue then that import surcharges have, in effect, facilitated the tariffication process in Indonesia.
13. The P4BM scheme, which was initiated in May 1986 and subsequently extended in December 1987 and 1988, was designed to encourage investment in particular industries—most notably the export-oriented industries. According to the scheme, imports of materials and machinery by producers who export at least 65 percent of their output are not subject to import licensing and quota

arrangements. Other producers are subject to import duties, but can claim a refund on the duties paid for imports used in the manufacture of exports.

14. Master lists are prepared by the Ministry of Industry on a case-by-case basis for each product. These lists are reviewed twice a year.
15. Because the price of local milk is higher than that of imported milk, the mixing requirement implies an even higher level of protection to domestic milk producers in terms of value.
16. For example, in exchange for the purchase by Garuda (the state-owned airline) of nine Airbus A-330s from Airbus Industries, Airbus has agreed to purchase aircraft parts worth US\$100 million over the next 20 years. Fokker, a Dutch aircraft company, has also agreed to purchase components in exchange for Garuda's purchase of twelve jets. A similar agreement worth US\$57 million was negotiated with General Dynamics, a U.S. firm.
17. For example, prescription pharmaceuticals can only be imported if they incorporate high technology that has been developed from the importer company's own research efforts. Otherwise, import of the product can only be licensed to a domestic firm.
18. Confidential Report by the World Bank, May 25, 1993.
19. While the interest rates charged for export credits reflect market level rates of interest, to some extent the obligation of the banks to provide a minimum share of loans for the purpose of export finance implies some benefit to exporters. This is especially the case for exporters who could not otherwise obtain access to export credits.
20. It has been estimated that the largest benefits accrue to farmers growing tobacco and other estate crops. The benefits of the subsidy are shared between the farmer and the fertilizer importer (PT Pusri) or domestic fertilizer producer, although it is unclear as to how the benefits are distributed.
21. Subsidies on pesticides were eliminated in January 1989. And more recently in Fall 1993, the government announced an increase in the price of fertilizers.
22. In fact, a report by the World Bank notes that "water..is the most subsidized of all agricultural inputs in Indonesia" (p. 93). World Bank. 1989. Forest Land and Water: Issues in Sustainable Development, Report No. 7822-IND. Washington, D.C., World Bank.
23. Fane, George, and Chris Phillips. 1987. Effective Protection in Indonesia. Report submitted to the Ministry of Industry, Government of Indonesia, Jakarta.
24. The basic formula used to estimate the effective protection rate of the particular sector is:

$$ERP_j = \frac{T_j - \sum a_{ij} T_i}{1 - \sum a_{ij}}$$
 Where ERP_j = effective rate of protection of jth sector
 T_j = tariff on jth good
 T_i = tariff on the ith inputs
 a_{ij} = input coefficient of jth good
25. In 1988 and 1989, for example, domestic investment approvals amounted to Rp 14.3 and Rp 19.6 trillion, respectively.

26. United States, Department of Commerce. 1991. U.S. Direct Investment Abroad, Revised 1988 Estimates. Washington, D.C.: Department of Commerce.
27. Japan, Ministry of International Trade and Industry. Various years. Foreign Activities of National Firms, Nos. 3-12. Tokyo: MITI.

Appendix Table 1 Structure of Indonesian Trade, 1991 (percentage)

	Exports				
	World	Japan	United States	EC	ASEAN
Agriculture and food products	11.3	7.0	11.9	23.2	16.7
Raw materials	8.1	7.3	14.1	6.5	12.0
Mineral fuels	38.5	67.3	22.1	1.6	8.6
Basic metals	2.3	2.4	0.0	1.2	8.7
Chemicals	2.9	0.4	0.7	1.1	9.6
Resource-based manufactures	14.11	10.2	11.8	13.4	8.8
Textiles	6.2	0.9	2.5	12.3	20.2
Clothing	8.0	1.5	16.9	22.3	6.5
Nonelectrical machinery	0.3	0.1	0.2	0.2	1.6
Electrical machinery	1.4	0.3	3.2	1.5	3.2
Transport equipment	0.6	0.1	0.3	0.8	0.7
Furniture, footwear, precision instruments, misc.	6.4	2.5	16.4	15.9	3.4
Total (US\$ thousands)	28,997	10,763	3,509	3,743	3,052

	Imports				
	World	Japan	United States	EC	ASEAN
Agriculture and food products	5.5	0.3	3.1	1.8	8.3
Raw materials	7.0	1.6	12.5	3.2	3.7
Mineral fuels	9.0	0.8	3.5	0.4	40.8
Basic fuels	7.6	11.1	3.4	4.1	3.2
Chemicals	13.6	9.9	15.1	15.7	16.4
Resource-based manufactures	5.5	4.1	3.7	6.1	3.5
Textiles	3.4	2.0	2.3	0.7	0.9
Clothing	0.1	0.0	0.0	0.0	0.1
Nonelectrical machinery	27.3	40.2	28.5	36.8	12.6
Electrical machinery	8.2	7.2	9.3	15.2	6.7
Transport equipment	9.2	18.3	14.2	11.7	1.5
Furniture, footwear, precision instruments, misc.	3.6	4.5	4.4	4.4	2.3
Total (US\$ thousands)	25,869	6,327	3,397	4,061	1,835

Source: United Nations, Community Trade Statistics database.

Appendix Table 2 Nominal and Effective Rates of Protection (percentage)

I-O Code	Industry/sector	1987 ^a			1989 ^b		1990 ^b	
		NRP	ERP	RERP	NRP	ERP	NRP	ERP
1	Paddy	10	24.1	9.1	10	24.1	10	24.1
2	Maize	10	24.5	9.5	10	24.5	10	24.6
3	Other cereals	5	8.8	-4.3	5	8.8	5	8.8
4	Hand-pounded rice	10	10.7	-2.7	10	10.7	10	10.8
5	Cassava	0	0.9	-11.3	0	0.9	0	0.9
6	Other tubers	30	35.1	18.7	30	35.1	30	35.1
7	Dried cassava	0	-1.1	-13.1	0	-1.1	0	-1.0
8	Peanuts	46	63.2	43.4	30	42.8	30	42.8
9	Soybeans	60	100.6	76.3	60	100.6	60	100.7
10	Other beans	30	53.1	34.6	28	49.8	28	49.9
11	Vegetables	21	28.4	12.9	21	28.4	21	28.4
12	Fruit	28	30.9	15.1	25	27.6	25	27.7
13	Rubber	0	4.7	-8.0	0	4.7	0	49.9
14	Sugar cane	33	89.5	66.6	10	44.5	10	44.6
15	Brown sugar	33	68.2	47.9	33	105.1	33	105.3
16	Coconuts	0	3.2	-9.3	0	3.2	0	3.3
17	Coconut Oil	0	-2.1	-13.9	0	-2.0	0	-1.9
18	Palm oil	0	8.9	-4.3	0	8.9	0	9.1
19	Other fiber crops	14	18.8	4.4	4	6.9	4	6.9
20	Tobacco	14	36.0	19.5	14	35.9	14	36.2
21	Coffee	0	2.0	-10.3	0	2.0	0	2.1
22	Tea	0	2.1	-10.2	0	2.1	0	2.2
23	Cloves	5	8.2	-4.9	5	8.3	5	8.3
24	Pepper	-1	-0.1	-12.2	-5	-4.4	-5	-4.4
25	Nutmeg	-19	-19.1	-28.9	-13	-12.2	-13	-12.2
26	Other estate crops	0	4.7	-8	-4	-0.4	-4	-0.3
27	Other crops	12	15.2	1.3	5	7.4	5	7.4
28	Livestock	15	15.9	1.9	15	16.7	15	16.7
29	Slaughtering	24	69.6	49	28	114.9	27	108.2
30	Milk livestock	100	600.0	600.0	100	600.0	31	600.0
31	Poultry	22	28.6	13.1	17	20.6	17	20.7
32	Other livestock products	24	27.0	11.7	17	18.5	17	18.5
33	Wood and bamboo	-18	-21.2	-30.8	-38	-42	-38	-42.0
34	Other forest products	0	-1.8	-13.7	-36	-40.4	-36	-40.4
36	Marine fish, etc.	24	29.8	14.1	18	22.3	13	15.9
37	Freshwater fish, etc.	29	33.8	17.7	29	34.3	29	34.3
38	Dried smoked fish	21	25.3	10.2	23	30.9	22	30.8
39	Coal	3	1.1	-11.1	3	1.0	3	1.4
40	Crude oil and gas	0	-0.8	-12.8	0	-0.8	0	-0.7
41	Iron sands	-10	21.6	-31.1	-10	-21.7	-10	-21.3
42	Tin ore	-10	-18.3	-28.2	-10	-18.1	-10	-17.7
43	Nickel	-10	-18.6	-28.4	0	-4.1	0	-3.8
44	Bauxite	1	-1.4	-13.3	1	-1.4	1	-1.2
45	Copper	0	-4.0	-15.6	-10	-17.1	-10	-16.8
46	Gold and silver	-2	-7.2	-18.4	-2	-7.2	-2	-6.7
47	Other metal ores	0	-3.9	-15.5	0	-3.9	0	-3.6

Appendix Table 2 (continued)

I-O Code	Industry/sector	1987 ^a			1989 ^b		1990 ^b	
		NRP	ERP	RERP	NRP	ERP	NRP	ERP
48	Chemical and fertilizer ores	0	-1.0	-13.0	0	-1.0	0	-0.9
49	Salt	0	-3.8	-15.5	0	-2.6	0	-2.2
50	Asphalt	5	4.4	-8.2	5	4.4	5	4.5
51	Quarrying	10	10.7	-2.7	10	10.7	10	10.8
52	Processed meat	41	600.0	600.0	52	600.0	41	600.0
53	Milk products	43	600.0	600.0	21	16.9	21	18.0
54	Processed veg. and fruits	0	21.2	-30.8	12	8.2	11	6.6
55	Processed fish, etc.	32	600.0	600.0	28	573.7	20	374.4
56	Refined veg. and animal oil	0	-3.7	-15.3	0	-3.6	0	-3.5
57	Milled polish rice	10	13.1	-0.6	10	13.1	10	13.3
58	Other meat cereals	4	-19.3	29.0	4	-19.6	4	-19.5
59	Wheat flours	0	600.0	600.0	0	600.0	0	600.0
60	Other flours	17	89.7	66.8	40	600.0	40	600.0
61	Bread and bakery products	40	107.6	82.5	50	372.9	44	307.2
62	Noodles, etc.	36	51.7	33.3	50	245.3	47	216.4
63	Sugar	67	600.0	600.0	37	248.8	37	248.2
64	Chocolate and confectionery	32	139.9	110.9	43	600.0	35	523.2
65	Syrup	15	8.7	-4.4	30	89.3	30	93.3
66	Ground coffee	29	176.3	142.9	29	176.9	29	177.4
67	Processed tea	0	-3.2	-14.9	0	-2.6	0	-2.4
68	Processed soybeans	12	-37.6	-45.1	35	8.7	35	9.0
69	Other foods	21	58.9	39.6	29	105.5	21	58.8
70	Animal feeds	12	47.8	29.9	12	29.9	12	31.1
71	Alcoholic beverages	61	115.4	89.3	51	88.7	38	63.3
72	Nonalcoholic beverages	30	85.7	63.2	50	600.0	45	600.0
73	Cigarettes	60	600.0	600.0	60	600.0	60	600.0
74	Other processed tobacco	11	29.7	14.0	9	12.9	9	13.4
75	Spinning	24	120.0	93.4	16	57.8	11	34.0
76	Weaving	45	195.1	159.5	41	217.3	22	100.7
77	Textile goods, not apparel	46	94.4	70.9	42	84.9	27	57.3
78	Knitting	27	24.9	9.8	17	3.5	12	-5.3
79	Wearing apparel	34	39.1	22.3	24	16.5	17	19.1
80	Carpets and rope, etc.	20	44.0	26.6	20	50.6	20	55.3
81	Other textiles	9	-8.6	-19.7	14	6.8	11	10.2
82	Leather	-15	3.8	-8.8	-48	-71.0	-48	-70.8
83	Footwear, etc.	53	582.8	500.2	66	600.0	51	600.0
84	Sawn processed wood	-12	-13.4	-23.9	-30	-44.9	30	-44.7
85	Plywood	0	21.5	6.8	0	25.2	0	25.8
86	Wooden building materials	28	177.3	143.7	25	506.2	21	458.9
87	Wooden furniture	49	383.4	324.9	46	600	37	600
88	Other wood products	11	63.9	44.1	11	180.5	11	181.1
89	Woven goods, not plastic	26	116.8	90.6	10	64.9	10	65.3
90	Paper and paperboard	48	598.1	513.6	20	73.3	19	69.5
91	Paperboard and paper products	30	44.8	27.2	24	69.9	24	73.2
92	Printing and publishing	5	-16.5	-26.6	25	-6.6	5	-5.8

Appendix Table 2 (continued)

I-O Code	Industry/sector	1987 ^a			1989 ^b		1990 ^b	
		NRP	ERP	RERP	NRP	ERP	NRP	ERP
93	Basic chemicals	8	8.2	-4.9	7	6.4	6	5.2
94	Fertilizers and pesticides	24	77.1	55.7	3	19.1	3	19.2
95	Plastics, resin, fiber, etc.	15	55.4	36.6	6	14.9	6	15.3
96	Paints, lacquer, etc.	22	83.1	61.0	33	282.0	33	289.3
97	Medicine	24	55.9	37.0	24	59.9	24	63.7
98	Cleaning mat. and cosmetics	25	113.5	87.7	38	431.2	38	443.5
99	Other chemical products	16	30.2	14.5	17	43.3	14	34.6
101	Oil refining	0	-2.2	-14.0	0	-2.1	0	-1.9
102	Liquid natural gas	0	0.5	-12.6	0	-0.5	0	-0.5
103	Coal products	1	-12.5	-23.1	5	2.9	5	3.7
104	Soaked remilled rubber	0	-3.3	-15	0	-2.9	0	-2.7
105	Tires	39	600.0	600.0	58	600.0	51	600
106	Other rubber products	34	124.8	97.6	42	203.4	30	141.8
107	Plasticware	28	103.0	78.5	36	516.5	33	467.6
108	Ceramics and earthenware	65	600.0	600.0	55	444.8	37	288.7
109	Glass and glassware	41	138.9	110.0	44	165.4	33	120.4
110	Structural clay products	40	90.5	67.5	31	63.2	24	47.9
111	Cement and lime	29	169.6	137.0	27	155.0	18	94.3
112	Other nonmetallic products	26	47.5	29.7	30	62.7	24	51.4
113	Basic iron and steel	13	21.5	6.8	13	21.2	13	21.6
114	Nonferrous basic metal	3	5.5	-7.3	2	0	2	0.3
115	Kitchenware	34	198.7	162.6	33	191.1	33	192.2
116	Agriculture, tools, and cutlery	37	89.3	66.4	48	153.2	45	143.6
117	Metal furniture, etc.	42	142.4	113.1	37	111.0	33	98.1
118	Structural metal products	26	106.0	81.1	28	124.3	28	123.5
119	Other metal products	16	34.5	18.2	20	55.5	24	74.9
120	Nonelectric machinery	33	166.4	134.2	31	138.4	28	120.4
121	Electrical machinery	38	151.8	121.3	48	366.5	47	366.5
122	Communications electronics	29	92.4	69.1	38	163.9	31	114.3
123	Household electrical equip.	55	600.0	600.0	44	362.7	40	325.1
124	Other electrical equipment	33	72.4	51.5	32	69.5	30	65.5
125	Batteries	59	600.0	600.0	54	600.0	28	600.0
126	Shipbuilding	8	6.1	-6.7	0	-8.6	0	-8.1
128	Motor vehicles, not motorcycles	75	498.3	425.5	79	600.0	79	600.0
129	Motorcycles	92	600.0	600.0	93	600.0	93	600.0
130	Other bikes	37	111.0	85.6	35	80.8	31	68.8
132	Scientific equipment	10	8.9	-4.3	22	31.1	22	32.5
133	Optical, photographic equip.	19	29.4	13.8	19	28.7	19	33.4
134	Watches and clocks	11	17.3	3.1	15	34.8	14	32.3
135	Jewelry	32	122	95.2	13	30.2	13	30.4
136	Musical instruments	49	135.6	107.1	47	127.2	39	102.4
137	Sports equipment	30	76.5	55.2	41	206.9	34	176.3
138	Other manufacturing	44	146.4	116.6	31	82.6	29	79.3

Notes: a. Source of estimates is Fane and Phillips (1989).

b. Source of estimates is Republic of Indonesia, Ministry of Industry.

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