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TRADE POLICY REVIEW OF INDONESIA

Since the first trade policy review in 1991, Indonesia has continued its economic reform programme, begun in the mid-1980s, albeit at a reduced pace, says the GATT Secretariat's latest report on Indonesia's trade policies and practices. The current medium- and long-term development plans target non-oil export growth as the primary means of generating economic prosperity, employment and poverty reduction. Market-opening measures are seen by the Government as the best means to promote export-led growth and further diversify the economy away from oil and gas. Trade and investment reforms introduced in successive deregulatory packages have further opened up segments of the economy to greater international competition.

The report points out that the flattening of export growth in early 1994 highlights the need for Indonesia to maintain the pace of reform in order to improve economic efficiency and foster internationally competitive industries. "The most recent trade reforms in May and June 1994 are an encouraging sign of the Government's recognition of the problems, but the measures themselves are quite modest. More yet is needed to overcome the anti-export bias of the trade régime and stimulate domestic competition."

Trade-related reforms since 1990 have focused primarily on lowering tariffs and surcharges, reducing import licensing restrictions, and deregulating the investment régime. Tariffication of non-tariff barriers has been extended and rates reduced on some products, such as iron and steel, previously tariffied. Import licences currently cover approximately 260 tariff lines, compared to over 1,100 in 1990. Average tariffs, including surcharges, have been reduced slightly since the previous review, but there remain substantial peaks and dispersion.

In the Uruguay Round, Indonesia agreed to increase its tariff bindings from under 10 per cent to approximately 95 per cent of its tariff lines, at ceiling rates of 40 per cent, except for certain alcoholic and agricultural products which are subject to much higher ceiling bindings. Indonesia also agreed to remove surcharges and non-tariff measures within ten years on bound items. Combined with the move away from non-tariff barriers, these changes will improve the transparency and predictability of the Indonesian trade régime.

The proliferation of export controls, especially on natural-resource-based products, runs counter to Indonesia's import liberalization efforts and risks undermining the advantages extended to efficient exporters from trade reforms. Some 85 per cent of wood products and 60 per cent of agricultural commodities are covered

by export prohibitions, restrictions, licensing or taxes. "Such policies," says the report "may contribute to the development and expansion of inefficient downstream industries, dependent on long-term government support. Drawing attention to Indonesia's plywood production as an example, the report says: "Indonesia's plywood-processing is technically inefficient by world standards, wasting timber and appearing to contribute little to forest conservation."

The continuation and broadening of reforms aimed at creating a less regulated and more market-oriented economy should benefit Indonesia's trading partners and the domestic economy. The agricultural and food-processing sectors could be a major beneficiary of more liberal trading measures. In particular, the poor performance up till now of Indonesia's food-processing sector given its natural advantages in agriculture, could be enhanced if the protection-inflated costs on important inputs, such as sugar and flour, were removed.

Indonesia's autonomous trade reforms will be supported by the maintenance of an open, stable and predictable global trading régime that can successfully combat protectionist pressures in major external markets. "It is therefore imperative," says the report, "that Indonesia's trading partners assume their full responsibilities for aiding Indonesia's autonomous liberalization process by ensuring market access and stable trading conditions for its developing export base."

Notes to Editors

1. The GATT Secretariat's report, together with a report prepared by the Government of Indonesia will be discussed by the GATT Council on 29-30 November 1994 under the Trade Policy Review Mechanism (TPRM). This is the second review of Indonesia since the launching of the TPRM in December 1989, and covers the period since the last review in April 1991.

2. The TPRM enables the Council to conduct a collective evaluation of the full range of trade policies and practices of each GATT member at regular periodic intervals, to monitor significant trends and developments which may have an impact on the global trading system.

3. The two reports, together with a record of the Council's discussion and of the Chairman's summing up, will be published in due course as the complete trade policy review of Indonesia and will be available from the GATT Secretariat, Centre William Rappard, 154 rue de Lausanne, 1211 Geneva 21.

4. The reports cover developments in all aspects of Indonesia's trade policies, including domestic laws and regulations, the institutional framework, trade-related developments in the monetary and financial sphere, trade practices by measure and trade policies by sector. Attached are the summary extracts from these reports. Full reports will be available for journalists from the GATT Secretariat on request.

5. Since December 1989, the following reviews have been completed: Argentina (1992), Australia (1989 & 1994), Austria (1992), Bangladesh (1992), Bolivia (1993), Brazil (1992), Canada (1990, 1992 and 1994), Chile (1991), Colombia (1990), Egypt (1992), the European Communities (1991 & 1993), Finland (1992), Ghana (1992), Hong Kong (1990 & 1994), Hungary (1991), Iceland (1994), India (1993), Indonesia (1991), Japan (1990 & 1992), Kenya (1993), Korea, Rep. of (1992), Macau (1994), Malaysia (1993), Mexico (1993), Morocco (1989), New Zealand (1990), Nigeria (1991), Norway (1991), Peru (1994), the Philippines (1993), Poland (1993), Romania (1992), Senegal (1994), Singapore (1992), South Africa (1993), Sweden (1990), Switzerland (1991), Thailand (1991), Tunisia (1994), Turkey (1994), the United States (1989, 1992 and 1994), and Uruguay (1992).

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TRADE POLICY REVIEW MECHANISM
INDONESIA

Report by the Secretariat - Summary Observations

Since 1990, Indonesia has continued its economic reform programme, begun in the mid-1980s, albeit at a somewhat reduced pace. Trade and investment reforms introduced in successive deregulatory packages, most recently in May and June 1994, have further opened-up segments of the economy to greater international competition. Market-opening measures are seen by the Government as the best means to promote export-led growth and further diversify the economy away from oil and gas. The Government's Sixth Five-Year Development Plan (REPELITA VI) and the Second Twenty-Five-Year Long-Term Development Plan, both commencing on 1 April 1994, target non-oil export growth as the primary means of generating economic prosperity, employment and poverty reduction.

During the period 1990-94, Indonesia maintained impressive economic performance. Annual real GDP growth remained above 6 per cent, and annual inflation was held to below 10 per cent. Average income levels of currently US$760 are projected in REPELITA VI to pass US$1,000 by the year 2000. Aided by on-going trade and other market-based reforms, including investment and financial deregulation, and by sound stabilization policies, Indonesia's trade performance and orientation was strengthened, and its dependence on the oil sector further reduced. Non-oil manufacturing increased its share of GDP from 19 per cent in 1990 to over 22 per cent in 1993, and non-oil manufactured exports more than doubled in real terms to account for over half of Indonesia's merchandise exports. The current account deficit narrowed to some 2 per cent of GDP in 1993 and, with substantial capital inflows, has permitted a healthy build-up in Indonesia's international reserves.

Following a degree of economic overheating in the early 1990s, monetary policy was tightened through increased interest rates, the introduction of prudential bank controls and curbs on foreign borrowing by public sector enterprises, including banks. These policies were successful in cutting inflation to under 8 per cent in 1992 and reducing the current account deficit as a share of GDP. Fiscal policy, largely controlled by the balanced budget principle, played a predominantly neutral stance in economic stabilization, despite the financing of real expenditure increases by foreign aid funds. Currently, a degree of macroeconomic imbalance appears to be re-emerging, following the Government's relaxation of monetary policy during 1993-94 to stimulate growth in the face of deteriorating export performance. Recent reforms in the foreign investment régime are intended to stimulate capital inflows; the Government may, therefore, need to monitor closely possible inflationary pressures.

The flattening of export growth in early 1994 highlights the need for Indonesia to maintain the pace of reform in order to improve economic efficiency and foster internationally competitive industries. The most recent trade reforms are an encouraging sign of the Government's recognition of the problems, but the measures themselves are quite modest; more yet is needed to overcome the anti-export bias of the trade régime and stimulate domestic competition.

Indonesia in World Trade

Indonesia has continued to improve its position in world merchandise trade, ranking some 17th in world imports and 18th in world exports in 1993, compared with 23rd and 19th, respectively, in 1990 (counting the European Union as a single trading entity). Indonesia's share of world merchandise trade over this period grew from 1.3 to 1.7 per cent.

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The share of merchandise trade in Indonesia's GDP has continued to improve since 1987, reaching over 50 per cent in recent years. However, it remains lower than peak levels of well over 60 per cent recorded in the 1970s. Exports increased their share in recent years, while that of imports declined slightly. Intra-industry trade almost doubled between 1985 and 1992, albeit from a low base. Exports of ore have halved in relative importance to one-third of the total, while manufactures have increased their share from 13 per cent in 1985 to around half of total exports.

Under REPELITA VI, non-oil exports are seen as the engine for future growth and are projected to grow annually by 16.8 per cent. However, despite the impressive growth and diversification of trade, some worrying signs are emerging. Textiles and clothing, wood products, especially plywood, and footwear dominate non-oil manufactured exports, accounting for around half of total non-oil exports and for 50 per cent of the growth in such exports between 1988 and 1992. Growth in non-oil exports, however, fell from 28 per cent in 1992 to 16 per cent in 1993, and has fallen further recently. This fall can be attributed principally to declining world prices for textiles and clothing, as well as to lower reduced growth in volume because of intensified international competition. Moreover, export growth is expected to decline further, partly because prices for wood products are expected to increase at a slower rate, or even to fall, during 1994-95.

The bulk of Indonesia's trade continues to be with other Asian countries; these account for two-thirds and one-half of exports and imports. The share of Japan, which remains Indonesia's single most important trading partner, has declined, especially for exports; this reflects Indonesia's diversification out of oil and the fall in the relative importance of Japanese investment. The importance of Singapore, the Republic of Korea and Chinese Taipei as export destinations has grown, and this relationship has been reinforced by growing investment links. The European Union recently edged out the United States as Indonesia's second most important trading entity, especially for imports; main EU markets are the Netherlands, Germany and the United Kingdom.

Institutional Framework

Indonesia, a unitary republic headed by the President, is governed by the People's Consultative Assembly, constitutionally the highest authority of government, and the House of People's Representatives. The President executes policies in accordance with broad guidelines determined, usually every five years, by the Assembly. All laws must be passed by the President and the People's House. Although government in Indonesia is highly centralized, provincial governments have some limited powers over industrial and agricultural development. International trade matters, the responsibility of the national government, are generally implemented through laws, decrees, regulations or instructions.

Policy-making, directed by the President through the Cabinet, is highly informal and centralized. Executive authority rests with the President, assisted by his appointed ministers, who need not be parliamentarians. The Economic Stabilization Council, chaired by the President, oversees economic, including trade-related, policies considered by the Cabinet on Economic Affairs, which comprises the four Co-ordinating Ministries to which all other Ministries are responsible. Matters going before Cabinet are discussed beforehand by Ministers, and agreed informally with the President. Other elements in the decision-making process include the Monetary Board, chaired by the Minister of Finance, which formulates monetary policies, and the Commercial Off-Shore Loan Team (COLT), which controls foreign borrowing by public enterprises.

Trade policy formulation is handled mainly by the Co-ordinating Ministry for Industry and Trade, under which the Ministry of Trade functions. The Co-ordinating Ministry for Economy, Finance and Development Supervision, which includes the Ministry of Finance, also plays an important rôle. Trade policy changes are initiated by the Ministry of Trade, through its Directorate-General for Foreign Trade. The inter-departmental Economic Policies Deregulation Team, established in 1985, continues to play an important rôle

in developing the reform programme. The Investment Co-ordinating Board administers the investment régime, and all foreign and domestic investment projects require approval by the President.

The Government interacts both formally and informally with the private sector in setting trade-related policies. The main official "umbrella" body representing private interests before the Government is the Chamber of Commerce and Industry (Kadin). However, the Government also interacts directly with individual industry associations, which number around 350. Close ties also exist between the Government and large business groups, or conglomerates.

No independent statutory body exists in Indonesia to advise the Government on, or to review, trade-related policies. The Tariff Team, an inter-departmental body formed in 1989 to advise the Ministry of Finance, continues to "fine-tune" tariff rates and to review industry requests for tariff assistance. Since the previous Trade Policy Review, the Tariff Team, whose deliberations are not made public, has recommended increased duties on certain products, such as petrochemicals, mainly to provide infant industry protection; however, according to the Indonesian authorities, it has since been directed by the Government not to recommend tariff increases. The Government also receives advice from various external agencies, such as the World Bank, the IMF and the Harvard Institute for International Development, as well as from domestic research institutes, including the University of Indonesia and related institutes, the Centre of Policy and Implementation Studies and the Centre of Strategic and International Studies.

Trade Policy Features and Trends

Indonesia's trade and sectoral policies are set within the framework of indicative five-year and broader twenty-five year plans, developed by the National Planning Agency. The Sixth Five-Year Development Plan (REPELITA VI) and the Second Long-Term Development Plan seek to continue past policies and performance. Major economic projections of REPELITA VI include average real annual GDP growth of 6.2 per cent, based on non-oil GDP growth of 6.9 per cent; annual inflation of below 5 per cent; annual non-oil export growth of 16.8 per cent; current account deficits of less than 1.7 per cent of GDP; and average employment growth of 2.9 per cent. The Plan places great reliance on continued economic diversification and deregulation to boost export-led growth in manufactures and foster an increased rôle for the private sector.

Indonesia is a signatory to the Tokyo Round Agreement on Subsidies and Countervailing Measures; the Agreement on Technical Barriers to Trade; and the Multifibre Arrangement (MFA). Indonesia has observer status in the Agreements on Government Procurement, Customs Valuation, Import Licensing, Civil Aircraft and Anti-Dumping. Indonesia has justified many of its trade restrictions under GATT for infant industry reasons, and not used Article XVIII:B balance-of-payment provisions since 1979. Indonesia participated actively in the Uruguay Round both individually and as a member of ASEAN and the Cairns Group. The Government has accepted the Final Act of the Uruguay Round without reservation; thus, by virtue of the Single Undertaking of the Round, extending its commitments in areas such as anti-dumping, customs valuation and import licensing. It has also signed the plurilateral Agreement on Government Procurement.

Tariffs are applied on an m.f.n. basis to the vast majority of imports. Limited tariff preferences are extended to other ASEAN members under the Preferential Trading Arrangement (PTA), and the GSTP. Since January 1993, along with other ASEAN countries, Indonesia has begun to implement the ASEAN Free-Trade Agreement (AFTA), under which a Common Effective Preferential Tariff (CEPT) is to be introduced by 2003, and not 2008, according to a proposal just adopted. When fully implemented, maximum tariffs of 5 per cent will apply to intra-ASEAN trade, subject to exclusions, including services and most unprocessed agricultural products. Indonesia has offered to apply CEPT tariff reductions to some 80 per cent of its tariff items, affecting about half its imports from other ASEAN countries. Like other members, Indonesia has excluded several important manufactures from the tariff reductions, including electrical products, petroleum products, transport equipment and iron and steel.

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Indonesia's exports are eligible for GSP treatment in developed markets. In 1992, the United States reviewed Indonesia's GSP status for alleged violations of workers' rights. This review is currently in suspension. Removal of GSP status by the United States would affect some 16 per cent of Indonesian exports to the United States, mainly of textiles and footwear.

Recent evolution

Since the last Trade Policy Review in 1990, five major successive deregulatory packages, each focusing on different sectoral targets, have been implemented in June 1991, July 1992 and 1993, and May and June 1994. The 1994 reforms, in particular with respect to foreign investment, may be seen as an attempt to revitalize the expansion and diversification of manufactured exports.

Trade-related reforms introduced since 1990 have focused primarily on lowering tariffs and surcharges, reducing import licensing restrictions, and deregulating the investment régime. Tariffication of non-tariff barriers has been extended and rates reduced on some products, such as iron and steel, previously tariffied. Import licences, including sole importation licences extended to BULOG and other State-trading enterprises, currently cover approximately 260 tariff lines, compared to over 1,100 in 1990. Average tariffs, including surcharges, have been reduced slightly since the previous review, but there remain substantial peaks and dispersion. Largely prompted by concerns that slower growth of inward FDI in 1993 was beginning to inhibit export performance, Indonesia virtually discontinued divestment and local ownership requirements in May 1994.

Self-sufficiency, already achieved in rice, remains a central policy objective in agriculture and in some major industrial sectors, such as cement, fertilizers, steel and transport equipment, designated as "strategic" industries by the Government, and frequently dominated by public enterprises (PEs). In agriculture, the pricing and marketing of major crops, such as rice, sugar, soybeans, wheat and flour and, since June 1994, garlic, are controlled by the National Logistic Affairs Bureau (BULOG). Input subsidies apply to irrigation and fertilizers, although the latter are currently being phased out. Petroleum subsidies have been removed, except for those on kerosene and on natural gas supplied to certain manufacturers, including urea fertilizer producers, following the decision in 1993 to increase domestic fuel prices to the then international levels. However, such adjustments in domestic fuel prices are still subject to presidential approval; such approval is also required to modify domestic prices of rice and fertilizers. Cement prices are also government-controlled.

Export controls, including bans, quotas, taxes, licensing and compulsory quality standards, currently affect over half of Indonesia's non-oil exports, especially in the area of wood products. These are justified by the Government on the grounds that they promote environmental conservation, expand value-added production, ensure adequate domestic supplies or enable exporters to capture market rents through higher world prices. However, such controls penalize upstream producers while assisting downstream processing industries against import competition, by suppressing input prices below international levels. The policy thus risks promoting inefficient downstream industries dependent on long-term support.

As an example, plywood production has increased rapidly following the introduction of log export bans in the mid-1980s, to become Indonesia's second most important export. The industry has clearly benefited from access to cheaper logs, at prices estimated to be approximately half those prevailing on world markets, as well as requirements that logging concessionaires establish local wood-processing mills. However, Indonesia's plywood-processing is technically inefficient by world standards, wasting timber and appearing to contribute little to forest conservation. The replacement of export bans on unprocessed logs and rattan in 1992 with export taxes is likely to make little practical difference, given the high, and often prohibitive, specific tax rates that apply.

Despite substantial achievements to date in trade policy reforms, the complex import and export controls in force often work against each other. There are wide disparities in levels of effective assistance between

sectors and individual industries; thus, agriculture, with the main exceptions of sugar and soybeans, is moderately assisted relative to manufacturing, and within manufacturing, effective assistance also varies widely across industries. Such wide disparities in assistance distort producer incentives and lead to inefficiencies in production, as resources are encouraged to move into relatively highly assisted activities.

Type and incidence of trade policy instruments

Tariffs, import licensing and export controls are the principal instruments of trade policy in Indonesia. Tariffs have grown in relative importance as import licences have been reduced.

Following the June 1994 reforms, the simple average tariff, including surcharges, is 20 per cent, compared with 22 per cent in 1990. Although few items (some 1 per cent of tariff lines) now bear tariffs of above 40 per cent, most reductions have focused on products, especially intermediate inputs and capital goods, already receiving relatively low duties. Some 43 per cent of items are currently dutiable at rates of 10 per cent or below, compared to just over 30 per cent in 1990. Tariff peaks exceeding 40 per cent now primarily apply to motor vehicles, with rates of up to 275 per cent, and alcohol (up to 170 per cent). Recent tariff reforms have tended to increase tariff dispersion, thereby undermining some of the efficiency gains from tariff reductions. The average tariff rate on final goods is double that for unprocessed products, and substantial tariff escalation exists in industries such as transport equipment, textiles and paper products.

Tariff predictability in Indonesia is enhanced by the exclusive use of ad valorem duties, with no variable, seasonal or specific tariffs in the schedule. However, as much as half of all imports enter at concessional rates, mainly as intermediate inputs for approved investment projects, and under drawback and exemption schemes for exporters. Additional exemptions are also periodically authorized to specific users, such as those extended to certain cable-makers on imports of polyethylene, by the Ministry of Finance.

The use of import surcharges, which had been used both to protect against allegedly dumped imports and to compensate domestic producers in certain sensitive industries for the removal of import licences, has been rationalized. Surcharge rates, previously as high as 40 per cent, are currently a maximum of 25 per cent, except for transport equipment where they rise to 100 per cent. Their coverage has been lowered from some 5 per cent of items in 1990 to just over 1 per cent. Surcharges remain, in principle, subject to annual review.

In the Uruguay Round Indonesia agreed to increase its tariff bindings from under 10 per cent to approximately 95 per cent of its tariff lines, at ceiling rates of 40 per cent, except for certain alcoholic and agricultural products which are subject to much higher ceiling bindings. It also agreed to remove surcharges and non-tariff measures within ten years on bound items. Combined with the move away from non-tariff barriers, these changes will improve the transparency and predicability of the Indonesian trading régime.

Changes made to Indonesia's sales tax system in 1993 discriminate against imports. Taxes, of either 10 or 20 per cent, applied to imports of most non-alcoholic drinks, two-wheeled motor cycles with small engine capacities, sports equipment and games, are not levied on domestically-produced goods. Domestically-produced motor vehicles with a minimum of 60 per cent of local content are taxed at 20 per cent, compared with a tax rate of 35 per cent on vehicles of lower local content, including imported vehicles. In addition, excise taxes continue to discriminate against imported cigarettes.

On-going reforms to Indonesia's import licensing system have reduced its coverage from some 1,100 tariff lines in 1990 to about 260 at present. Nevertheless, restrictive import licences continue to distort domestic production patterns; about one-third of domestic production is covered by import licences or bans. Licensing is particularly prevalent on certain agricultural commodities, processed foods and beverages, paper products, engineering products, transport equipment, basic metals and certain chemicals, such as explosives. Import

bans apply to most foreign printed material, certain chemicals, especially pesticides, and certain plastic scraps of polymers and ethylene. In 1993, prohibitions on motor vehicle imports were replaced with higher tariffs, surcharges and licences on imported motor vehicles not assembled in Indonesia. Imports of second-hand ships (below 5,000 DWT) and other second-hand goods are generally banned.

The substantial rôle played by State-trading and other firms granted import privileges lessens the predicability and transparency of the trading system. The close, and often informal, relationship between the Government and authorized importers creates uncertainty for suppliers and promotes a system that may be vulnerable to manipulation by vested interests. Imports of many strategic products, including BULOG-controlled agricultural commodities, are controlled to ensure that imports do not displace domestic production. IP (producer-importer) licences, applying mainly to iron and steel, restrict imports to domestic producers of these products.

All six IT (registered importer) licence holders, covering principally agricultural commodities, such as dairy products and cloves, alcoholic beverages, certain propylene and copolymers, as well as agricultural hand tools and equipment, are State-trading entities. AT (sole agent) licences are extended to national distributors appointed by the Government, and currently apply, in combination with IT licences, to imports of motor vehicles not produced in Indonesia. Moreover, exclusive importation rights are given to several other State-trading entities, such as BULOG, over major agricultural commodities, such as rice, sugar, wheat and wheat flour, soybeans and garlic; PERTAMINA over oil and petroleum products; and DAHANA over explosives. Importer-producer (PI) licences, formerly enabling domestic assemblers of motor vehicles and machinery, including engines, to import completely-knocked-down (ckd) kits, were abolished in 1992 and 1993.

The proliferation of export controls, especially on natural-resource-based products, runs counter to Indonesia's import liberalization efforts and risks undermining the advantages extended to efficient exporters from trade reforms. Some 85 per cent of wood products and 60 per cent of agricultural commodities are covered by export prohibitions, restrictions, licensing or taxes. As noted earlier, such policies contribute to the development and expansion of inefficient downstream industries, dependent on long-term government support.

Indonesia's standards, which essentially follow or are less stringent than international norms, do not appear to be a major import impediment. Indonesia is in the process of introducing, through the National Standardization Council, a system of mainly voluntary national standards, based on international ones, for health, safety and consumer protection. Standards are applied equally to imported and domestically produced products. On the export side, compulsory standards have been used, largely unsuccessfully, to improve the quality of rubber, coffee and other exports.

Government procurement in Indonesia is largely reserved for domestic suppliers. Where foreign contractors are awarded contracts, they are encouraged to use domestic products. Public tendering of contracts is obligatory for contracts exceeding Rp 500 million, but foreign suppliers are only considered if they meet Indonesia's countertrade arrangements. These require foreign firms to purchase non-oil exports from Indonesia to the value of the contract. Countertrade deals, involving numerous eligible non-oil products declared by the Ministry of Trade, are encouraged by the Government, and various such agreements have been reached in the last four years - including the export of Indonesian aircraft to Malaysia in return for imported cars.

A number of manufacturing industries are designated "strategic commodity industries" under the supervision of either the Ministry of Industry or the Strategic Industries Management Agency (BPIS), established in 1989. Many of these industries are dominated by public enterprises (PEs), of which there are over 180; they account for some 15 per cent of GDP. PEs have been characterized by relatively poor performance and economic inefficiencies, and are sheltered from competition by government regulation over investment and

trade controls. The Government has attempted, with limited success, to improve PE performance, through commercialization, greater monitoring of financial performance by the Ministry of Finance, and share divestiture.

Precise details of the sectoral policies, including financial support, applied to strategic industries remain obscure and their effects largely non-transparent. Transparency is undermined by the substantial off-budget funding apparently provided by the Government to aid certain public enterprises, such as to the State-owned aircraft firm, PT IPTN, which also benefits from interest-free loans financed from the re-afforestation fund. Aid to State-owned enterprises, especially the aerospace industry, is justified by the Government as a means of promoting high-technology R&D. Many strategic industries are, however, characterized by non-competitive behaviour, often sanctioned by government regulation and controls restricting entry, including both domestic and private investment.

Localization plans, implemented through "deletion" programmes, continue to aid domestic component production for machinery and engines. These plans, often aimed at high local content, have had only limited success, resulting in the more flexible application of the deletion programmes. The Government's new policy, beginning with motor vehicles in 1993, is to replace deletion programmes with localization plans that link tariff concessions of imported components to the level of local content achieved by the motor vehicle assembler. These arrangements continue to provide high protection to domestic component suppliers.

Temporary measures

Although Indonesia has no domestic legislation under GATT Article XIX for taking emergency action to safeguard domestic industries, the Government is empowered to introduce import controls where it is considered to be in the national interest. Such action would normally take the form of tariffs and surcharges, and would be considered by the Tariff Team.

Indonesia has no legislation for providing anti-dumping relief. Tariff surcharges have, however, been used as a de facto means of protecting domestic industries from allegedly "dumped" imports. The Government is currently studying the introduction of formal anti-dumping and countervailing legislation along GATT-consistent lines.

New initiatives

The Indonesian Government remains committed to the ongoing reform of its trading system. The deregulatory packages of May (investment) and June (trade) 1994 represent a welcome impetus to the reform programme. The Government's tariff objective is to achieve, within seven years, a tariff structure of up to 5 per cent on upstream raw materials; 10 per cent on intermediate upstream products; 20 per cent on intermediate downstream products; and 30 per cent on final goods.

Trade policies and foreign trading partners

Continuation of Indonesia's reform programme, if supported by continued prudent use of monetary and fiscal policies, should further reduce the still substantial anti-export bias inherent in its trade régime, lead to improved resource-efficiency and help improve Indonesia's international competitiveness on both home and export markets. However, reforms need to go beyond removing restrictions on international trade to tackle impediments to competitive behaviour within the domestic economy. Measures such as drawback facilities and free-trade zones, although useful, are only partially effective in counteracting the anti-export bias and the "high cost" economy.

Indonesia's trade measures are applied on a non-discriminatory basis. Nevertheless, it has, along with other neighbouring ASEAN members, supported the establishment of the ASEAN Free Trade Area (AFTA).

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Care should be taken to ensure that such developments, beginning in 1993 with the phased implementation of the Common Effective Preferential Tariff (CEPT) Scheme, do not impede non-discriminatory trade liberalization.

Indonesia has made great strides in cutting tariffs and reducing the coverage of licensing restrictions. However, peaks are still high, and further reforms are necessary. It is important for trading partners and the domestic economy that Indonesia pursues a movement towards lower, more uniform tariff rates. Recent reforms have done little to reduce tariff disparities, which may even have been increased. There is a risk that substantial tariff escalation, with concomitant high effective protection, may become a permanent feature of the Indonesian tariff system.

The continuation and broadening of reforms aimed at creating a less regulated and more market-oriented economy should benefit both Indonesia's trading partners and - primarily through more competitive markets and improved resource allocation into more efficient uses - for the domestic economy. The agricultural and food-processing sectors could be a major beneficiary of more liberal trading measures. In particular, the poor performance up till now of Indonesia's food-processing sector given its natural advantages in agriculture, could be enhanced if the protection-inflated costs on important inputs, such as sugar and flour, were removed.

Trade, investment and economic growth are closely linked. Increased efforts to remove impediments to international trade and investment can be expected to contribute to Indonesia's economic prosperity. Liberalization of investment rules need to be complemented by trade reforms to ensure that private investment is attracted into efficient industries that can survive without government assistance.

Indonesia's autonomous trade reforms will be supported by the maintenance of an open, stable and predictable global trading régime that can successfully combat protectionist pressures in major external markets. It is therefore imperative that Indonesia's trading partners assume their full responsibilities for aiding Indonesia's autonomous liberalization process by ensuring market access and stable trading conditions for its developing export base. This can best be achieved through the speedy implementation of the Uruguay Round results and the establishment of a strengthened multilateral trading régime under the World Trade Organization.

TRADE POLICY REVIEW MECHANISM

INDONESIA

Report by the Government - Executive Summary

Objectives of trade policies

The trade sector plays a significant role in contributing to the growth of the economy. This can be seen from its share in the Gross Domestic Product (GDP) which has reached approximately 17 per cent with an average growth of 7 per cent annually in the past five years. The trade sector also makes a substantial contribution in the absorption of manpower, i.e. approximately 15 per cent of the total employment opportunities. Apart from this role, the trade sector in particular is significant in supporting the smooth flow of goods and services from the producer to the consumer; it encourages the establishment of reasonable prices, supports production efficiency, increases earnings, and encourages the growth of the national economy. The trade sector is able to encourage the growth of the national economy mainly because of the increase in exports of non-oil commodities.

Thus trade policies will constantly be aimed at encouraging various economic activities to maintain or increase the growth of the economy in order to maintain and secure continuous national development. The success of national development will create better living standards and national stability, so that it can give a positive contribution to the development and peace of the world.

The measures which are taken to achieve such objectives are conducted, *inter alia*, through deregulation and reducing red tape in various sectors, including trade. Deregulation policies are directed at increasing the efficiency of the economy by reducing the cost of transactions and by eliminating business barriers. The measures take the form of: reducing tariffs, eliminating non-tariff measures, and reducing other transaction costs. In addition, various barriers to the smooth flow of goods and services have also been eliminated by simplifying the procedures as well as the documents. These measures are also aimed at creating a more open trade system and healthier business competition which will, in the end, contribute to the attempt to create a more liberal and open multilateral trade system.

Description of the import and export system

Indonesian foreign trade, both export and import, is conducted openly and liberally with some exceptions for specific reasons. Payment can be made under any terms which are normally applied to international trade. The trade system works because it is supported by the free foreign exchange system, which means that there are limits to obtaining and using foreign exchange for export and import purposes. In the export and import system there are four categories of regulations for the category of products which are traded, i.e: first, products which are traded freely; second, products which are prohibited from being traded; third, products which may be traded only by licensed exporters or importers (approved traders); and fourth, products with controlled trade.

Trade Policy Framework

Domestic laws and regulations governing the application of trade policies

Trade activities in Indonesia are regulated by the Civil Code (KUHP) and by the Commercial Code (KUHD). Both Codes have been valid since 1848, before the independence of Indonesia. Due to various

advancements and changes today, both Codes are being adjusted. The provisions which regulate trade activities are drawn up into various sources, i.e. laws, government regulations, presidential decrees, presidential instructions, and ministerial decrees.

Summarized description of the process of trade policy formulation and review

The formulation of trade policies is, in principle, the full responsibility of the Minister of Trade. However, taking into account the close relationship between trade and other sectors, when the Minister of Trade decides on a policy he may consult with and receive inputs from other relevant institutions. If the scope of a trade policy involves the authority of various relevant departments, the decision may be made by a Joint Decree of the ministers concerned. Trade policies may be drawn up in the form of a Presidential Decree if the substance is extensive and if it concerns the duties of various institutions. Apart from this, trade regulations may also be provided in the form of laws which require the approval of "DPR" (the Indonesian legislative assembly).

Bilateral, multilateral, regional and preferential trading agreements

Indonesia is constantly increasing its international cooperation at multilateral, regional, bilateral fora as well as in the form of preferential trading and cooperation in commodity agreements, in order to further develop foreign trade.

Growing bilateral cooperation has become increasingly significant in the attempts to increase Indonesia's foreign trade, in spite of the trends to form trade groups. Such cooperation is based on principles which are mutually beneficial and which are applied without discrimination or special treatment.

At multilateral fora, Indonesia is active in various GATT activities, such as the Multilateral Trade Negotiations - Uruguay Round. Indonesia has an interest in the success of the Uruguay Round because it is desirous to participate in realizing a more open and fair multilateral trade system. The system will be able to increase global trade and Indonesia will take part in it in order to support the continuity of national development. In addition, through the UNCTAD forum, Indonesia, together with other developing countries, undertakes to increase international trade. Such trade cooperation is, among other things, conducted under the agreement on the Global System of Trade Preferences (GSTP).

The Asean Free Trade Area (AFTA) will be implemented through the Common Effective Preferential Tariff (CEPT) mechanism. Through the CEPT mechanism, import tariffs will be reduced gradually to 0-5 per cent within 15 years from 1 January 1993. The products which are included in the CEPT scheme are all manufacturing goods, including capital goods and processed agricultural products. Agricultural products in the form of unprocessed raw materials or raw materials which are contained in the HS tariff item Chapter 1-24 and similar products under other HS numbers are not included in the CEPT scheme. Also excluded are products which are processed by simple methods with minor changes from the original products.

In the Asia-Pacific Economic Cooperation (APEC), the basic attitude taken by Indonesia is to try to make APEC an effective means of economic cooperation among its member countries. Such cooperation is effective in the sense that it can be developed and is encouraged by the advanced countries assisting other APEC member countries which are less developed, in order to minimize the gap between them within the shortest possible time. Thus the economic strength among the APEC member countries in the Pacific region will be more balanced.

In accordance with the position and interest of Indonesia as a producer and exporter of various types of agricultural commodities, Indonesia also participates in various international commodity agreements, such as those for coffee and rubber.

Implementation of Trade Policies

Indonesia's trade policy measures

In order to increase the efficiency and competitiveness of Indonesian products, tariffs will constantly be reviewed and gradually reduced. In addition, attempts are also being made to apply tariffs to non-tariff measures. In 1994, the tariff rate of 0-40 per cent constitutes more than 99 per cent of the tariff items while in 1989 the tariff of 0-40 per cent represented about 77 per cent. In addition, the surcharges were also reviewed. In the deregulation policy of 27 June 1994, 122 tariff items or 1.3 per cent of the total available tariff items are still charged surcharges, and are valid for one year. Prior to applying of the deregulation policy, 220 tariff items were charged surcharges.

Import duties are based on the c.i.f. value. If the contract is on the basis of the f.o.b. price, shipment and insurance cost will be added to the price. For imported goods with LPS, the decision on import duty is based on the price which is normally applicable in the exporting country. Whereas for goods which are imported without LKP, i.e. imported goods the value of which is less than the f.o.b. value of US$5,000 the calculation of the import duty is based on the actual price which is usually stated in the invoice.

In the framework of increasing competitiveness and in order to maintain buyer's confidence in Indonesia's exported goods, a quality standard is provided for goods which are traded. Quality standards are technical specifications or something which is standardized, compiled according to a consensus of all parties involved, paying heed to the conditions of health, safety, development of science and technology, and being recognized by the authorized standardizing agency. To coordinate, synchronize, and develop standardizing activities in Indonesia, a National Standardizing Board has been formed. One of its policies is the Indonesian National Standard, which has reached 4,346 standards.

In order to facilitate and to expedite foreign trade, especially by supplying facilities for the development of non-oil exports as well as to create a more attractive investment climate, a Bonded Zone has been established along with a Production Entrepot for Export Purposes. Also, a surveyor has been appointed to inspect specific exported goods, i.e. P.T. Superintending Company of Indonesia (P.T. Sucofindo).

The procurement of government goods and services is conducted in four ways, i.e.: by public tender, limited tender, direct appointment, and by direct procurement. The provision for the procurement of such goods and services which are funded partly by offshore loans/aid/grants, is fully effective unless provided otherwise in the draft agreement on offshore loan. The procurement of goods and services shall, as far as possible use domestic products, paying heed to the national capacity/potential, to the extent that they are produced domestically.

In the framework of trade cooperation among Asean member countries, the provision on the rules of origin is applied to products which are listed in the Asean-PTA scheme and CEPT for AFTA. Goods which are covered in the scheme will be given preferences if they meet the requirement of the origin of the goods.

Development trade cooperation

Indonesia's trade with countries which have a regional cooperation commitment, such as APEC and Asean as well as bilateral cooperation and preferences, continue to develop, and such cooperation will continue to increase in the future.

Indonesia's total trade with members of the Asia-Pacific Economic Cooperation (APEC) in the period 1989-1993, increased by an annual average of 12.10 per cent. In 1989, the total trade reached US$29.9 billion

and in 1993 it became US$47.2 billion. Within this five-year period exports and imports increased by 11.38 per cent and 13.21 per cent per annum, respectively. In 1993, Indonesia's total trade with its trade partners associated with APEC was 72 per cent of Indonesia's total trade throughout the world.

In the period 1989-1993, the growth of Indonesia's exports to the Asean countries increased annually by 24.41 per cent on average, and the growth of its imports was 11.88 per cent. In 1993, the value of Indonesia's export and import trade with Asean member countries was US$8.04 billion, of which US$5.44 billion was for exports and US$2.60 billion was for imports. In 1993, Indonesia's trade with Asean member countries represented 11 per cent of Indonesia's total trade with all parts of the world.

Indonesia's balance of trade with 50 countries who have signed the trade agreement in the period 1989-1993 was, overall, positive to Indonesia. However, bilaterally, the balance of trade varied between positive and negative.

Exports of two agricultural commodities which were included in the commodities agreement, i.e. coffee and rubber, had different trends in the period 1989-1993, i.e. rubber exports increased and coffee exports decreased. Exports of rubber increased overall by an average of 2.8 per cent per annum, with a decrease, however, for sheets and crepe. Exports of coffee decreased by 12.6 per cent per annum. This was due to the decrease in the exports of Robusta coffee which represented 85 per cent of the total exports, despite the increase in the exports of Arabica coffee.

Indonesia gets GSP facilities from the United States, Canada, Japan and the European Community. Alleviation of import duty is provided on a unilateral basis. It can be obtained by using the Certificate of Origin Form in the implementation of its exports, following compliance with the rules of origin applied in the importing country which provided the preference. In addition, Indonesia is also a member of GSTP which may turn into one of the significant coordinating institutions to increase cooperation among the developing countries. Although it has currently no effective advantages, however, in the future it will become important to Indonesia, especially in order to encourage attempts to diversify exports of non-oil commodities.

Programme for trade liberalization

The deregulation programme in the trade sector is part of the entire deregulation programme in various economic sectors, such as taxation, finance, investment, monetary, banking, and other sectors. The deregulation programme has been implemented intensively since the early 1980s.

Prospective changes in trade policies and practices

Indonesia will continue to make various adjustments consistently in order to create an efficient economy and healthy competition as well as to establish a more open system of trade.

Wider Economic and Development Needs, Policies and Objectives

Economic policies

Developments in the Indonesian economy are directed towards meeting the basic needs of the people and towards creating a balanced economic structure, i.e. on where the emphasis is on industrial strength, supported by a strong agricultural sector. This economic structure is expected to increase income per capita, along with a more equal distribution of wealth. The industrial sector will increasingly serve as the main activator of national development.

Economic performance

Developments in the economic sector to date have been able to open up the structure of the Indonesian economy. The economic structure has also developed from traditional agrarian to a more advanced economy with a firmer structure, i.e. an economy which is supported by stronger industry and agriculture, so that the basic needs of the community are more satisfied and more equal. The growth of Indonesia's Gross Domestic Product (GDP) in the period 1989-1993 averaged nearly 7 per cent per annum. This economic growth was also accompanied by success in reducing the population growth rate to 1.37 per cent, so that the average standard of living for Indonesian people continues to increase.

The inflation rate which, at the beginning of the development of the New Order, was a big problem in national development, was successfully reduced and controlled, and this has thus encouraged the establishment of a more stable economy. The inflation rate which reached 650 per cent in 1966, was reduced to an average of 17.2 per cent annually in the 1970s. In the 1980s the inflation rate decreased again to 8.7 per cent per annum, on average. In 1990 and 1991, the inflation rate increased slightly, i.e. by 9.5 per cent per annum, on average, due to the heated Indonesian economy: the result of increased economic activities domestically, especially the relatively sharp increase in investment. However, under various policies the inflation rate was successfully controlled to below 5 per cent in 1992. In 1993, the inflation rate increased again, but still remained below 10 per cent.

The Government of Indonesia has already made attempts to increase both Domestic and Foreign Investment, by creating a conducive investment climate. The efforts were first made in 1984 by the enforcement of the new Taxation Law which was subsequently followed by deregulation, debureaucratization, simplified licences and offers of extensive business opportunities to the business sector. Since the enforcement of the Capital Investment Law in 1967, up until 31 July 1994, already 8,734 PMDN (domestic investment) projects have been approved with an investment value of Rp 283.3 trillion, and 2,977 PMA (foreign investment) projects with an investment value of US$85.3 billion have been approved. Currently 44 countries have invested their capital in Indonesia; investments from Japan, Hong Kong, Taiwan, the UK and the USA total 21.1 per cent, 15.8 per cent, 10.3 per cent, 9.4 per cent, and 8.6 per cent, respectively. Business sectors which have attracted a large number of foreign investments are the chemical, paper, hotels and restaurants industries, metal goods and mining with 22.7 per cent, 9.9 per cent, 9.2 per cent, 9.0 per cent, and 7.7 per cent, respectively.

External Economic Environment

Major trends in imports and exports

In the period 1989-1993, Indonesia's balance of trade was constantly positive and tended to increase by 14.10 per cent per annum, on average. The total value of exports per annum increased, on average, by 13.83 per cent, i.e. in 1989 the value was US$22.1 billion, then in 1994 it had increased to US$36.8 billion. In the same period, the value of non-oil exports grew by 20.47 per cent per annum, on average. The increase in export values was also followed by a change in the composition between oil and non-oil exports, as well as among the non-oil commodities. In 1989, non-oil exports were 60.8 per cent of total exports, rising to 73.5 per cent in 1993.

The majority of the imports consisted of raw materials and auxiliary materials as well as capital goods for domestic industrial purposes, including industries for export purposes. Thus, developments of such imports and capital goods may also affect the export performance of non-oil commodities. The development of imports is also affected by both domestic and foreign investment. In the past five years, the average growth of imports has increased by 14.12 per cent annually, i.e. in 1989 the value of imports was US$16.3 billion, and in 1993 it had reached US$28.3 billion. 63.5 per cent of the value of imports in 1993 took the form of raw materials

and auxiliary materials, and the remainder was capital goods and consumer goods (25.2 per cent and 3.9 per cent, respectively).

Developments in terms of trade and commodity prices

Terms of trade in 1988 declined compared to 1987. After 1988, it tended to increase, reaching its peak in 1990, before declining. However, the terms of trade within the five-year period still increased by 1.12 per cent per annum. In addition, prices of primary commodities exported by Indonesia fluctuated, with varying developments.

Trends in the balance of payments, reserves and exchange rates

Due to Indonesia's success in increasing exports, specifically of non-oil commodities, the balance of trade for goods has constantly shown a surplus. This is contrary to the balance of trade for services, which has constantly shown a deficit larger than the surplus balance of trade for goods, so that the current account is in deficit. However, the larger balance of capital inflows makes the overall balance of payments positive.

The policy of the managed float exchange rate system was applied in November 1978. However, in the period November 1978 to September 1986, the "managed" factor was still dominant. Consequently the exchange rate of the rupiah was less flexible. In that period the depreciation of the rupiah was not sufficient to cover the difference between domestic inflation and inflation abroad, especially in primary trading partners. Consequently, this caused an over-valuation of the rupiah.

International macroeconomic situation affecting the external sector of the contracting party concerned

The growth of the world economy started to recover in 1992, albeit relatively slowly. World economic growth improved constantly, until it reached 3.0 per cent in 1993. This improvement will continue in 1994.

In the past five years, the world economy has also been marked by the weakening of the US dollar against the yen. The depreciation of the dollar was, *inter alia*, a fundamental factor in the huge deficit of trade transactions between the United States and Japan, in addition to the effects of non-fundamental factors, such as market sentiments. The strengthening of the yen's exchange rate has resulted in higher prices for imported goods, thereby increasing the burden of interest payments and repaying instalments on Indonesia's offshore loans. However, the situation of the balance of payments was also affected by the positive impact of the decline in interest rates on the international market, especially up until the end of 1993. Another conspicuous development was the flow of funds, especially short-term funds, from the industrial countries to developing countries in fairly large amounts.

In the past few years the world economy has also been marked by the strengthening of regionalism in trade and investment. There is concern that this will cause a trade and investment diversion from developing countries, including Indonesia. Meanwhile, as a follow-up to the ASEAN Free Trade Area (AFTA), members, as from January 1994, reduced tariffs and import duties for several types of commodities.

Problems in External Markets

Indonesia has been allocated a manioc quota from the European Union for the period 1993-1995, amounting to 2,475,000 tons, or 825,000 tons per annum. This quota is relatively small compared to Indonesia's production of manioc. Development of Indonesia's textile and garment/apparel (TPT) exports were obstructed by limitations or quotas. The total quota allocated to Indonesia is relatively small compared with Indonesia's

capacity for TPT production. The countries which apply the TPT quotas to Indonesian exports are the United States, Canada, Norway, and European Union members.

Indonesia as a newcomer in international trade, specifically in the export of manufacturing products, also has to face various accusations of dumping practices. Such dumping accusations are mostly launched by Australia and the European Community.

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