Indonesia Trade Brief

Trade Policy

In the context of the East Asian financial crisis, Indonesia pursued trade liberalization in 1998 under the auspices of an IMF program. Tariffs and non-tariff barriers were reduced, and foreign investment was liberalized extending also to services industries. In 2005, the government implemented a new tariff harmonization plan, which aims at setting a uniform tariff of 5 percent for most products by 2010. However, protectionist elements still remain, particularly through nontariff barriers in agriculture, textiles, and steel. Indonesia's latest MFN Tariff Trade Restrictiveness Index (TTRI)[1] for overall trade is 4.6 percent, which is similar to the average TTRI of 4.8 percent for the East Asia and Pacific (EAP) region, but significantly lower than the average of 11.6 percent for lower-middle-income countries. It ranks 56th of 125 countries, where 1st is the least restrictive. Treatment of non-agricultural imports and agricultural imports is similar, with TTRIs of 4.7 and 4.4 percent, respectively. Following a significant drop between 1995 and 2001, the simple average of the MFN applied tariff rate has remained steady at 6.9 percent in 2007 (latest available), slightly lower than the average for both the EAP region and lower-middle-income countries, which are 8 and 10.3 percent, respectively. In 2007, Indonesia decreased its maximum tariff by 13 percentage points to 102 percent and applied this rate to vanilla, of which Indonesia is one of the top exporters in the world. The trade policy space, as measured by the wedge between bound and applied tariffs (the overhang), has remained steady at 30.3 percent, similar to its regional and income group comparators. Over the 1995–2008 period, Indonesia was the 13th largest initiator of antidumping (AD) investigations (of 44 AD user countries). Most AD investigations were on steel products, paper products, and wheat flour, and the main target countries were China, the Republic of Korea, and India.

Since 1998, Indonesia has also taken steps to liberalize key services, notably financial services, telecommunications, and shipping. There have recently been a number of policy reversals in these areas, however, and a variety of trade and investment restrictions remain. In 2007, the government consolidated existing laws on domestic and foreign investment into a unified legal framework, and issued investment negative lists in July and December 2007 to provide a transparent set of restrictions for foreign direct investment (FDI). Although these lists clarified the areas where foreign investment could take place, they also added new levels of restrictions, and increased restrictions for many services sectors.[2] These included rising foreign ownership restrictions and some scale limitations. According to the GATS commitments index, the country ranks 94th of 148 countries, suggesting room for deeper commitments to multilateral liberalization. Indonesia now allows 99 percent foreign ownership in the banking sector, but has not revised its GATS commitment at the WTO, which remains bound at 52 percent.[3]

In response to rising food prices, the Indonesian government removed tariffs on several imported goods, including wheat and soybeans in 2008.[4] The government also limited exports of rice to maintain domestic supply, allowing the state agency to export only when domestic stockpiles were above a threshold of 3 million tons and domestic prices were below their target price.[5]

In late 2008 as world economic growth slowed, protectionist tendencies arose. Indonesia restricted imports by introducing new import licensing requirements for five categories of goods (food and beverages, textiles and garments, footwear, children's toys, and electronics) in December 2008, and for iron and steel in February 2009.[6] Further, the country increased tariffs on 17 product lines including steel, electronic parts, chemicals, food, and beverages (February 2009).[7] After initiating only one anti-dumping investigation in 2007, Indonesia initiated seven AD investigations in 2008 (six in the last

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Unless otherwise indicated, all data are as of August 2009 and are drawn from the World Trade Indicators 2009/10 Database. The database, Country Trade Briefs and Trade-at-a-Glance Tables, are available at http://www.worldbank.org/wti.

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quarter), making it the 8th largest initiator last year. Two safeguard investigations were also initiated during 2008 on iron/steel, wires/nails, and glucose. To stimulate exports, the government opted to decrease export duties for some goods.[8] Although new tariff polices discriminate against foreign goods, in June 2009 the government announced a new liberal investment policy. It provides national treatment to foreign investment; protection against expropriation; repatriation of capital, profits, and wages; elimination of restrictions on the size of investment; and only a limited negative list of activities not open to foreigners. At the same time, a 2008 shipping law will come into effect starting in 2010 that contains the cabotage principle, which requires coal, oil, and gas, as well as domestic shipping, to be performed by locally registered vessels.[9]

External Environment

Indonesian exports face a less favorable external environment than its comparators as judged by a Market Access TTRI[10] (including preferences) for 2007 of 4.2 percent for all goods, which is slightly higher than the averages for both the EAP region (3.8 percent) and lower-middle-income countries (2.4 percent). The simple average of the rest of the world tariff faced by Indonesian exports is 10 percent. When weighted by actual exports, it is 3.5 percent, with the barrier faced by agricultural goods significantly higher than that faced by non-agricultural goods at 9.2 and 2.9 percent, respectively. Indonesia was the 5th largest target of antidumping legislation, facing 145 investigations during 1995–2008. In 2008 Indonesia faced 11 anti-dumping investigations initiated against it, and tied for 3rd most frequently targeted country with Taiwan (China), being surpassed only by China and Thailand. In 2009 there have been four additional investigations initiated against the country. The Indonesian rupiah plummeted in the fourth quarter of 2008 by 20 percent against the U.S. dollar, to register an annual depreciation of 6 percent. In the second quarter of 2009, there has been a 10 percent appreciation of the currency over the first quarter.

Indonesia's main integration agreement is the ASEAN (Association of South-East Asia Nation) free trade agreement (AFTA). Although tariff elimination has progressed effectively, services liberalization among members has been less comprehensive. Liberalization of air transport, telecommunications, tourism, and healthcare is planned for 2010, when ASEAN ownership limits expand to 70 percent. Indonesia also has increased market access for goods and services through the free trade agreements (FTAs) it has negotiated as part of ASEAN. ASEAN has FTAs with China, Japan, Korea, Australia, New Zealand, and, since August 2009, India. The goods FTAs with China and Korea are expected to be fully realized by January 1, 2010. The FTA with Korea extends beyond goods trade with the services agreement taking effect in May 2009, and an investment component signed in June. The ASEAN-Australia-New Zealand FTA signed in February 2009, is comprehensive, covering goods and services as well as investment and intellectual property issues, whereas the FTA with India is currently restricted to goods. Both FTAs are expected to come into effect on January 1, 2010. In March 2008 ASEAN signed a FTA with Japan that would eliminate tariffs on 93 percent of goods exported from ASEAN. Indonesia signed a more comprehensive bilateral agreement with Japan (its main export market) that took effect in July 2008. It encompasses assistance to build Indonesia's technological capacity and migration of Indonesian nurses.[11]

Behind the Border Constraints

In terms of the conduciveness of its institutional environment to business, Indonesia is ranked 122nd out of 183 countries in the Ease of Doing Business index for 2009. The Logistics Performance Index, a measure of the ease of trade facilitation, rates Indonesia well at 3.01 on a scale from 1 to 5 with 5 being the highest performance. This is compared with 2.58 for the EAP region and 2.47 for countries in the lower-middle-income group. It ranked 43rd in the world and 4th in the EAP region, with Malaysia leading the EAP regional group. The country performed best in the area of tracking and tracing shipments but ranked 11th out of 13 countries in the EAP region in the area of domestic logistics costs, due mostly to the relatively high cost of transporting goods.

In response to a drop in the availability of credit brought on by the financial crisis, Indonesia instituted several trade financing policies that were designed to increase the availability of financing to exporters. These include the establishment of an export-import bank in December 2008. Swap agreements with Asian central banks also facilitated trade by alleviating exchange rate pressures and the scarcity of foreign exchange.[12]

Trade Outcomes

Buoyed by rising commodity prices, Indonesia's total trade in goods and services grew by 11.6 percent in real (constant 2000) dollars during the 2005–07 period. However, as commodity prices fell and global demand shrunk in the latter part of 2008, trade growth decelerated to 9.7 percent for the year. Real export growth of goods and services was 9.5 percent in 2008 while import growth was 10 percent. As Indonesia's main export markets, including Japan, the United States, Singapore, China, and Korea, face growth contractions or slowdowns, exports are forecast to fall in 2009 by 3 percent, while imports are expected to grow, although at a severely diminished 1.5 percent.

In nominal U.S. dollar terms, total trade grew by 24.4 percent in 2008, which was a 10 percentage point increase over 2007. Although the manufacturing export base has been widened, Indonesia's exports are still dominated by commodities (oil and gas, coal, and palm oil), and high commodity prices in the first half of 2008 drove goods exports up by 18 percent. Exports in services grew by 21.5 percent, but accounted for only 10 percent of total exports. Plummeting oil revenues made goods export growth register a negative 8.5 percent growth in the last quarter of 2008 on a year-on-year basis, after increasing 26.9 percent in the previous quarter. The first two quarters of 2009 registered a negative goods export growth of 31 percent and 26 percent respectively, compared to the same period in 2007. However, an earlier than expected recovery from China bodes well for Indonesian commodity exports, and on a quarter-on-quarter basis, exports did increase by 17 percent in the second quarter of 2009.

Total imports grew by 31.6 percent in 2008 (double their 2007 rate), driven by a 36 percent increase in goods imports and an 18.9 percent growth in services imports. In the last quarter of 2008, imports continued to rise in nominal U.S. dollar terms by 43.2 percent. In 2009, goods imports registered a 32 percent decrease in both quarters on a year-on-year basis. A possible optimistic signal of domestic demand recovery is that on a quarter-on-quarter basis goods imports grew by 4 percent in the second quarter of 2009. Foreign direct investment increased in dollar terms and stayed steady at 1.6 percent of GDP in 2008.

Notes

1. TTRI calculates the equivalent uniform tariff that would keep domestic welfare constant. It is weighted by import shares and import demand elasticity.
2. Magiera, 2008.
3. USTR, 2009
4. FAO, 2009.
5. Arnst, 2009, p. 9.
6. World Bank, April 2009, p. 22.
7. WTO, p. 69.
8. World Bank PREM Trade Group, January 2009, pp. 3, 9.
9. Global Trade Alert, 2009.
10. MA-TTRI calculates the equivalent uniform tariff of trading partners that would keep their level of imports constant. It is weighted by import values and import demand elasticities of trading partners.
11. Bilaterals.org, 2009a, 2009b, 2009c.
12. World Bank PREM Trade Group, June 2009, p. 11.

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