

TRADE POLICIES AND THE EXPORT PERFORMANCE OF INDONESIA, 1983-1997

Agus Eko Nugroho¹

ABSTRACT

Article figures out trade policies and performance of Indonesia in 1983-1997 by presenting introduction, a brief review of international trade theory, the exchange rate policy, and trade promotion export-led performance. It is concluded that the government has promoted the export-increase of manufacturing exports in 1990.

Keywords: *trade policies, export performance*

ABSTRAK

Artikel membahas kebijakan perdagangan dan kinerja Indonesia pada tahun 1983-1997. Dalam artikel ini disajikan pendahuluan, penjelasan singkat teori perdagangan internasional, kebijakan perdagangan saham, dan kinerja promosi perdagangan ekspor. Disimpulkan bahwa pemerintah telah meningkatkan ekspor Indonesia pada tahun 1990.

Kata kunci: *kebijakan perdangan, kinerja ekspor*

¹ Staf Pengajar Fakultas Ekonomi, UBiNus, Jakarta

INTRODUCTION

As in other developing countries, the export performance of Indonesia plays an important role to the fluctuation of the economy. In the late of instance, the massive increase in world prices greatly contributed to the rise in Indonesia's export earnings and therefore, the high growth of GDP over 1970 – 1981, that was 8.6% annually. By contrast, the world recession in 1982 and 1983 reduced the demand for Indonesia's oil export as well as other commodity exports. Consequently, the decrease in Indonesia's export resulted in the slow growth of GDP. In the period of 1982 – 1986 the growth of GDP dropped to just 4.01% (Hill, 1996).

Concerning substantial role of export to the economic growth, since 1983 Indonesia has started to promote trade deregulation which includes simplifying port and custom procedures and reducing non-tarif in favour of tariff barriers. As a result, the trade deregulation has been observed to have a significant contribution to the rise in non-oil exports. Nowadays, the high growth rate of non-oil export is mainly contributed by two factors. The first factor is the rapid increase in the exports of wood products. The second factor is mainly due to the strong export performance of textile and footwear products.

This article aims at analyzing the major trade promotion in Indonesia and its relationship with the export performance during the period of 1982 – 1997. The period of analysing focusing on the pre-crisis period of 1997/1998 is to insulate the impact of the crisis to the volatility of Indonesia's export performance, since this study is trying to analysis the relationship between the Indonesian trade policy of the export performance. The method used in this study is descriptive analysis which only focuses on the review of the relationship between Indonesia's trade policies and the overall trend of its export.

DISCUSSION

A Brief Review of International Trade Theory

As in many textbooks of international economics, international trade between countries occur mainly because of different resources endowments across countries. A country, for instance, may lagerly have a particular resource such as natural oil and limited supplies of timber, while another has large supplies of timber but lacked reserves of natural oil. Therefore, there two countries can obtain mutual benefits by conducting international trade beetwen each other. Such, benefits often refer to the concepts of the comparative advantage of international trade that was originally developed by David Ricardo (1817). However, that concept is only succesfull in explaining the overall benefit of international trade beetwen countries, in which, it cannot show the effect of international trade on the income distribution within countries.

Krugman and obstfeld (1994) argue two reasons that the international trade has strong effect on the income distribution. Firstly, factors of production move costly from one industry to another and secondly, industries employ production factor differently. Consequently, eventhough, the presence of international trade likely results in a shift in a country's production process, it may increase the demand for a particular factor of production factor differently. Consequently,

eventhough, the presence of international trade likely results in a shift in a country's production process, it may increase the demand for a particular factor of production and reduce the demand for others. As result, international trade may generate the reduction in the welfare of some other groups within each nation.

Since there are different benefits among economic participants in international trade, barriers of such tend to exist in the real world. According to literature, protection of international trade usually take place when a group of economic participants has enough political role to establish barriers against foreign competitors. There are various reasons as to rationalize the presence of trade barriers. One of important reasons is to maintain domestic government programs because spesific programs require a protection against international competitors. In developed countries, for example, the protection of national food security is one of important reasons to establish international trade barriers. Differently, in most developing countries the protections of their infant industries are the main argument of such barriers.

Furthermore, there are also various ways in which developing countries can protect their infant industries against foreign competitors, involving both tariff (TBs) and non-tarif barriers (NTBs). In the case of tariff barriers, most developing countries usually set lower tariff rate on imported raw materials rather than final commodities. The main objective is to encourage domestic productions and also because infant manufacturing industries. Such protectionism is well known as import substituting industrialization is originally inspired by the concept of export pessimism that firstly introduced by Prebisch (1950) and Nurkes (1961). There are two main arguments of export pessism. Firstly, if all developing countries adopt export promotion strategies, there will be insufficient market demand for their manufactured export in developed countries. Secondly, advanced countries will impose a high protection of their domestic market against manufactured products from developing countries.

Recently, most economies suggest, however, that the infant-industry-argument of protection as a strategy of industrialization has turned out to be an ineffective policy because such a protection will not be able to improve the competitiveness of the protected industry. Indonesia, for example has protected automative and strategic industries against foreign competitors for more industries are still inefficient, industries against foreign competitors for more than a decade, but these industries cannot significantly improve their competitiveness. These industries are still inefficient, compared to the same industries in developed countries. Not surprisingly, their products mostly focus on domestic market and not for international market. This case is known as a pseudo infant industry which means that protected industries have nothing to do entrepreneurs , technological and managerial skills. Shortly, many trade restriction just provide a place for inefficient to survive but they cannot make industries running more efficient (Krugman and Obstfeld, 1994).

However, not all industilization among developing countries has failed in their economic development. A small group of developing countries in East Asia has experience a rapid growth industrialization that focused toward foreign rather than domestic market. These countries are often refered to as the newly industrializing countries (NICs) which include South Korea, Hongkong, Taiwan, and Singapore. The difference between NICs and import-substuting industrialized countries is that NICs allow international competitors to engage competitions in their domestic markets. Even though, NICs have not followed a strictly free trade, the rate of protection in these countries are much lower than those in most developing countries (Liu, 1994).

The successful story of NICs in promoting their manufacturing sectors has been observed to have a large impact on the change in the industrialization strategy among other developing countries. Many developing countries that had earlier followed the import-substituting strategy have started to open their economy. Then the export-oriented-industrialization strategy have started to open their economy. The export-oriented-industrialization (EOI) becomes the main strategy of industrialization in most developing countries. This has also been driven by the World Bank's programs which include technical assistance and loans for trade liberalization of developing countries. By 1995, World Bank has allocated more than US\$ 20 billion for more than 60 developing countries to promote the trade liberalization through structural and sectoral reforms (Salvatore, 1988).

Another successful story of EOI strategy can also be traced through the rapid economic growth of other Asian Countries. The ASEAN-4 (Indonesia, Malaysia, Thailand, and Vietnam) has also achieved the annual economic growth of 6.0% in 1990. These countries since the mid-1980s, have promoted the private-sector-led-economic policy with a special attention to improve foreign trade and investment. Besides as a result of this strategy, according to Parker (1994), such a rapid manufacturing industrialization is also reinforced mainly by two blessing events. The first event was the Plaza Accord that has made the South Asian labour-intensive manufactured industry much more competitive than Japan, Korea and Taiwan. The second event was steady growth of world trade following the 1982-1983 recession that has provided a strong demand for Southeast Asian manufacturing exports.

The Exchange Rate Policy

The presence of international economic integration indicates that countries are much more interdependent which implies that booms or recessions in one country rapidly spill over to other countries through trade flows and monetary integration. The Asian monetary crisis is a simple example, in which, the large depreciation of Thai baht in the early of 1997 immediately caused the large depreciation of other Asian currencies (South Korea, Malaysia, Philippines and Indonesia). For this reason, the exchange rate management plays a crucial role to macroeconomic policy of countries.

Theoretically, there are three ways in determining the exchange rate: fixed, managed-float and flexible exchange rate system. Although, in terms of policy, the view of what the exchange rate regime is right remains a debatable issue. Monetarist, for instance, suggest that the free-floating exchange rate system is the best policy because the central bank of a country may fully concentrate to control upon domestic money supply. In contrast, others argue that free-float exchange rate system is implausible because the volatility of exchange rate has been observed to be responsible for macroeconomic instabilities. Based on this reason, some also point out that managed-float exchange rate system is much more appropriate policy for developing countries in maintaining a competitive exchange rate is often referred to justify the importance of the managed-float exchange rate system. A competitive exchange rate has proved to be a powerful instrument for macroeconomic stability and thus promoting development.

The importance of managed-float exchange rate system, is also supported by Southeast Asian experience. In the 1990s, Singapore has greatly enjoyed the low inflation, a stable growth of monetary supply and real effective exchange rate. This achievement is followed by its neighbours (Indonesia-Malaysia), although with different levels (Islam and Chowdhury, 1997).

In the pre crisis period of 1978-1998, Indonesia established the managed-float exchange rate system, in which, the government of Indonesia actively intervened the exchange market in order to maintain the Rupiah competitiveness against a basket of currencies, this policy was carried out by approximating a 5% depreciation against the US dollar and maintaining a slightly higher domestic investments (Fischer and Reisen, 1993).

The exchange rate policy has been observed to be one of major sources affecting the rapid growth of Indonesia's exports. According to Hill (1996), the large devaluation in March 1983 and November 1986 (Figure 2) and it was accompanied by the trade and banking deregulation are the major determinants of the rapid increase in exports, the devaluation of 1986, the export of Indonesia steadily increased in the period of 1986 – 1997.

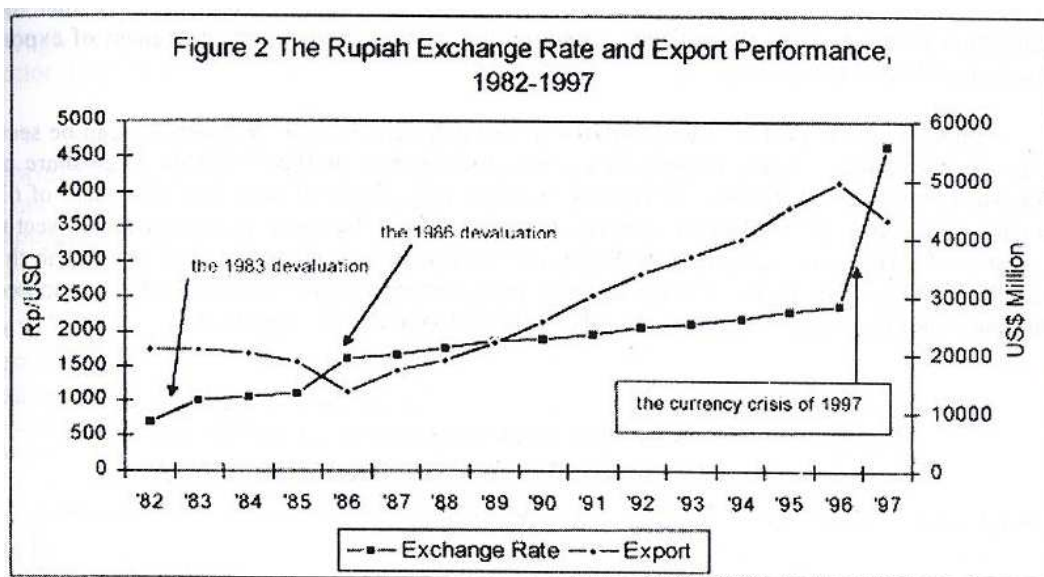


Figure 1 The Rupiah Exchange Rate and Export Performance, 1982 – 1997

Source: *The Indonesian Financial Statistic, Bank Indonesia (various issues)*

Following the Indonesian currency crisis of 1997, there has been an awareness that the policy of gradual depreciation and maintaining domestic interest rate above international level is not really obvious. The reason is because such a policy tended to attract not only foreign direct investment but also short-term portfolio investment of foreign funds, which led to a temporary current account deficit, this will then lead to the rise in the vulnerability of the economy toward external shocks, such as the large sudden devaluation of Thai baht in the early 1997. Under this circumstance, the Indonesian government should have large enough foreign exchange reserves that are committed to maintain the expected level of the Rupiah exchange rate. Following the Thai baht crisis of 1997, since the Indonesian government was reluctant to use its foreign reserves to defend the parity, rather it moved from managed-float to the free-float exchange rate system, the Rupiah exchange rate depreciated massively. For this reason, the dramatic depreciation of most Southeast Asian

curriences makes us to rethink the stable exchange rate achievement under managed-float exchange rate system.

Trade Promotion Export Performance

The downfalls of world oil prices since 1982 and it's impact to the flower growth of the oil-financed growth decade. In response to such a situation, the government of Indonesia has promoted the export – led growth strategy. Since 1989s, there have been extensive reductions in the trade barriers of Indonesia (Table 1). Most export taxes have been reduced and the structure of tariff has become the primary instrument of import protection. Many economics agree that the deregulation packages have a significant impact on the increase in the competitiveness of export. (Nasution, 1994 and Hill, 1996).

Generally, the impactof trade promotion to the Indonesian export performance can be seen by the structural change in the Indonesia's export was dominated by primary products: agriculture oil and gas. The share of oil and gas accounted to 71,8% of total exports in 1980, where the share of manufacturing sector was just 2,4 %. However, since 1989 the share of manufacturing exports has been larger than the share of oil and gas export, in 1996 the share of manufacturing export stood at 64,5 %, compared to the share of oil and gas export that was only 23,04% of total export (Figure 2).

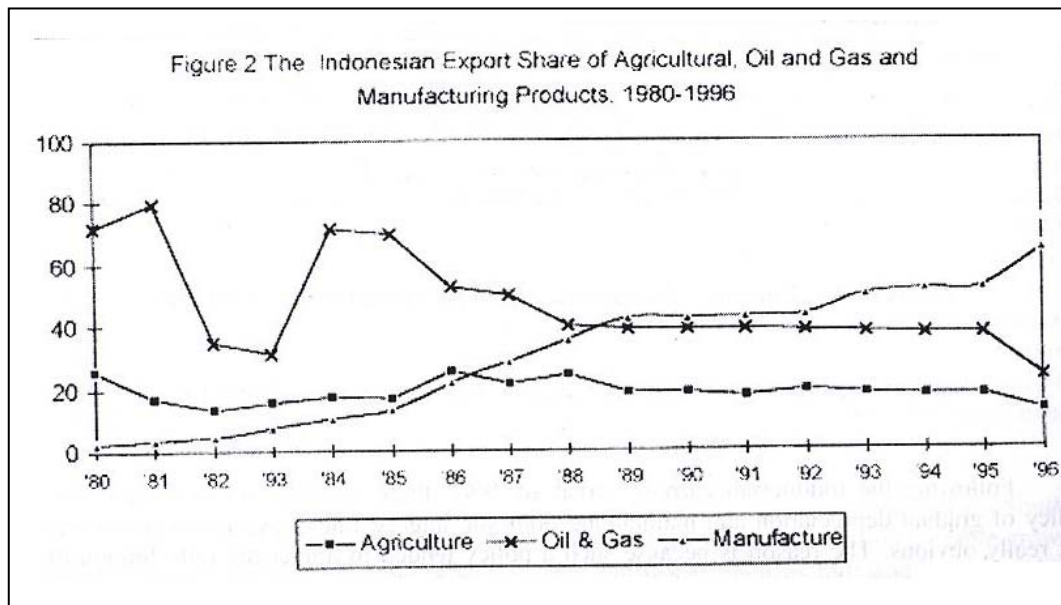


Figure 2 The Indonesian Export Share of Agricultural, Oil and Gas, and Manufacturing Products 1980-1996

It is important to note, however, that the effective rate of protection of Indonesia is still highest, compared to the other East Asian countries. The study of World Bank (1994) indicates that in the manufactured industry, Korea and Malaysia have effective rate of protection of 28% and 23%, respectively, while Indonesia is still the average of 50%. This means that domestic firms which are 50% less efficient than their international competitors will be able to survive in domestic market. The high effective rate protection also tends to create an anti-export bias, which means that resources are drawn from internationally competitive exporters toward domestically oriented firms. Therefore not surprisingly, the most of Indonesia's industries that enjoy a high effective rate of protection are inward-oriented, such as automotive, food processing and engineering industries.

In terms of protection policies, restrictive import licences are the most prevalent non-tariff barriers in Indonesia. After the October-1993 deregulation package, nine restrictive import licenses have covered about 398 products (Department of Trade and Industry, 1993). The trend of production, protected by NTBs focuses mainly on the protection of agricultural commodities. Even though, in the period of 1989 to 1992 NTBs significantly dropped to 10% in the agricultural sector, the restrictive import license in this sector remains high, compared to other sector.

The negative impact such as trade to promote a higher value added of downstream industries leads to the misallocations of resources. theoretically, in a small open economy the restriction of international trade can create the problem of domestic distortion: the endogenous distortion and the policy-induced distortion Johnson (1965). This theory can be traced through the Indonesia case of export restriction on the log export. The ban on log export since 1992 has pressured the domestic price of log that increases an incentive for log processors. This policy has failed to encourage the primary objective of raising the value added of wood processing such as woodworking and furniture productions, because such a restriction has been proved to increase the activity of plywood mills. This means that this policy has only been successful in capturing the international tropical plywood industry from Japan and Korea (Dick, 1991).

In the manufacturing sector, the production of food beverage and tobacco have the most restrictive import licenses. In 1992, for instance, the restrictive import licenses of this industry was 58,7% of total manufactured sector. Consequently, the high restrictions through NTBs strongly lead to inefficient production process and the inward looking orientation of this industry. Not surprisingly, the amount of Indonesia's processed food export is very small. World Bank (1994) estimates that Indonesia's processed food export was just US\$ 430 million in 1992, that was just 1-2% of non-oil exports. This situation was very contrast to which in Singapore where at the same time, the value of processed food export was over five times Indonesia's.

Table 1 Production Coverage of Restrictive Import Licensing, 1989-1992 (%)

Policy Instruments	
Exchange Rate	
1.	On March 30, 1983, Rupiah was devaluated by 28% from Rp907/USD; since then the exchange rate has been made more flexible.
2.	On September 12, 1986, Rupiah was devaluated by 31% from 1,134 to Rp1,644/USD
Monetary Policy	
1.	On June 1, 1983, financial reform was launched including removal of credit and rate celling for state banks operations, a reduction in the scope of credit program and introducing of new market-oriented instruments of monetary control.

<ol style="list-style-type: none"> 2. Deregulations packages were announced on December 1987, October 1988, December 1988, March 1989, February 1991, dan May 1993 which were focus to enhance financial efficiency and developing the capital market through reducing barriers to entry. 3. Improve monetary management to control inflation and to curb exchange rate speculation. 4. Removal of central bank's direct credit and major reduction of economic sector covered by subsidized "priority credit" in January 1990.
<p>Trade Policy</p> <ol style="list-style-type: none"> 1. On July 1993 and October 1993, general reduction of nominal tariff. 2. On May 2 1990, July 1993, October 1993 policies permit exporters. These policies permit exporter and suppliers of inputs for exporters to bypass the import licensing system and import tariff. 3. Major deregulation of import licensing system announced in December 1986, January 1987, May 1990, July 1992, and October 1993. 4. Major removal of NTB's general reduction in tariff rates launched on May 1990, July 1992, and October 1993. These are also covering simplification of licensing procedures in trade, manufacturing, health, and agricultural business. 5. Further removal of NTB's general reduction of import tariff and reopening of several.

CONCLUDING DISCUSSION

Following the end of the oil-financed growth decade, the government of Indonesia has promoted the exports-led growth strategy. The trade promotion has been observed to have a significant impact on the increase in manufactured exports in the 1990s. However, Indonesia's export and import regulation remains high. The main reason of the protection tends to create the misallocation of resources. In manufacturing sector, the productions of food beverage and tobacco have the most restrictive import licences. As a result, the high protection has generated the high cost of production and the inward-looking orientation of many Indonesia's food processing industries. As a consequence industries cannot compete in the world market.

The managed-float exchange system also plays a significant role on the increase in the manufacturing exports in 1990s. However, the necessary condition for the managed-float exchange rate policy the government should has large enough foreign exchange reserves to maintain the parity of the rupiah exchange rate. This is because this policy tends to attracts the short term portfolio of foreign investment that was fragile toward exchange rate speculations, leading to the increase in the vulnerability of the Indonesian economy toward the external shocks such as the Thai bath crisis of 1997.

REFERENCES

- Department of and Trade and Industry. 1993. *The Indonesia Trade Regulation and Export Guidance*. Jakarta: Department of and Trade and Industry.
- Dick, J. 1991. Forestry Land Use, Forest Zoning and Deforestation in Indonesia, article for state Ministry for Population and Environment (KLH) and the Environmental Impact Management Agency (BAPEDAL), for UN Conference on Environment and development.
- Fischer, B and Reisen, H. 1993. *Liberalising Capital Flows in Developing Countries: Pitfalls, Prerequisites and Perspective*. Paris: OECD.
- Hill, Hall. 1996. *The Indonesia Economy Since 1966: Southeast Asia's Emerging Giant*. Cambridge: University Press.
- Islam, I. and Chowdhury, A. 1997. *Asia Pasific Economies: a Survey*. London: Routledge.
- Jonshon, H.G. 1995. "Optimal Trade Intervetion in the Presence of Domestic Distortion." in R. Caves *et.al*, (1996) eds. *Trade, Growth, and Balance of Payment*, Ran McNally.
- Krugman, P.R. and Obstfeld, M. 1994. *International Economics: Theory and Policy*. Third Edition. New York: Harper Collins College Publishers.
- Liu, Pak-Wai. 1994. "Recent Development and Future Prospect of the Indonesia Economy" in You C. Kim (ed). *The Southeast Asian Economic Miracle*. New Jersey: Transaction Publishers.
- Parker, S. 1995. Trade and Investment in Southeast Asian Development" in You C. Kim (ed). *The Southeast Asian Economic Miracle*. New Jersey: Transaction Publishers.
- Salvatore, D. 1998. *International Economics*. Sixth Edition. New Jersey: Prentice Hall.
- World Bank, "Indonesia: Stability, Growth and Equity in REPELITA VI", World Bank Report No. 12857-IND, May 1994.