

# MARKETING POLICY TO IMPROVE COMPETITIVENESS OF AGRICULTURAL COMMODITIES FACING TRADE LIBERALIZATION

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## INTRODUCTION

Indonesian agricultural sector gives response to the change in the international and domestic trade environments. On international side, trade liberalization under WTO and AFTA arrangements have been prominent issue influencing the sector. The ultimate goals of the implementation of the trade liberalization are increasing quantity of the world trade, making the economy more efficient, and improving the welfare distribution among countries.

There are two WTO agreements on trade of agricultural commodity, namely Agreement on Agriculture (AoA) and Agreement on Sanitary and Phytosanitary (SPS). AoA contains agreements on reduction of agricultural trade barriers through gradual long-term reform program so as to generate a fair and equitable market-oriented agricultural trading system. The core agreements on AoA are: (1) To increase market access through reduction of import tariffs and conversion of non-tariff barriers into tariff barrier; (2) To reduce or eliminate export subsidy; and (3) To reduce or eliminate *domestic support* to producers<sup>1</sup>.

While agreements on SPS encompass: (1) To arrange policies adopted by member countries related to health standard and protection and sanitation for community security and health as well as animal, plant and environment protection such that the application of the standard does not create unreasonable barriers to international trade; (2) To allow for application of discriminatory standards with consideration of factors such as differences in the prevalence of particular pests and diseases; and (3) To allow a country for restricting import as the way to prevent the emergence of real risk in terms of pests or diseases spread even though it has not yet been scientifically proven<sup>2</sup>.

With regard to AFTA, ASEAN member countries agree to cut tariff rate to 0-5% starting in January 2003. Exception applies to highly sensitive

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<sup>1</sup> WTO, 1995. Results of Uruguay Round Table World Trade Organization. Geneva.

<sup>2</sup> WTO, 1995. *Ibid.*

commodities which are allowed to be imposed higher tariff rates until 2010<sup>3</sup>. Indonesia has included rice and sugar into the highly sensitive list with tariff rate around 30% for rice and 25% for sugar. The reason behind the policy is that these two commodities remain strategic in the Indonesian economy involving millions of small farmer.

In the domestic affair, one of the emerging issues is the implementation of decentralization and regional autonomy as specified in the Act number 22/1999 about Local Government and number 25/1999 about Financial Balance between Central and Local Governments. The expected outcome of this policy is an improved capacity of local governments to develop regional economy. Unfortunately, local governments tend to intensify collection of tax and retribution charge on commodities being delivered from one region (or island) to another. It was worried that excessive tax and retribution charge would increase marketing margins, hence marketing inefficiency, which not only oppose the spirit of trade liberalization but also depress producer prices and increase consumer prices. If this is true, then the Indonesia's agricultural commodities would become less competitive in both international and domestic markets.

The present paper aims to review : (1) the likely effects of trade liberalization on world as well as regional and Indonesian agricultural sector, (2) nature of decentralization policy and its effects on the marketing efficiency of agricultural commodities; and (3) major government policy to increase the marketing efficiency of agricultural commodities. Policy implications are drawn on the basis of these findings.

## **TRADE LIBERALIZATION : IMPACTS AND RESPONSES**

### **The Estimated Impacts**

#### ***Impacts on World and Regional Economy***

The implementation of WTO agreements by all member countries was expected to positively impact the agricultural production and trade and society's welfare. A number of studies revealed that trade liberalization through earlier and more comprehensive market opening offers substantial gains to the world or country's economy.

A study showed that halving trade barriers would result in world annual welfare gains of around US \$250 billion (62%) from services, US\$90 billion (22%) from agriculture and US\$66 billion (16%) from manufactures, or US\$400

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<sup>3</sup> Hadi, P.U. 2002a. Review Kesepakatan AFTA Bidang Pertanian. Pusat Penelitian dan Pengembangan Sosial Ekonomi Pertanian (unpublished paper).

billion from all sectors<sup>4</sup>. Elimination of the entire barriers would generate greater annual gains of approximately US\$750 billion from all sectors, around US\$150 billion (20%) of which is from agricultural sector.

The biggest gainers in absolute terms are the OECD countries in Asia and in Europe and North America because of the removal of large barriers and the size of GDP. ASEAN also stands to gain substantially in absolute terms, reflecting gains in all of the major areas of agriculture, services and manufactures. But in relative terms, developing countries do best. ASEAN, Africa, OECD Asia, India and Middle East, and Central and Latin America, would gain the most in proportion to their GDP because relatively higher barrier are being removed in these regions.

### ***Impacts on Indonesian Agricultural Sector***

In the spirit of WTO and AFTA agreements, Indonesian government has conducted a set of deregulation policies including in agricultural sector. Tariff rates imposed on the import of agricultural commodities, except rice and sugar, have been reduced to around 0-5%. Subsidies on agricultural inputs have been completely phased out since 1998. Therefore, Indonesian agricultural sector has been liberalized and responds only to market signals.

Trade liberalization under WTO as well as AFTA agreements by all member countries was expected to positively impacts the agricultural production and trade and society's welfare. A study revealed the scheme of Uruguay Round would decrease rice and non-grain productions by 0.8% and 0.3% per year respectively, but increase other grains and livestock production by 0.5% and 1.4% per year respectively<sup>5</sup>. The decline in non-grain production stems from a big decline in cane sugar production. Like rice, cane sugar production was highly protected and supported by the government through imposing import tariff and providing subsidy on farm input (especially fertilizers). These evidence suggest that rice and sugar are very sensitive to full implementation of trade liberalization.

Other empirical study on the effect of trade liberalization on rice, maize and soybean revealed that trade liberalization would increase import and consumer surplus, but decrease domestic production and producer surplus<sup>6</sup>. The consumer surplus would exceed the producer surplus contributing to the higher efficiency of the national economy.

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<sup>4</sup> Sparkes, P., N. Brown, S. Moran and R. Wickes. 1999. Global Trade Reform 2000 : Maintaining Momentum. Foreign Affairs and Trade, Australia.

<sup>5</sup> Ferrydanusethawan, T., M. Pangestu and Erwidodo. 2000. Trade Liberalization in the Asia Pacific : the Benefit for Indonesia. Paper presented at the ACIAR Seminar of "Policy Analysis of Linkages between Indonesia's Agriculture Production, Trade and Environment". CSIS. Jakarta, 12 June 2000.

<sup>6</sup> Erwidodo and P.U. Hadi. 1999. Effects of Trade Liberalization on Agriculture in Indonesia: Commodity Aspects. Working Paper 48. The CGPRT Centre, Bogor.

## ***Impact on Farm Income***

Despite the estimated positive impact of trade liberalization, it is worried that small producers will experience economic losses particularly during the adjustment period. This argument has motivated protectionist regime to oppose the policy toward more open trade.

Empirical studies showed that the impacts of trade liberalization on farm income varied across commodities depending on the degree of distortion in output and input markets. For instance, farm income for commodities under output protection and input subsidy, such as soybeans and garlic, would decline as the protection and subsidy are eliminated<sup>7</sup>. Producers are discouraged to produce these commodities due to higher input-output relative prices. Using an analogy, any other commodities under protection and subsidy, such as rice, sugar and fresh milk, trade liberalization would discourage domestic production and farm income. In the cloves case, where domestic output market was highly monopolized, elimination of monopoly would encourage farm production and income.

In the case of unprotected commodity, such as coconut oil, a study showed that production, farm income and export of the commodity would be promoted<sup>8</sup>. The unprotected commodities such as palm oil, rubber, coffee, and cocoa, trade liberalization would encourage domestic production, farm income and export<sup>9</sup>. Using an analogy, any other unprotected commodities such as tea, tobacco and pepper, trade liberalization would have positive impact on domestic production, farm income and export.

## **Government and Producer Response**

### ***Government Response***

There was an eagerness of the Indonesian government to support the trade liberalization under WTO arrangements. Import tariff rate of many agricultural commodities, including the very sensitive commodities such as rice and cane sugar, was significantly cut. At the same time, input subsidy has been completely phased out.

At present, the government has no effective instruments to control the increasing quantity of import and the declining price of rice and sugar, and the increasing price of fertilizers and pesticides. Responding to these unfavorable

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<sup>7</sup> Niki Juluw, V.P.H., N.A. Kirom, E. Jamal, S. Mardianto, S. Bahri dan A. Supriono. 1999. Pengkajian Daya Saing Produk Pertanian Utama Dalam Era Pasar Bebas. Laporan Hasil Penelitian Pusat Penelitian Sosial Ekonomi Pertanian. Bogor.

<sup>8</sup> Hadi, P.U., R. Kustiari, H.A. Malian, R. Suprihatini dan V. Siagian. 1999. Dampak Liberalisasi Perdagangan Terhadap Produksi dan Pendapatan Usahatani Kelapa. Pusat Penelitian Sosial Ekonomi Pertanian. Bogor.

<sup>9</sup> Hadi, P.U. 2002b. Impacts of Crisis on Tree Crops Economy. Working Paper. SMS-TCSDP Project Report. FAO. Jakarta.

changes, the government has been attempting to protect producers again by increasing tariff rates (but remain below the binding tariff rate) through various periodic WTO meetings. Import tariffs on rice and sugar are 30% and 20-25% respectively. Import of leg quarter chicken from the US is now under review and subject to tariffication in addition to non-tariff barrier (halal certificate). From the economic point of view, this policy tend to keep poultry growers maintaining inefficient production system while ignoring other more efficient opportunities<sup>10</sup>.

### ***Producer Response***

As the main agricultural producers, farmers have been responding to the progressive changes in the economic environment, especially output and input prices which are significantly influenced by the dynamics of the rupiah exchange rate against the dollar. In the case of import substitution commodities, such as rice, cane sugar, maize, soybeans, garlic and cloves, the uncontrolled import quantity would depress producer prices. At the same time, the price of farm inputs, particularly fertilizers and pesticides, tend to increase. These imbalance price changes likely discourage producers to maintain technology application which eventually reduce farm production and net gains. In the case of the major traditionally exported commodities such as oil palm, rubber, coffee and cocoa using more domestic inputs, trade liberalization has fostered their export.

On institutional aspect, there is a movement to build stronger farmer group or commodity associations. Farm organizations are becoming more active to influence government policy making process in favour of their interests. This is particularly true for commercial crops such as cane sugar, palm oil, cocoa, etc.

## **DECENTRALIZATION POLICY**

### **Nature of Decentralization**

According to ACT number 22/1999, the central government decentralizes or transfers its authority to the autonomous government, namely provincial and district or municipality government with emphasis on the latter. This policy aims to provide authority to local government in managing their local resources for the benefit of their people.

The authority of local government involves all areas of governance, except foreign political affair, national safety and security, law, monetary, fiscal, religion, macro planning and development control, balanced budgeting, state administration system, state economic institution, human resource development

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<sup>10</sup> Landstran, J.A. 1990. Liberalization of Agricultural Trade : the Way to Strong and Profitable Agriculture Extension Bulletin No. 324. Food and Fertilizer Technology Center. Taipei City, Taiwan.

and empowerment, natural resource utilization, strategic technology, conservation and standardization. The local government has an authority to manage and sustain the national resources available in its territory. Moreover, local regulations must not oppose the common interest, other standing regulations and standing higher acts.

The financial sources of local government consist of : (1) Local income including local tax, local retribution, profit gains from local government corporate, gains from local government's asset and other legal sources; (2) Balancing funds from central government (3) Local government loan; and (4) Other legal sources. Importantly, tax and retribution charges are fixed by an act. Moreover, tariff and method of local tax and retribution collection are stipulated in local government regulation commensurate with the standing acts.

The important thing that needs to be realized is that development is the process of structural change within a multi-dimensional society. The results of a development under regional autonomy or decentralization arrangements must be more favourable to the whole society as compared to those under the earlier arrangements<sup>11</sup>. Challenges faced by the regional authority would be continuing and strengthening the earlier specified development activities with borderless administration, ethnic and cultural boundaries. More importantly, macro and micro prudent policies are required to avoid the emergence of local egoism and a tendency toward disintegration phenomena as part of political euphoria .

The development of regional economy needs to consider the micro, macro and global aspects. At the micro level, the society has to be posed as the main actor of the economic development so as to improve its welfare. At the macro level, the state is regarded as the body in stabilizing and strengthening the national economy so as to assure the achievement of the better quality of live of the society as a whole. At the global level, the international trade and partnership needs to be built so as to contribute to the improvement of the society's welfare. The focal point of the decentralization will be how the regional authority manages the local available resources for successful regional development.

## **Impacts on Production and Marketing Cost**

By virtue of regional autonomy, local government develops any effort to maximize revenues, without careful consideration about its impact to economy. Some empirical evidences show that local government tend to maximize revenues through intensive collection of tax and retribution imposed on all agricultural commodities being delivered passing through every entry or exit points in the

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<sup>11</sup> Dwidjowijoto, R.N. 2000. Otonomi Daerah : Desentralisasi Tanpa Revolusi : Kajian dan Kritis atas Kebijakan Desentralisasi di Indonesia. Penerbit PT Elex Media Komputindo, Kelompok Gramedia. Jakarta.

region<sup>12</sup> <sup>13</sup>. As the retribution charge is collected at all these borders, the cumulative retribution charge will be very high. Retribution is also frequently illegally collected making marketing cost higher.

According to Indonesian Chamber of Commerce, there are about 1006 local government regulations in 2001 considered to be counter productive measures . They are related to retribution on : transporting commodities from one place to another, water use, service charge on public utilities, etc. The government has been reviewing these regulations and planned revise them. As for example, a number of live cattle from Kupang (East Nusa Tenggara province) to be delivered to Jakarta, always pass through Kupang and Surabaya seaports. The same cattle are then delivered from Surabaya to Jakarta by truck passing through many district borders. Retribution is also imposed on live cattle entering any cattle market place and any agricultural commodity entering any market place<sup>14</sup> <sup>15</sup>. If retribution charge is collected at all these borders, then the cumulative retribution charge will be very high. Retribution is also frequently illegally collected making marketing cost higher.

The excessive tax and retribution collection results in higher transportation cost, which means larger marketing margin or consumer price spread. Normally, any additional marketing (and other) costs will be partly transmitted to producer and partly to consumer. Larger marketing margin not only makes marketing inefficient but also depresses producer price. The eventual unfavorable effect is the weakened competitiveness of Indonesia's agricultural commodities in both domestic and international markets. The dangerous ramification would be discouragement of domestic production and encouragement of imports which further squeezes the Indonesia's agricultural sector.

## MAJOR GOVERNMENT POLICIES

To enhance and improve the efficiency of marketing activity of agricultural commodities some policies have been launched by the government. *First*, the development and rehabilitation of infrastructure such as roads, bridges, railway, seaports and ferry inter-connection. This infrastructure intensifies inter-regional or inter-island flow of agricultural commodities and much reduces the delivery time which avoids commodity damages and losses. More importantly, the

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<sup>12</sup> Hadi, P.U., A. Thahar, N. Ilham and B. Winarso. 2002. Progress Report of Beef Project. An ACIAR-Funded Joint Research Project Between Center for Agro Socioeconomic Research (Indonesia) and Center for International Economics (Australia).

<sup>13</sup> Sudaryanto, T., P.U. Hadi, T.B. Purwantini, S.H. Susilowati dan Ch. Muslim. 1992. Agribisnis Pisang dan Nenas di Lampung dan Sumatera Selatan. Buku II : Nenas. Laporan Hasil Penelitian. Pusat Penelitian Sosial Ekonomi Pertanian. Bogor.

<sup>14</sup> Hadi, et al. 2002. *Ibid*.

<sup>15</sup> Sudaryatno, et al. 1992. *Ibid*.

transportation costs and losses can be reduced while maintaining the quality of the delivered commodities.

*Second*, introduce more appropriate technologies for harvest and post-harvest handling of fresh agricultural commodities<sup>16</sup>. Application of correct harvest technology can reduce losses. Furthermore, grading activity not only increases commodity prices but also avoid unnecessary garbage transportation costs. Better packing and transportation methods make fresh products remain more durable, avoiding unnecessary commodity losses.

*Third*, to develop sub-terminal markets for vegetables and fruits (especially orange) in Brastagi district of North Sumatra province. These market places function as transaction places between sellers (farmers or assemblers) and buyers (large traders, processors and exporters)<sup>17</sup>. For live animals, especially beef cattle, cattle market places were developed in almost all districts on Java and some districts on outer Java<sup>18</sup>. The advantage offered by the development of sub-terminal markets and cattle market place is lower transportation and transaction costs for commodity procurements because a huge amount of commodity can be sold and purchased in these market places.

*Fourth*, develop an agro-processing industry using appropriate technology to increase the storability, usage ease, taste and health of the processed products. For semi processed products, in particular, the technical specifications of the products must satisfy the requirements specified by the users, which is mainly manufacturing industry. Besides, placement of processing plant in producing region, particularly within commodity field (raw material oriented) very much reduces transportation costs of raw material, such as in the case of rubber, coffee, palm oil, cocoa, coconut oil, tea, tobacco, cane sugar, rice, canned fruit and vegetable, vegetable and fruit juice, etc.

*Fifth*, introduce business partnerships between farmers and large company. Through partnership, marketing margin in terms of transportation cost and traders' profit can be reduced because farmers can market their commodities directly to the company as their partner. In this case, farmers function as raw material suppliers, while the large company functions as a buyer, through particular arrangements agreed by both sides. Rubber and oil palm are the most prominent examples under business partnership arrangements. In addition, there has been growing partnership arrangement between vegetable farmers and grocery stores including super markets to produce and supply high quality vegetables.

*Sixth*, government has developed auction market, particularly for export commodity such as rubber, palm oil and tea. The auction is expected to further

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<sup>16</sup> Hadi, P.U., S.H. Susilowati, E. Suryani and B. Santoso. 2000. Studi Pemasaran Komoditas Hortikultura Menunjang Gema Hortina 2003. Pusat Penelitian Sosial Ekonomi Pertanian. Bogor.

<sup>17</sup> Hadi, et al. 2000. *Ibid*.

<sup>18</sup> Hadi, et al. 2002. *Ibid*.



improve marketing efficiency which leads to higher price and farmers income . In the future, it is hoped that the auction market can be expanded to other commodities.

*Last*, the government continues to develop and disseminate price and market information to the farmers. This program is expected to reduce market imperfection and inefficiencies due to lack of information.

Any policies which enable reductions in marketing costs would contribute to the improvement of the comparative advantage of the commodities. Similarly, any policies which facilitate improvement of product quality would improve their competitive advantage. Higher comparative and competitive advantage of a commodity, of course, would improve competitiveness of the commodity in both domestic and international markets.

It is likely that decentralization has tended to promote local government to impose more taxes and retribution charge on marketed commodities in order to generate more local government revenues for self financing the local development. This tendency needs to be watched, however, because excessive taxes and retribution charge would increase marketing cost. The other possible unfavourable local government policy that needs to be observed is restriction on transferring agricultural commodities from one region to another. All these unpopular policies would not only oppose the trade liberalization agreements under WTO arrangements but also make marketing system inefficient, eventually weakening the competitiveness of Indonesia's agricultural commodities in both domestic and international markets.

## **CONCLUSION AND IMPLICATION**

1. Liberalizing trade is an important element in the overall policy of increasing international competitiveness. The important thing for each developing country is to be active in articulating its priorities in improving market access and WTO rules. For developing countries to benefit fully from a rules-based system requires market openings to be available in areas where they have an export potential and the capacity to supply. Studies on the experiences of developing countries have shown that those having actively participated in the multilateral trading system, and adopted outward-oriented trade policies based on low barriers to imports and exports, experienced the highest sustained rates of economic growth.
2. Decentralization is required to facilitate effective planning and implementation of national and regional development as the span of control by central government becomes narrower. It is worth noting, however, that excessive collection of tax and retribution as is being done by regional authority at various levels would be counter productive because it just makes

marketing of agricultural commodities larger than ever before. All regional development policies must be in line with national policy, efficient tracks and the spirit of trade liberalization.