Recent Developments of Indonesia-US Economic Relations

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INTRODUCTION

There are many factors affecting the economic relations between Indonesia and the United States of America. Recently two events took place that greatly influenced the economic development of both countries and which also affected their economic relations. The first event which had extensive consequences for the economic development of the US, and which very much affected US foreign economic relations, was the increasing deficits in the US current account during the last few years, and the emergence of the US as the biggest capital importing country at present. The swelling of the US current account deficit caused by substantial increases of imports as well as by the considerable increase of capital inflow into the country, had obviously an impact on the international flow of goods and capital. And had inevitably also an impact on the economy of Indonesia.

The second event which occurred in Indonesia, which had a great impact on the economic development of the country, and which also very much effected its foreign economic relations, was the increase of the income from oil in the 1970s, followed by the drop in the prices and income from oil in early 1983. As a consequence, important changes have taken place in the pattern and volume of imports as well as investments in Indonesia, the impact of which was also felt in other countries including the United States of America.

In the following exposé, the consequences of those two important events will be discussed, particularly as it affected the economic relations between In-

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donesia and the US. The emphasis will be put on trade relations. Apart from that, the impact on the flow of capital and investment between the two countries will be briefly mentioned. At the end of this essay, the impact of the policies adopted, by the Government of the US in coping with the demand for protection coming from domestic industries, and by the Indonesian Government in overcoming the disequilibrium of its balance of payments, will be discussed.

DEFICIT IN THE CURRENT ACCOUNT OF THE US

The deficit in the current account of the US, which has been increasing for the last several years caused by the jump of imports into the country, has been exploited by Indonesia and by other countries by selling more goods to that country. Indonesia has managed to increase considerably its exports to the US market, and in fact the recovery of the Indonesian economy after undergoing a recession in 1982, was mainly caused by the increase in its exports to other countries. According to IMF estimates, while the domestic demand in Indonesia increased by 6 per cent in 1982, foreign demand dropped by 14.6 per cent so that the GDP on the whole declined by 0.4 per cent during that year. However, in 1983 exports of goods and services rose by 7.1 per cent and they even rose by 15.4 per cent in 1984. The strong demand from abroad stimulated the growth of GDP by 5.1 per cent in 1983 and by 6.7 per cent in 1984. From those figures it was evident that the recovery of Indonesia during 1983/1984 was export-led and one of the strongest export markets was the US during that period.

The export of non-oil/gas products to the US in 1984 increased considerably, namely by 39.2 per cent while exports to the other main markets, namely Japan, increased only by 6.2 per cent and to Singapore by 4.7 per cent (data from Central Bureau of Statistics). The significant increase of non-oil/gas export has changed the position of the main markets for Indonesian non-oil/gas products. Before 1984, the main market for Indonesia's non-oil/gas exports was Singapore, the second was Japan and was then followed by the US as the third one. In 1984 the position was reversed, the US took the first place, Singapore second and Japan third. It was therefore obvious that the change in the current account of the US had a great impact on the direction of Indonesia's foreign trade.

The change in the balance of payments of the US had another impact, namely that since the deficit of the US current account was accompanied by an increase in the exchange rate of the US dollar vis-a-vis other foreign currencies, a shift took place during that period in the direction of Indonesia's exports; many products normally exported to Europe and other countries were diverted to the market of the US. One of the consequences, which may in the longer run be harmful, is that many old customers in Europe who normally imported goods from Indonesia, such as for instance the buyers of garments, plywood or coffee, had difficulties in obtaining goods from Indonesia as Indonesian exporters were more interested in selling their goods to the US as a consequence of the stronger dollar. The loss of regular customers could become a problem if the exchange rate of the dollar later returns to its initial level, because it would not be easy for the Indonesian exporters to regain their old customers, once they switched over their purchases to other suppliers.

Another consequence of the flood of imported goods into the US was the increased pressure from domestic industries to acquire protection in the form of import restrictions. A most significant example is the import of textiles and garments. Since 1982 Indonesia has already felt the impact of this tendency, when export quotas were imposed on several categories of Indonesian garments. Since then, the restrictions have widened, and since 30th June 1985, 34 categories of textiles and garments have been subjected to quotas in the US.

Recently the Indonesian public was alarmed by a draft bill in the US Congress known as the Jenkins and Thurmond bill. Although the Jenkins-Thurmond bill has not yet been adopted as law, its impact has already been felt. As the bill will very much restrict the flow of Indonesia's textile exports into the US, it created a great deal of uncertainty, causing reluctance of some US buyers to conclude long term contracts for the purchase of Indonesian textiles, awaiting further decision on the bill. This is the reason why the bill is considered very disturbing by Indonesian exporters.

On the other hand, the US Government considered that the extent of protective measures adopted by the US Government is somewhat exaggerated in the Indonesian Press, because as a matter of fact Indonesia's exports to the US, including textiles and garments, have continued to increase quite rapidly in the last few years. However, the Jenkins-Thurmond bill has indeed attracted the attention of a wide circle of the business community in Indonesia, as well as in other countries due to the target of the restriction being aimed at certain countries in Asia (11 of the 12 target countries of the bill are Asian countries). Therefore, the bill is considered very discriminatory to the textile exporting countries in Asia. With such discrimination, it is felt that the US Congress has ignored one of the basic principles of the GATT, namely the principle of non-discrimination.

A similar case occured earlier, namely in the countervailing duties proceeding which was launched by the US textile industry last year. The industry in the US at that time submitted a petition to impose countervailing duties on the import of textiles, mainly from the textile exporting countries in Asia. This has raised the feeling that Asian countries were made the victims of trade restrictions so that the countervailing measures were regarded as very discriminatory.

It can be added here that the CVD measure as well as the Jenkins-Thurmond bill which are strongly opposed by Indonesia and by other Asian countries have also reduced the credibility of the US in the eyes of the general public, particularly with respect to US efforts to start a New Round of Multilateral Trade Negotiations in the framework of the GATT, intended to maintain a free and non-discriminatory trade system. The attempts to reduce the possibility of access of export products from certain Asian countries will certainly reduce the confidence of Asian countries in the sincerity of the US in its efforts to maintain the present system of multilateral trade as contained in the GATT provisions.

INCREASE AND DECREASE OF INCOME FROM OIL IN INDONESIA

In the meantime, in Indonesia developments have also taken place that affected the economic activities in this country, which also affected its foreign economic relations including the relationship with the US. The most important event was the steep increase in revenues derived from oil in 1973/1974 and once again in 1979/1980. One of the consequences of the increased income from oil was that development efforts accelerated during the 1970s and the import of capital goods and industrial raw materials have increased considerably.

For example, in the fiscal year of 1979 the import of non-oil/gas products into Indonesia increased by 13.3 per cent, in the fiscal year of 1980 it jumped by 42.7 per cent, in the fiscal year of 1981, although the world was already hit by the recession, Indonesia's imports still rose by 20.6 per cent and even in fiscal year 1982, when the recession reached its worst phase, Indonesia's imports still rose by 14.9 per cent. In that year the import value of Indonesia was around US$18 billion, including the import of oil to the amount of approximately US$4 billion. Thus, during the period of about 10 years since 1973/1974, Indonesia became one of the important importing countries in the world, absorbing many goods and services from other countries, mainly from the developed countries, including capital goods and industrial raw materials originating from the United States of America.

It should be noted that although the income from oil rose in the 1970s, the Indonesian Government continued its policy of attracting loan capital as well as investment capital from abroad, particularly soft loans through the IGGI and the World Bank as well as the Asian Development Bank. This policy was intentionally adopted by the Indonesian Government and it appeared later that the policy was regarded as being farsighted as it was justified by subsequent developments. When the income from oil dropped in 1983, Indonesia was able to soften its consequences, because Indonesia could still attract loans with soft terms from creditor countries. Nevertheless, Indonesia could not prevent that an increasing proportion of its loans had to be sought in the private capital market with normal commercial conditions. While in the fiscal year 1980, 50 per cent of Indonesia's foreign loans was in the form of soft loans, in fiscal year 1984 the situation was quite different, namely that only 32.3 per cent of the total loans in that year constituted concessional loans, the remaining were loans with semi-concessional terms, and even part thereof were loans with normal commercial terms.

As stated above, due to the increased income of oil together with the constant inflow of foreign capital, during the 1970s Indonesia was able to further increase its import of capital goods as well as raw materials in order to promote investments in various development projects beside adding to its foreign exchange reserves which was steadily growing. The situation started to change since the fiscal year of 1981, due to a deficit in the overall balance of payments occurring in that year. A similar situation occurred in the fiscal year of 1982, which was the worst year for Indonesia. In that year a capital outflow to the amount of US$3.3 billion took place. The current account showed a very big deficit, namely of US$6.8 billion, or around 7.6 per cent of the GDP.

A deficit of that magnitude cannot last for long. In normal circumstances, the deficit in the current account of Indonesia is around 3 per cent of the GDP. Therefore, the Indonesian Government took several measures to restore its external equilibrium. The adjustment measures were mainly taken in the form of reducing imports through the devaluation of the rupiah in early 1983 and the rescheduling of several big projects most of which were import intensive. As a consequence, for the first time after more than ten years, Indonesia's imports declined in fiscal year 1983 by 17.3 per cent and declined again in 1984 by around 6 per cent.

The drop of Indonesia's imports was naturally felt by its trading partners, mainly by the main exporting countries in Asia like Japan, Hong Kong and Taiwan, but also by its trade partners in Europe. Interesting to note was the fact that in 1983 and 1984 imports from the US was still increasing, namely by 4.8 per cent in 1983 and by 1.3 per cent in 1984, although imports from other countries showed a decline. Imports from Japan for example, dropped by 12.8 per cent in 1983 and dropped again in 1984 by the same percentage, namely 12.8 per cent.

INFLOW OF CAPITAL

Those are the shifts that took place in the pattern of trade between Indonesia and the United States of America as a consequence of the important events which took place in both countries during the last few years. Beside the impact in the field of trade, the domestic development of US as well as that of Indonesia had also an impact in other fields, such as the flow of capital in both countries. As has been mentioned above, in the last few years the United States which was usually a capital exporting country, became a big capital importing country. The impact thereof was felt by other countries, particularly other capital importing countries like Indonesia. These countries are facing competition from the US in attracting funds from the international capital market. So far Indonesia has managed to keep importing capital with concessional terms, a.o. through the IGGI forum. One capital exporting country which has become more and more important for Indonesia is Japan, which is not surprising and which has at present the biggest surplus of domestic savings. Aside from official capital, Indonesia also continued to obtain private capital, either in the form of loans or direct foreign investment. Here the situation was not so easy, because the flow of private foreign investment has greatly diminished since the recession and since much capital was flowing to the US. The Indonesian Government had to make extra efforts in order to continue attracting investment from outside, if it desires to maintain the flow of foreign investment as in the years before the recession.

The attractive market for foreign capital in the US may have affected also the flow of Indonesian private capital. It is commonly believed that part of the capital owned by Indonesian nationals flowed to the US, to be invested there, either in the form of shares and securities or invested in industrial business and real estate. All these mean that Indonesia was not exempted from the impact of the emergence of the US as a capital importing country and had to work harder in order to obtain a part of the international capital flow for the financing of its national development.

INTEREST RATE

Meanwhile the high level of interest rate prevailing in the US have unavoidably also an impact on Indonesia. Among other things, Indonesia's debt burden became heavier, although Indonesia had so far also managed to maintain its burden of debt within tolerable limits. However, it could not be prevented that in the last years the Indonesian debt burden has increased. While in the fiscal year of 1980 the debt-service ratio with respect to net exports was 10.6 per cent, the ratio reached 22 per cent in fiscal year of 1984. This means that Indonesia has already reached the limit where it could no longer increase its debt burden without jeopardising its external position.

Another aspect of the high level of interest rate in the US was that also in Indonesia the interest rate of banks increased, the more so since Indonesia is adhering to a free foreign exchange system, so that one cannot expect interest rates in Indonesia to decline when the rates in other countries are still high. In early 1985 for example, the interest rate of private bank loans varied around 21-32 per cent. With such high rates, private investment would certainly be depressed. This means that as long as the interest rate abroad is still high, Indonesia still has to cope with the problem of how to stimulate private investments at home.

It was evident in general that the recent developments that took place in the US were partly beneficial to Indonesia, as for example with regard to the improvement of the export market for Indonesia in that country, but on the other hand there were also less advantageous effects, such like the difficulty to attract private capital to Indonesia and concerning the debt burden which became heavier as a consequence of the high interest rate in the US.

GOVERNMENT POLICY IN THE COMING FEW YEARS

What will we be facing in the coming years? The US Government under President Reagan seems to work hard to resist the pressure coming from domestic industries to expand protection. However, at the same time the Reagan administration is pressuring its trade partners to widen their markets for US exports. The main target is Japan, but also Europe which is known to be giving many subsidies to its agricultural products. But in addition, also the developing countries, mainly those with medium income in Asia, will be subjected to pressure from the US to open up their respective markets.

In its policy statement (23rd September 1985), the US Government urged other countries to join in maintaining the international trade system which is "open, free and fair." In the same statement, it was also stated that the open and free trade system in the US has resulted in a growth rate of the economy which is much better than other countries which are more protectionistic. The appeal of the US that other countries also open up their markets could be understood if it is based on the consideration that in this way the volume of international trade will expand and will benefit all countries. However, if other countries do not or not adequately open their markets, it is still doubtful whether the US will maintain its open trade policy, although its Government has so far stated that this policy has been beneficial to the US economy.

The impression that one gets from the US statement is that, if other countries do not reduce their protection, the US Government will also expand its protection. Therefore, there is a kind of inconsistency in the US position. On the one hand the US Government is convinced that the policy adhered to so far was the right policy, but on the other, it seems that there is an intention to change the policy if other countries fail to follow.

In the effort pressuring other countries to open up their respective markets, the US Trade Representative office has drawn up a report on trade restrictions prevailing in other countries, including Indonesia. The US will request those trade restrictions to be reduced or eliminated. With regard to Indonesia for example, the report stated that trade obstacles which are applied by the Indonesian Government will be requested to be reduced, like for example the restriction on import of fresh fruits and aircraft, but it also includes the import restriction of sugar confectionary (the import value from USA in 1984 was US$183,000), chocolate confectionary (US$46,000) and almonds (US$51,000).

Thus in the next few years, it can be expected that the pressure from the US on other countries to open up their respective markets and to further apply fair trade will be greater. The question that now arises is what is meant by fair trade. One can understand if fair trade includes matters like export subsidies or import restrictions which are discriminatory. However, the developing countries cannot understand if the export of textiles or garments from developing countries is considered unfair because in these countries the level of wages is far lower than that in the United States. Surely, the difference in factor endowments in each country and the difference in price of factors of production are exactly the basis for the existence of international trade.

The influence of the US in the future will also be felt through international institutions like for instance the International Monetary Fund and the World Bank. Through the IMF for instance, the US Government will insist that the requirement for obtaining assistance from that agency would be that developing countries should adopt more free trade policies. This will mainly be felt by those countries which are facing a debt crisis and which are urgently in need of assistance from the IMF. But Indonesia, although it is not confronted by a crisis of foreign debt, would also feel similar pressures through this international agency. The same applies to the World Bank. The developing countries which require substantial assistance from the World Bank would feel the pressure to give a wider role to the private sector in their economic development. The developing countries which require assistance from the World Bank will be advised to make wider use of the market in their economic policies and to reduce Government intervention in the economy. Such pressures will certainly also be felt by other international institutions, like for instance the Asian Development Bank and other regional development banks where the United States have considerable influence.

How will things develop in Indonesia in the near future? One of the effects of the 1982 recession is the mounting demand of the domestic industry to expand protection. The increased demand for protection was caused in the first place by a drop in the market demand, both in the domestic market and in the export market. and by the weak competitive power of the domestic industry. Secondly, the demand emerged because of anxiety about dumping of goods from abroad which may disrupt the market. Besides, at the time the prevailing import duties were regarded as not effective, so that the domestic industry was often confronted with unfair competition from imported goods. In a situation like that, protection to the domestic industry became wider and many non-tariff measures were introduced, particularly in the form of import licensing and quota system. In general, when a quota was determined to restrict imports, it was meant that the measure was of a temporary nature (two years), but recently more requests have come from domestic industries to defer the elimination of those quantitative restrictions.

Therefore, Indonesia now finds itself at a crossroad, facing a choice of whether to continue with its present protective import policy or to gradually return to a more competitive trade system. It would be difficult to predict which way the Government will finally decide, but according to the present author's observation, most opinions in Indonesia at present are not in favour of Indonesia turning inward, staying away from international economic activities, isolating itself from the in and outflow of capital, goods and services from and to other countries. Public opinion seems to agree that Indonesia has to face up to the challenges that come from outside, by improving efficiency and strengthening the competitiveness of its domestic industries.

It is obvious that the problem is not an easy one. Among other things, restructuring of domestic industries is required in order to make them competitive. It is hoped that industrial restructuring in Indonesia will not be as difficult as in several other countries, because existing industries have not become rusted like in some other countries, so that it will relatively be easier to make structural changes. However, it is also certain that this process would require Government assistance. The Government has to assist the industries which are going to switch their activities to new areas or those industries which will renew their machineries and other equipment. It stands to reason that the process of industrial adjustment will take some time.

Therefore in the next few years Indonesia and the United States of America will be faced with complex and sensitive problems. One must be constantly alert in order to avoid collisions and start building a system of co-operation which will be of benefit to the long-run development of both countries.