World Agriculture & Trade

Dana Downie, Foreign Agricultural Service

Indonesia's Financial Crisis: Implications for Agriculture

After years of rapid growth, poverty reduction, and political stability, Indonesia slipped into a deep economic crisis in 1997-98. Triggered by a regional financial crisis that began in Thailand in July 1997, Indonesia's sudden economic collapse had several contributing factors, including a rapid increase of short-term, private debt and a weakly regulated banking system.

The economic chaos has cut U.S. agricultural exports to Indonesia by over half, from $639 million in January-September 1996 (before the crisis) to $312 million during the same period in 1998. By itself, Indonesia is not a large market for U.S. agricultural exports, which totaled $57.2 billion in calendar year 1997. However, it is one of several countries in Asia caught up in this regional crisis.

Indonesia and its ailing Southeast Asian neighbors, together with South Korea, accounted for 16 percent of the increase in U.S. agricultural exports from 1990 to 1996. During this period, annual growth of U.S. agricultural exports was 11 percent for this group of countries compared with 7.3 percent for the world.

Drought & Currency Devaluation Generate Social Unrest

Indonesia's economy was placed in a precarious financial position partly because of the borrowing practices of Indonesian companies. The World Bank estimates that from 1995 to the beginning of the regional crisis, private firms were saving 9-11 percent on the cost of loans by borrowing in foreign currencies without protection from currency devaluation. These firms assumed that the government's exchange rate controls would protect them from this risk.

But when it became too expensive for the government to defend the country's currency in August 1997, the *rupiah* began depreciating. The exchange rate spiraled out of control beginning in late 1997 as foreign investors panicked and started withdrawing their funds. At the same time, local firms with foreign borrowings began selling rupiah to purchase enough foreign currency to cover their principal and interest payments, furthering the rupiah's decline.

As the rupiah depreciated, the foreign debt of these local firms soared to levels far exceeding their debt repayment capacity. The country's banking sector froze, unwilling either to provide the short-term financing needed for operating capital or to open letters-of-credit for imports of raw materials and intermediate inputs some industries needed to operate. Businesses began shutting down and unemployment began rising.

The financial crisis hit when the country was being subjected to one of its worst droughts in 50 years. The El Niño-induced drought lowered production of food, including rice, the staple. Food shortages and the inflationary pressure from devaluation led to rapidly rising food prices. As prices for food and other necessities soared and unemployment increased, the buying power of large segments of the population eroded. Social unrest erupted in May 1998, ending the 32-year Suharto presidency. Given the depth of current economic and related problems, positive economic growth is unlikely to resume within the next 2-3 years.

All Categories of U.S. Ag Exports to Indonesia Are Sharply Below Pre-Crisis Levels

	1996	1998	Change 1996-98
	$ million		*Percent*
Cotton fiber and linters	203.4	116.8	-43
Soybeans	153.7	98.4	-36
Fruits, vegetables, and nuts	43.4	9.7	-78
Wheat and products	67.6	22.4	-67
Meat, poultry, and dairy products	52.8	13.0	-75
Corn	32.5	0.2	-99
Soybean meal	14.5	11.7	-19
Other	274.5	156.8	-43
Total	639.0	312.2	-51

January-September.

Economic Research Service, USDA

To deal with the financial crisis, the Government of Indonesia (GOI) and the International Monetary Fund (IMF) established a framework of reforms for an IMF loan to Indonesia in a series of agreements in late 1997 and early 1998. The reforms in the agreement directly affecting agriculture included eliminating the import monopoly of Indonesia's National Logistics Agency (BULOG) as well as subsidies for wheat, wheat flour, sugar, soybeans, and garlic. Other measures involved reducing import tariff rates on all food items to a maximum of 5 percent, deregulating trade in agricultural products across district and provincial boundaries within the country, and removing all formal and informal barriers to investment in palm oil plantations.

The consequences of the financial crisis and the drought for Indonesians have been uneven. Many farmers are benefiting from higher export demand for their produce with the devaluation of the country's currency, and farmers outside the drought areas are receiving higher prices for food crops. The urban poor are most affected by food shortages and high food prices.

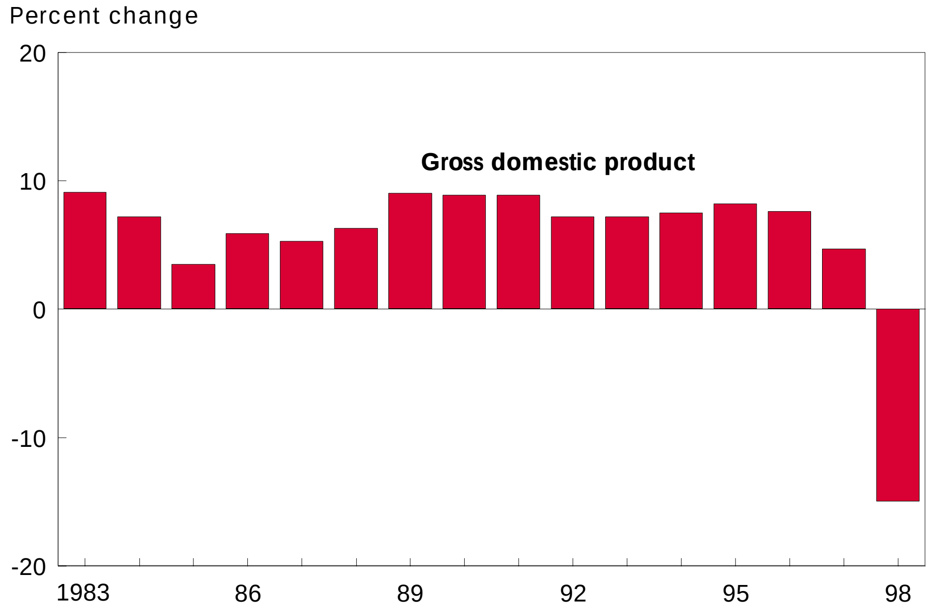
Among the U.S. exports affected by the Indonesian crisis, the largest dollar-value reductions are in cotton fiber and soybeans, the leading U.S. exports to Indonesia. Percentage value losses are greatest for U.S. exports of corn used in livestock feeding and for the higher-valued livestock and horticultural products.

Crisis Slows Textile Industry

Little cotton is grown in Indonesia because it is not able to produce competitively. However, the abundant availability of low-cost labor has been the basis for the rise of a large spinning and textile industry, turning out products for its domestic market and for export. Indonesia had become one of the world's largest importers of cotton fiber and has been a top-five importer of U.S. cotton in recent years.

Though Indonesia's textile exports have increased with its currency devaluation, overall textile production has decreased. With the onset of the financial crisis, domestic purchases of textile products dropped more than exports increased.

Indonesia's Economy Collapsed After Years of Fairly Steady Growth



Inflation-adjusted. 1998 forecast.
Economic Research Service, USDA

Weak Currency Values Have Plagued Indonesia in 1998

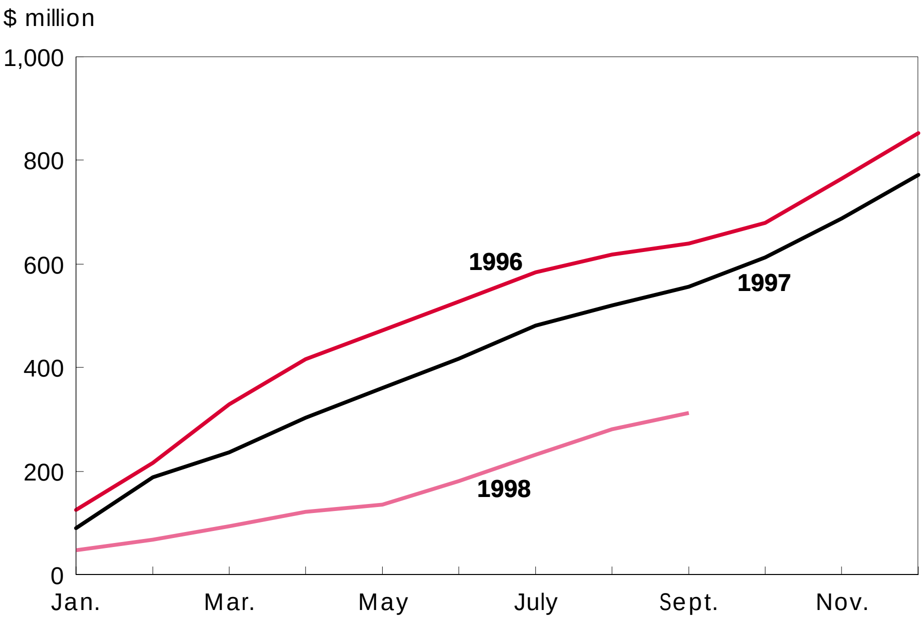
Source: Pacific Exchange Rate Service.
Economic Research Service, USDA

Several large and medium textile mills have offset the loss of domestic sales by increasing their exports from 60-70 percent of output to as much as 95 percent of output. Indonesia's key competitors in textile trade include Pakistan, India, the Philippines, and Malaysia.

The volume of Indonesia's cotton fiber imports have dropped significantly with the crisis. Many spinning mills have

World Agriculture & Trade

U.S. Agricultural Exports to Indonesia Are Down Substantially in 1998



Cumulative exports.
Economic Research Service, USDA

closed, unable to import cotton fiber due to the difficulty in opening letters-of-credit, the lack of short-term credit for operating capital, and the sharply devalued Indonesian currency which made imports far more expensive. In addition, production costs have been rising as the minimum wage was raised, interest rates increased, and the cost of water and electricity rose. Currently it is estimated that only 4-4.5 million spindles (for thread making) are in operation, down from a total of 6-7 million spindles installed.

With the worsening of the crisis in 1998, Indonesia has increased its use of USDA's GSM-102 program for financing cotton imports. Registrations for the first 10 months of fiscal year 1998 are approaching a record $35 million, up from the fiscal 1997 total of $13 million. However, Australia has become a more competitive cotton exporter to the Indonesian market compared with the U.S., with the 25-percent devaluation of the Australian dollar against the U.S. dollar since March 1997. The U.S. and Australia were the leading suppliers of cotton to Indonesia in the 1995/96 marketing year (beginning August) with shares of 36 percent and 21 percent. Australia replaced the U.S. as the number-one supplier in 1996/97 and will likely remain at the top in 1997/98.

Demand Drops for Soybeans, Wheat, & Feedstuffs

Soybeans are an important protein source for many lower income Indonesians and contribute 15 percent of the protein consumption in the country. The two principal soy foodstuffs are tempeh (fermented soybean cake made using whole soybeans) and tofu. These soybean products are a more affordable source of protein than livestock products. Domestically grown and imported soybeans are used only for food. Soybean meal required for livestock feeding is entirely imported. Soybean production is not well suited for Indonesia's climate.

As soybean prices rose and incomes fell with the onset of the crisis, a decline in soybean consumption by low-income consumers has been offset by middle-class consumers switching from livestock products to soybean-based protein sources. Nevertheless, Indonesia's total soybean imports have fallen. U.S. soybean exports to Indonesia are off 36 percent in January-September 1998 from the same period in 1996. With economic recovery, sales to Indonesia are expected to continue only at or slightly above current levels in the near term, given that establishing an efficient process for private sector imports will likely take some time.

In the longer term, imports should expand as consumption gains once again outpace production increases. Indonesia's recent liberalization of soybean imports as part of the IMF loan arrangement will encourage soybean trade. As a result of liberalization, a cooperative of soybean product producers—Indonesian Tahu and Tempeh Producers Cooperative—reportedly plans to start importing soybeans monthly beginning in January 1999 under USDA's GSM-102 export credit program.

Wheat consumption and imports will be sharply lower the next 3-5 years until consumer incomes recover. All wheat consumed in Indonesia is imported because the crop is not well suited to Indonesia's tropical climate.

In the past, BULOG controlled virtually all aspects of the importation, distribution, and pricing of wheat. Now that wheat imports have been liberalized, Indonesia will offer post-recovery opportunities for commercial sales of U.S. wheat in a market that has been dominated by Australia and Canada in the past. The largest usage of wheat flour (60 percent) is for making instant noodles. The baking industry takes an additional 30 percent of flour, and biscuit manufacturers use the remaining 10 percent. When Indonesia purchases U.S. wheat in the future, it will likely include soft white wheat for confectionery products and for noodles.

Soybean meal and *corn* usage plummeted with the collapse of Indonesia's poultry production, which consumed more than 90 percent of the country's manufactured feed before the crisis and was the largest and fastest growing Indonesian livestock sector. Poultry producers faced a profit squeeze due to reduced consumer demand from the economic slowdown and escalating feed costs following the currency devaluation. The crisis also sharply reduced the availability of short-term credit for poultry producers, and the poultry industry may decline even further in 1999 if economic conditions remain unchanged or worsen.

From 1985 to 1997, broiler output had been expanding at an annual rate of 13.6 percent. Broiler production is now only 30-40 percent of the pre-crisis level of 13-14 million birds per week. Egg production is also just 30-40 percent of the pre-crisis level (1,800-2,000 tons per day).

Indonesian soybean meal imports declined to 430,000 metric tons in marketing year 1996/97 (beginning October) from a year-earlier level of more than 1.1 million metric tons. India has been the predominant supplier of soybean meal to Indonesia, followed by Brazil. U.S. corn exports to Indonesia have essentially evaporated, declining from $32.5 million in January-September 1996 to less than $200,000 in 1998.

Prior to the crisis, the poultry industry's rapidly increasing feed requirements for corn had started to outpace domestic corn production, and corn imports had begun to rise. But with the onset of the crisis, Indonesian corn importers began exporting corn to Malaysia and Thailand. Corn imports are expected to resume only when the poultry industry begins to recover.

It may take 4-6 years before the Indonesian poultry industry returns to its former scale. The pace of recovery will be determined by recovery of the country's economy, reform of its financial systems, and growth in consumer income.

Drought Hurts Rice & Palm Oil Production

Near self-sufficiency in *rice* has long been a strategic objective of Indonesian agricultural policy. However, BULOG generally purchases rice in international markets to offset production shortfalls. To offset crop losses due to the El Niño-related drought, Indonesia is expected to import a record 5.7 million tons of rice in calendar year 1998, almost one-fourth of total world rice trade and the largest amount of rice ever imported by a single country. Thailand and Vietnam have supplied the bulk of Indonesia's imports, with China and Pakistan also selling significant quantities.

This year has demonstrated that even small production shortfalls (less than 5 percent in 1997/98) in a country that is a major consumer of rice can lead to substantial imports relative to the world rice market. Rice production in 1998/99 is expected to rebound with the ending of the drought, so imports will likely drop back to previous levels.

Future rice policy is still uncertain as IMF and the Government of Indonesia continue discussions. Apparently, BULOG will continue to stabilize domestic rice prices with imports and procurement/distribution of domestic rice.

The drought also reduced *palm oil* production in Indonesia, and in neighboring Malaysia, the world's two largest exporters of palm oil. Now that the drought is over, palm oil production should begin recovering with the next crop production cycle which begins in March 1999.

As the crisis deepened in early 1998, the price of cooking oil rose very rapidly. The GOI tried various restrictions on palm oil exports in an effort to limit domestic cooking oil price increases. More recently, the GOI substituted export taxes for the export restrictions on crude palm oil and on some of its byproducts to as high as 60 percent, to encourage producers to direct more products toward the domestic market.

These efforts by the GOI to curtail exports, combined with the general financial uncertainty for the near term, may have limited the expansion of the palm oil sector this year. The Indonesian Palm Oil Producers Association reports that planting of new seedlings has fallen to about 75 percent of the normal annual level. The impact of this slowdown in plantings will not be immediate because palm trees do not begin oil production for 5-6 years.

The financial crisis that swept through the Southeast Asia region has affected Indonesia more than its neighbors. The slowdown in U.S. agricultural exports to Indonesia has been uneven across commodities. U.S. exports to Indonesia are expected to resume growing when the economy turns around, but the growth will likely be slower than in the recent past.

Gary Vocke (202) 694-5241
gvocke@econ.ag.gov **AO**

Easing the Impact on Indonesia's Poor

Since Indonesia's economic and weather problems began in 1997, the number of people in poverty has increased sharply. To assist the growing number of poor, the Government of Indonesia has expanded a targeted program through the National Logistics Agency (BULOG) that provides 10 kg of subsidized rice per month to poor and near-poor households. (The Food and Agriculture Organization of the UN estimates that the country's population of 203 million consumes an average of 149 kg of rice per person annually, compared with 24 kg of corn and 19 kg of wheat.) This subsidized rice program is now reaching several million households. The government has also set up food-for-work projects in drought-stricken areas.

The U.S. government is also providing food assistance to Indonesia during this crisis with a $52-million package under the P.L. 480 Title II program. The grant includes 73,482 tons of rice, 314 tons of corn-soybean blend, and 11,040 tons of wheat-soybean blend for arrival from August through December. An additional donation of wheat under the Section 416(b) program totaling 500,000 metric tons is being prepared for delivery over the next several months.