# THE DYNAMIC DEVELOPMENT OF ASIA-PACIFIC ECONOMIC COOPERATION (APEC):

## THE CASE OF INDONESIAN TRADE AND INVESTMENT

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# THE DYNAMIC DEVELOPMENT OF ASIA-PACIFIC ECONOMIC COOPERATION (APEC):
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A thesis presented by

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## ABSTRACT

The aim of this thesis is to study the dynamic growth of the Pacific Rim particularly in the context of the establishment of the Asia Pacific Economic Cooperation Forum (APEC). The development of APEC commenced in Canberra with one goal-to secure trade and investment liberalization. After the 1994 Bogor Declaration in Indonesia, there has been an extension and acceleration of this objective with moves to the creation of a free trade area.

This thesis uses the Ashfaq Ahmad et al formulation to study the relationship of Indonesian trade and investment to economic growth. In this analysis, the study explores some potentialities and problems of Indonesia's trade and investment data. Since the early reform measures with the relaxation of some economic regulations in 1966, the economy has now entered a phase of extensive deregulation.

This thesis discusses ASEAN perspectives of APEC, indicating the different nuances appearing among ASEAN members, especially Malaysia with its EACC proposal. Moreover, it also confirms that APEC members benefit from intra-trade and investment, especially the Industrializing country members. The study also concentrates on the Indonesian perspective of APEC and illustrates the concerns that Indonesia has in respect of maintaining trade and investment growth in the context of a more formalized APEC.

The thesis confirms the transformation of Indonesia from a poor nation of the 1960's to become one of the NIE's of the present day. However, it reveals

that notwithstanding the economic growth that has occurred, the benefits have not been evenly spread throughout regions and sectors of the economy.

Halifax, June 1997

Arief Fadillah

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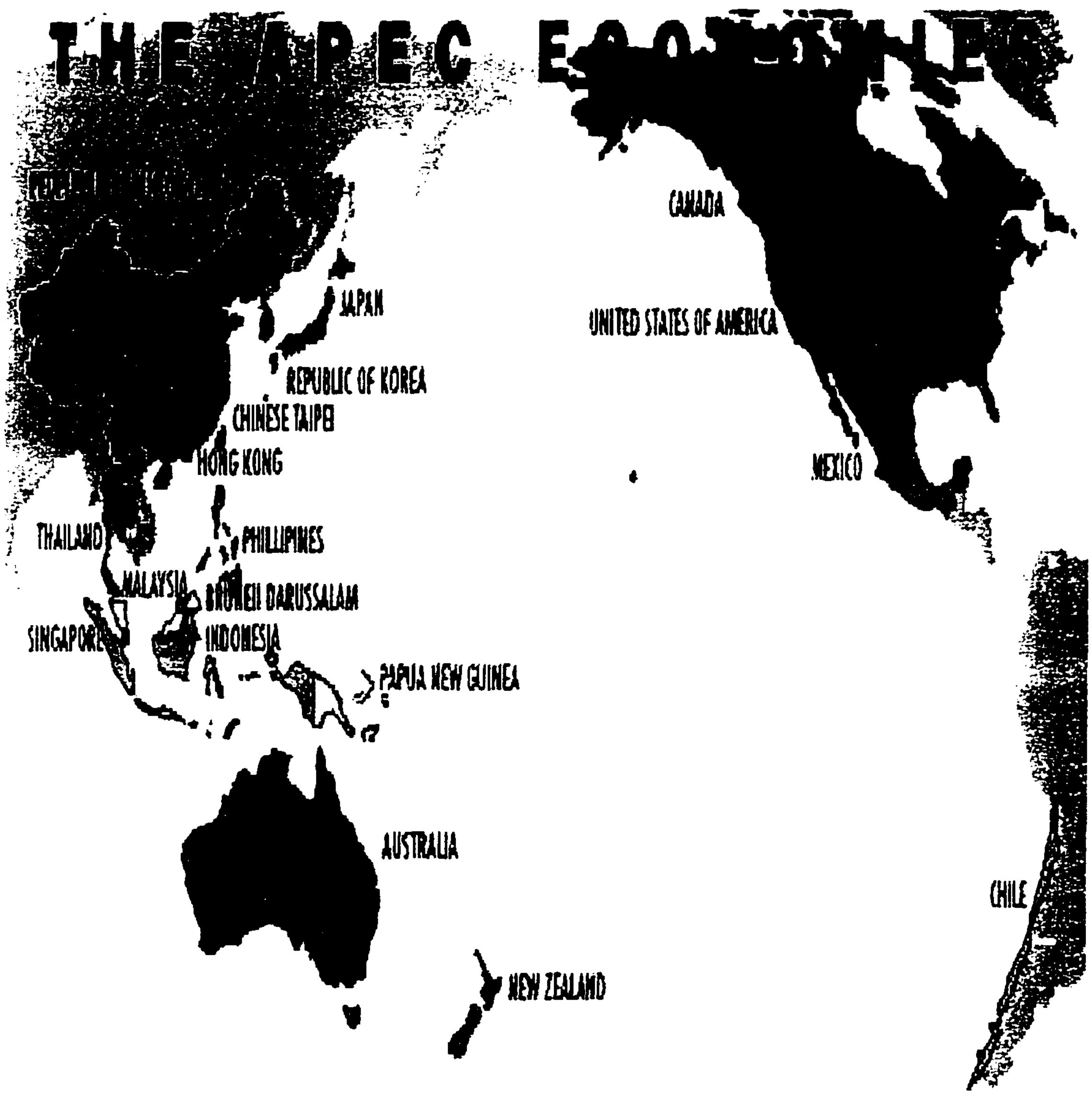
## LIST OF ABBREVIATIONS

| | |
|---|---|
| AFTA | Asean Free Trade Area |
| AMMs | Asean Ministerial Meetings |
| APEC | Asia-Pacific Economic Cooperation |
| ASEAN | South East Asian Nations |
| BPS | *Biro Pusat Statistik* (Central Bureau of Statistics) |
| CEPT | Commonly Effective Preferential Tariff |
| COR | Capital Output Ratio |
| EALM | Economic APEC Leaders Meeting |
| EU | European Union |
| FDI | Foreign Direct Investment |
| GATT | General Agreement on Tariff and Trade |
| GDP | Gross Domestic Product |
| ICOR | Incremental Capital Output Ratio |
| IDT | *Inpres Desa Tertinggal* (Presidential Instruction Program for Less-Developed Villages) |
| IMF | International Monetary Fund |
| IPTN | *Industri Pesawat Terbang Nusantara* (National Aircraft Industry) |
| MNCs | Multinational Corporations |
| MPR | *Majelis Permusyawaratan Rakyat* (People's Consultative Assembly) |
| NAFTA | North America Free Trade Area |
| NICs | Newly Industrializing Countries |

| | |
|---|---|
| NIEs | Newly Industrializing Economies |
| PAFTA | Pacific Free Trade Area |
| PBEC | Pacific Basin Economic Council |
| PEC | Pacific Economic Cooperation |
| PECC | Pacific Economic Cooperation Council |
| Pelita | *Pembangunan Lima Tahun* (Five-Year Development) |
| PMA | *Penanaman Modal Asing* (Foreign Investment Law) |
| PMDN | *Penanaman Modal Dalam Negeri* (Domestic Investment Law) |
| PTA | Preferential Trading Arragement |
| PUSDATA | *Pusat Data* (Centra Data of The Ministry Of Industrial and Trade) |
| Rp. | *Rupiah* (the Indonesian currency) |
| Supersemar | *Surat Perintah Sebelas Maret* (Executive Order of March Eleventh) |
| TNCs | Transnational Corporations |
| UNCTAD | United Nation Conference on Tade and Development |
| WTO | World Trade Organization |


THE APEC
CANADA
JAPAN
UNITED STATES OF AMERICA
REPUBLIC OF KOREA
CHINESE TAIPEI
HONG KONG
MEXICO
THAILAND
PHILLIPINES
MALAYSIA
BRUNEI DARUSSALAM
SINGAPORE
INDONESIA
PAPUA NEW GUINEA
AUSTRALIA
CHILE
NEW ZEALAND

# CHAPTER 1

# INTRODUCTION

In this chapter we provide a background study to guide the emergence of regionalism in some parts of world. In this respect the discussion concentrates on the Asia-Pacific Economic Cooperation Forum (APEC). We then put forward the research question posed, the thesis statement and thesis structure. We also provide an overview of the remaining chapters of the thesis.

## 1.1 BACKGROUND

In recent years, regionalism in many areas of the world has undertaken different forms such as sectoral cooperation, free trade associations, customs unions, and common markets. These examples of regional economic cooperation have occurred in order to increase trade and enhance member countries' economic competitiveness in the developing international system. To be specific, the Association of Southeast Asian Nations (ASEAN)[1] in the 1960s, the European Union in the late 1980s, and NAFTA (North America Free Trade Area)[2] in 1994 are examples of regionalism. The need for regionalism seems to be an increasing trend and the development of APEC is one of the important

---

[1] Initially ASEAN members consisted of the neighboring in Southeast Asian countries of Indonesia, Singapore, Malaysia, Thailand, Philippines, and then Brunei (ASEAN-6). Recently, in 1995, Vietnam joined and other countries such as Laos, Myanmar, and Cambodia may join in the future, so by 2000 the ASEAN could consist of ten members covering all of Southeast Asia.

[2] The members of NAFTA include the United States of America, Canada and Mexico and will spread to other Latin American states such as Chile, for which Canada and Chile signed a bilateral agreement in the Fall of 1996.

initiatives for the Asia Pacific region.

The formation of the Asia-Pacific Economic Cooperation Forum (APEC)[3] did not occur until 1989 because of beliefs among economists, politicians, businessmen, policy-makers, and others that it would be difficult to form such an intergovernmental cooperation. For example, Peter Drysdale[4], cautioned in *International Economic Pluralism* (1988)[5] that due to the diversity of political and economic structures, religions, and cultures in the region, among other things, it would be difficult to form an Asia-Pacific economic cooperation organization. This view was shared by many other economists. However, increased market integration has occurred in the Asia-Pacific region since the 1970s, and despite the economists' predictions the APEC agreement has reinforced the trends of greater intra-trade of goods and services and capital flows.

As we indicated earlier, regionalism can take various forms and we can, for example, contrast APEC and the European Union (EU). Kim, Choate and Evans[6] point to differences in the degree of involvement by governments in the establishment of the cooperation. In the EU, governments have led the process as is evidenced by the Treaty of Rome in 1957. The private sector has followed these initiatives to create a large and integrated market within Europe. In

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3 The members of APEC include ASEAN-6, Japan, the Republic of Korea, the People's Republic of China, Taiwan, Hongkong, Australia, New Zealand, Papua New Guinea, NAFTA, and Chile.

4 Juanjai Ajanant, The Evolution and the Next Phase of APEC, paper for the future of APEC Workshop, Toronto, May 15, 1996.

5 Drysdale, Peter. International Economic Pluralism, Columbia University Press, New York, 1988

6 Bundy, Barbara K. Burns, Stephen D. and Weichel, Kimberly V. The Future of the Pacific Rim, p.7, Praeger Publisher, USA, 1994.

contradistinction, the APEC integration has been market driven, not government driven. In APEC, the market has been an important focus for creating cooperation among the member states, whereas the governments have been very reluctant to institutionalize or fully support the movement. Kim, Choate and Evans[7] believe that there is a significant role for government involvement in the future of APEC. Another difference between APEC and EU is that although regionalism is believed to stimulate regional economies, there is a serious risk resulting from the regional protectionism of blocs within APEC such as in East Asian and South-east Asian countries.

Despite this caveat there are many factors that can lead to the success of APEC. The Asia-Pacific region is very populous; with more than two billion people living in APEC member economies, including the most populous country in the world, China. As a result there is great potential for economic development. APEC's dynamism however, lies in the further development of cross-border capital flows-both Foreign Direct Investment (FDI) and portfolio. The Newly Industrializing Economies Countries (NIEs) of ASEAN (Indonesia, Malaysia, and Thailand) have benefited from a significant inflow of FDI (from Japan and the USA) which combined with their internally generated capital has allowed them to achieve high growth rates. The economic development in the region can be described as follow the "flying geese pattern of five tigers". This can be described as Japan as the lead bird, followed by the East Asian NICs (The Republics of Korea and Singapore, Hong Kong and Taiwan), the Southeast

[7] Ibid. p. 7.

Asian NIEs and so on. Japan has been the pivot as a country with the most advanced levels of technological sophistication, which will be transferred via FDI, learned and/or imitated by the next wave of geese of other Asian countries. As the APEC membership comprises of the major world economies outside of Europe such as Japan, Australia, New Zealand, USA, and Canada then the potential for APEC to be a major economic force is present.

After several meetings, in November 1994 the leaders of APEC members made a step forward by designing a foundation of "Trade Liberalization and Investment." At this informal Economic APEC Leaders Meeting (EALM), they adopted the Leader Declarations of Common Resolves, otherwise known as the Bogor Declaration, by which they committed themselves to achieve free and open trade in the region by 2010, in the case of industrialized economies and 2020, in the case of developing economies. Since that time, there have been the commitments to accelerating the improvement and implementation of trade liberalization and investment the Asia-Pacific region.

## 1.2 RESEARCH QUESTION

There is no doubt that some countries of the Asia-Pacific region such as Indonesia, Malaysia, Thailand, and Australia, have achieved something remarkable in their rapid economic development in the 1980's. Growth rates have exceeded those achieved at the height of the industrial revolution in Britain, Europe and the USA. Recently, the focus has shifted to trade liberalization and investment. These have become major issues on many agendas, especially in the Asia-Pacific region. It is expected that trade liberalization will enhance trade among Asia-Pacific countries by eliminating trade and non-tariff barriers with adjustments in customs procedures and administrative guidance. It is hoped that trade liberalization will also further generate capital flows (both FDI and portfolio) within the Asia-Pacific region.

The research in this thesis will seek to illustrate that foreign direct investment (FDI) and trade have a positive and mutual reinforcing relationship for Indonesia. Therefore, the main research questions we are addressing are as follows:

a. What is the role of foreign direct investment and trade in APEC countries?
b. Why is APEC important for its members, especially for its ASEAN members and in particular Indonesia?
c. What is the correlation between foreign direct investment and trade in Indonesian development?
d. What does and will Indonesia gain from APEC?

## 1.3 THESIS STATEMENT

We will indicate in this thesis that foreign direct investment (FDI) has contributed to Indonesian economic development and Indonesia has received more FDI from APEC members than from other countries. According to Ashfaq Ahmad[8] (1996), investment and trade have positive correlations with the

[8] Ashfaq Ahmad, Someshwar Roo and Collen Barnes, Foreign Direct Investment and APEC Economic Integration, p.3, Working Paper Number 8, Industry Canada, February 1996.

economic development within APEC as a whole. Our purpose is to examine these issues for Indonesia.

Based on neo-classical and regional development theory, we will explain two critical points. First, that government intervention has led to growth in Indonesian trade and investment; and second, that the success of high-performing Asian economies (HPAEs), some of which are ASEAN members, could lead to an increase Indonesian trade and investment. We will argue that need for trade and investment policies to be framed so that they do not diverge from the GATT/WTO and APEC agreements. Meanwhile, although Indonesia has already achieved gains from trade and investment, the distribution of these gains is not distributed evenly across the country. Rather the gains have been concentrated in Java Island and among some elite groups. However, overall the number of people living below the poverty line is decreasing.

A second hypothesis relates to ASEAN and APEC. The main reason for the development and growth of these has been to achieve stability, security and "peace" which in turn encourage the member's economic development. On one hand, widening economic cooperation with its partners is ASEAN's first priority. On the other hand, ASEAN members need to maintain their intra-ASEAN trade in order to keep the regional market strong. Therefore, we hypothesize that although the ASEAN members will tend to keep APEC as a dialogue partner and not as an institution for economic cooperation, ASEAN should support APEC. They should work with its members in order to increase both North-South and trans-Pacific cooperation, and this will benefit ASEAN's economic development.

## 1.4 THESIS STRUCTURE

Chapter 2 reviews the literature on the neo-classical perspective on trade as an engine of growth in development theories will a coverage of the theory of Foreign Direct Investment (FDI) and regionalism theories. This chapter also includes a research design which is divided into two sections, namely methodology and research data collection.

Chapter 3 discusses the evolution of APEC and the differences in its members and dynamism that can bring. This Chapter studies the advantages and disadvantages of APEC, and the characteristics of the APEC region, especially in terms of population and economic indicators. The discussion contained in this chapter explains the importance of intra-APEC trade and investment.

Chapter 4 studies the ASEAN, focusing on its evolution and on its relationship with APEC. This chapter will also attempt to answer the question of why APEC is so important to ASEAN and Indonesia's foreign trade policy.

Having provided an understanding of APEC and ASEAN, in Chapter 5, we will provide an in depth analysis of Indonesian economic and in particular Indonesia's policies of trade and investment.

This serves as a backcloth to examine two issues in Chapter 6,

(i) What is the correlation between foreign direct investment and trade in Indonesian development?

(ii) What does Indonesia gain from APEC?

Chapter 7 contains a summary conclusion and suggestions for further analysis.

# CHAPTER 2

# LITERATURE REVIEW and RESEARCH DESIGN

The structure of this chapter is divided into two sub-sections: literature review (Section 2.1) and research design (Section 2.2). We review the neo-classical perspectives on trade as an engine of growth, investment theory on Foreign Direct Investment (FDI) and regionalism theory. This chapter also presents a research design in order to seek the important tools for studying investment and trade in APEC.

## 2.1 LITERATURE REVIEW

### 2.1a Trade from Neo-classical Perspectives

The basic principles of trade liberalization were designed by the classical and neo-classical economists, starting with Adam Smith[1], who argued that before a nation can be opened to international markets, foreign trade will postulate the existence of idle land and labour. The excess resources are used to produce a surplus of goods for export, and trade thereby "vents" a surplus productive capacity that would otherwise be unused.[2]

Meanwhile, David Ricardo[3] argued that international trade will be determined by the maximal utilization of production structures based on comparative advantage.

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[1] He wrote "An Inquiry into the Nature and Causes of the Wealth of Nations in 1776"

[2] As quoted in Meier, Gerald. M. Leading Issues in Economic Development, Oxford University Press, p.489, fourth edition, New York - Oxford, 1984.

[3] As quoted in Hunt, Diana. Economic Theories of Development: An analysis of competing paradigms, p. 302, Harvester Wheatsheaf, New York-London-Toronto-Sydney-Tokyo, 1989.

Theoretically, comparative advantage means allocating and utilizing resources better than others. Thus, in theory, one country would ultimately be better off by participating in foreign trade than by not participating in it. Furthermore, the theory of comparative advantage argues that trade is very important to a country's growth. To be specific, the Ricardian Model argues that countries mutually gain from trade if they concentrate on what they do best (the benefits of specialization), where they have a comparative advantage, and leave to other nations what they can produce with less efficiency. It states that the consequences of reducing trade barriers could result in an increased demand because the costs of production will be lowered. As a result, trade can be directly involved in the development of a nation as it is considered to be an engine of growth.

John Stuart Mill[4] identified direct and indirect advantages of comparative advantage. Direct advantages mean more efficient employment of the productive forces of the world. Indirect advantages mean that a small country could overcome the barriers of being a small country by widening the extent of the market, inducing innovations and increasing productivity through foreign trade. Since Ricardo and Mill were concerned with the idea of trade as an engine of growth, they therefore favored free trade.

Neo-classical economists, especially Eli Heckscher, and Bertil Ohlin, studied trade and industrialization policy[5], beginning with the approach that countries could mutually gain from trade if they specialized in the products in which they had the best

[4] Meier, Gerald. M (1984), Op. Cit. p. 459.
[5] As quoted in Krugman, Paul R. and Maurice Obstfeld. International Economic: Theory and Policy, p.257, Harper Collins College Publishers, New York, 1994.

factor endowment. To justify free international trade, they and other neo-classical economists argue that comparative advantage can be the best justification to free international trade. It provides a framework for economic development based on the idea that free international trade will gradually reduce the income gap between the rich and the poor countries. Free trade would widen both the market and possible consumption and investment choices. Trade would also decrease the unit cost of production. The argument here is that if production increases in the long-run, then with the theory of economies of scale there will be the tendency of unit cost to decrease if production increases.

The backbone of neo-classical theory is that if market and price distortions are permitted to exist this will lead to non-optimal resource allocation, and the consequence of this will be less efficiency and welfare. Therefore, neo-classical economists recommend that all market and price distortions should be removed. They recognized that economies might be affected from various types of international and domestic factors which are created by government policies or arise from within a country. Those factors could also distort the efficient functioning of the market system.

We can therefore pose the question, is government intervention necessary to remove or correct the distortions if distortions were immediately recognized? Based on different neo-classical theories, including laissez-faire theory, there are differences in the degree of acceptable government intervention in the economy. Some argue that government intervention to correct endogenous distortions is for the most part discouraged, because it is thought that it will likely exacerbate the situation.

On the other hand, other neo-classical welfare philosophists acknowledge that in some circumstances, government interference might be justified and they attempt to elaborate a set of guiding principles for ensuring effective intervention. We illustrate this in a set of guiding principles with special reference for underdeveloped countries.

Distortions will only be allowed in the international marketplace in countries possessing monopolistic power through tariff barriers. It is the assertion of optimum tariff theory that where a country has monopolistic power in the international market place, the market prices for its exports and imports will not relate to the country's marginal national revenue and marginal national cost of imports. Therefore, through appropriate export and import duties, a country can equalize the relative prices of goods for domestic consumers and producers with their relative cost opportunities in international trade. In short, neo-classical welfare theory offers guidance both on the suitable degree of government intervention to correct special distortions in the domestic realm and the design that the guidance should take, and if not optimal, then at least suitable, tariff structures and tariff reform programmes.[6]

Another distinctive welfare theory is infant industry protection. According to the infant industry argument, developing countries may have a potential comparative advantage in manufacturing, but new manufacturing industries in developing countries cannot initially compete with well established manufacturing in industrializing countries. Therefore the government intervention should give temporarily support for new industry, until the industry is strong enough to compete

[6] Hunt, Diana (1989). Op. Cit. p.302-305.

in international markets.[7] The infant industry argument is not so much an issue in foreign trade rather than for appropriate intervention in domestic trade or at home. The welfare theory argues that infant industry protection should be protected for maximum of 10-20 percent with a "learning" period of five to eight years.

In terms of East Asia's success, the High-Performing Asian Economies (HPAEs) have been more successful than other economies because they provided a stable macroeconomic environment and a reliable legal framework to promote domestic and international competition. They also focused on international trade and eliminated price controls and other distortion policies. As a result, low relative price distortions exist.[8] Certainly, development economists have been fascinated by the success of East Asian development. While we can point to the success of East Asia in terms of few price distortions, there is a paradox here. On the one hand there should be little state interference, yet on the other there has been State guidance.

### 2.1b Foreign Direct Investment (FDI)

In the emerging global economy, the large number of cross-border economic transactions has the potential to increase a nation's development if factors of production are mobile. Neo-classical economist Ricardo assumes that if labour is the only factor of production, comparative advantages can appear because of the differential labour productivity. In fact, labour is not the only factor which influences production. Other factors include a country's resources such as capital, natural endowment, technology, and land. Differences in a country's resources can drive

[7] Krugman (1994). Op. cit., p. 257.

[8] World Bank. The East Asian Miracle: economic growth and public policy, p.9, Washington: a World Bank Policy Research Report, 1993.

the foreign trade of nations as has been illustrated in the Heckscher - Ohlin Theory or factor-proportions theory. It emphasizes the interplay between the proportions in which different factors of production are available in different countries and the proportions in which they are used in producing different goods.[9] The determinants of comparative advantage lie in the difference of factor endowment of two states and in the ways in which the two commodities are produced, by either labour intensive or by capital intensive processes.

A surprising result arose from the testing of Heckscher-Ohlin theory - the "Leontief paradox", developed by Wassily Leontief in 1953. In this paradox, the United States would be expected to be an exporter of capital intensive goods and an importer of labour intensive goods. The Leontief paradox reversed this assumption. It demonstrated that the United States' exports were less capital intensive than its imports. Being produced with a lower ratio of capital to labour than its imports. Another significant result was that the United States' exports products were more skilled-labour intensive involving more scientists and engineers. This was a reflection of the fact that the United States is a high skilled country, with a comparative advantage in sophisticated products.

Another distinctive theory of investment is the Harrod-Dommar theory[10], which focuses on the "capital output ratio (COR)", which is simply a measure of the productivity of capital or investment. The COR could also refer to the relationship between a state's total stock of capital and its total national product. The assumption of this theory is that the output of any economic unit, from a small firm to a national

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[9] Krugman (1994). Op cit., p. 65.

[10] Malcolm Gillis, Dwight H. Perkins, Michael Roemer and Donald R. Snodgrass. Economic Development, second edition, p. 45, W.W Norton & Company, New York - London, 1987.

industry relies on the capital investment in that unit. This theory has been used in developing countries as a simple model to describe the relationship between growth and capital requirements.

Instead of using the Harrod-Dommar theory, economists often use the Incremental Capital Output Ratio (ICOR) to study growth based on the impact of additional capital to productivity. The assumption behind the ICOR is a single fixed number which is consistent with a production function that employs fixed proportions of capital and labour and constant returns to scale: if capital doubles, labour also doubles. Neo-classical economists, however, believe that instead of requiring fixed factor proportions, productivity could be achieved with varying combinations of labour and capital. For example, in a developing country with scarce capital, the government could try to induce manufacturers and farmers to employ more labour intensive modes of production, thereby, at the given amount of savings and investment, increasing both growth and employment.

International capital movement arises when the domestic savings of a country exceed its domestic investment (saving > investment), creating an export surplus which leads to investment abroad by the home country. On the other hand, when a country decides to pursue rapid economic growth, it sometimes cannot fulfill its investment needs from domestic investment. Domestic investment needs exceed domestic savings (investment > saving) and this situation necessitates capital borrowing from abroad. Furthermore, when a country has an inability to finance its imports through its export earnings, then capital borrowing is also needed (for example, the USA).

There are different ways of categorizing International capital movements. One method is to focus on the term of the flow; short to long term. Broadly speaking, short-term includes those assets with a maturity of less than one year; and long term, those with more than one year. Another method is to divide capital flows into portfolio and foreign direct investment (FDI). Such a division also encompasses the term division in that portfolio capital flows can be short-term eg money market and longer term eg capital market (bond, equities). FDI flows on the other hand are generally long-term.

FDI are international capital flows in which a firm in one country creates or expands a subsidiary in another. The distinctive features of FDI involves both a transfer of resources including often transfers of technology, management and marketing expertise and the acquisition of control.[11] The IMF defines foreign direct investment as

> "investment that is made to acquire a lasting interest in an enterprise operating in an economy other than that of investor, the investor's purpose being to have an effective voice in the management of the enterprise".[12]

Traditional economic theory has regarded the inflow of foreign investment to create export and import substitution industries as unambiguously beneficial for the host country. Foreign investment not only supplements domestic saving, but also encourages spin-offs in terms of the attraction of other investment and technology innovation. Arthur Lewis[13], an orthodox economist, argued that industries which are

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[11] *Krugman (1994). Op cit., p. 159.*

[12] Julius, DeAnne. "Direct Investment among Developed Countries: Lessons for the Developing World", IDS Bulletin, volume 22 number 2, p.15, the University of Sussex, England, April 1994.

[13] As quoted in Daniel, Philip. Foreign Investment Revisited, IDS Bulletin, volume 22 number 2, p. 2, the University of Sussex, England, April 1994.

based on foreign investment presume to increase the propensity to save, and stimulate new wants and aspirations by encouraging the import of hitherto unknown services and commodities. Neo-classical theory argues that, particularly in the success of developing countries where most governments deliberately steer their economies toward the patterns of incentives, the government of developing country should promote FDI and ensure FDI operations which will benefit its country.[14]

FDI can be classified in two ways, either based on the foreign investor or the host country[15]. FDI based on the foreign investor can take the following forms:

a. *Horizontal investment*, where the production line monopolistic or oligopolistic abroad is the same as at home. This type of FDI operates to exploit more advantages monopolistic and oligopolistic such as patents or differentiated products especially because the expansion at home would encroach upon antitrust law;
b. *Vertical investment*, based on the availability of a raw material resource and proximity to the consumer. This type of FDI operates to avoid risk, entry barriers to potential competitors, and eliminates oligopolistic uncertainty ;
c. *Conglomerate diversification,* based on the ownership, usually by acquisition and merger of a number of disparate activities often with no link between individual production or markets. In the past this has not accounted for a large share of FDI, but the trend is changing with increased cross-border acquisitions.

The forms of FDI based on the host country are:

a. Import-substituting FDI, involving production in the host country of products that have been previously imported. One of its consequences is that exports from the investing country to the host country will be affected, with a reduction in final products, but probably an increase in intermediate products and raw materials. This type of FDI is influenced by the size of the host market, transportation costs and tariffs;
b. Export-increasing FDI. The main reasons for investing in the host country include the seeking new resources for its inputs, for example raw materials and the production of intermediate goods, and the production of final goods;
c. Government-initiated investment. The foreign investor comes to a host country because the host government offers a number of concessions and privileges such as low taxes on export products for foreign investors. The host government

[14] Ibid, p. 2.

[15] Petrochilos, George A. Foreign Direct Investment and the Development Process, p. 17, Avebury- Gower Publishing Company Limited, England - Vermont, 1989.

offers the concessions in order to improve its balance of payments and create employment.

In studying FDI, one might further consider the theories of FDI[16] from the firm perspective which are divided into three approaches as follows:

a. Business Administration Approach;
This approach was developed to provide guidelines for the management of problems that firms experience because of their shift from domestic to multinational trade. Examples of such problems include foreign subsidies, foreign labour, arbitration of international conflicts, and foreign currency.
b. Industrial Organisation Approach;
This approach was based on the oligopolistic characteristics of corporations involved in FDI. Because they exhibit superiority in their sector for control in an imperfect market to maximize their gains, their investments and operations abroad will survive by strengthening and expanding their oligopolistic systems.
c. Product Cycle Approach;
This approach was developed up by Raymond Vernon[17] in 1966 and is known as Vernon's Product Cycle Theory. This theory is based on the combination of a three stage theory of innovation, growth and maturing of a new product with the research and development (R & D) factor theory.
The first stage of the theory is a new product or innovation technology stage where the product design is often changed because of an unfamiliar product for the market, the slow growth of sales and a price-inelastic demand for the product. R & D is an important factor at this stage in order to introduce the invention and to change the design thereafter.
The second stage is a growth stage. In this stage, the distinctive features of production are an increase in the sales of the product; the introduction of mass production and bulk sales methods; an increase of entries into the industry and intensifying competition among producers; and the beginning of price elastic product demand (sales become more responsive to price). The important functions inside the firm in this stage are the realization of economies of scale and managerial ability.
The third stage is the mature stage. When this stage is reached, the product becomes standardized and its production technologically stable.

We can recognize two important actors as vehicles for FDI: Transnational Corporations (TNCs) and Multinational Companies (MNCs). The difference between

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[16] Kojima , Kiyoshi. Direct Foreign Investment: a Japanese Model of Multinational Business Operations, p. 43, Praeger Publishers, New York, 1978.

[17] Vernon, Raymond. "International Investment and International Trade in Product Cycle", *Quarterly Journal of Economics*, Vol 80, p. 190-207, May 1966.

TNCs and MNCs is a technical distinction where the term TNCs refers to corporations that operate beyond international boundaries, while MNCs refers to the composition of the staff of the company[18].

Developing countries benefit from TNCs as they are suppliers of capital and significant stimulants to international trade, as well as providers of technology, skills and managerial knowledge. TNCs are significant traders of goods and services, and also serve an important conduit of international technology flows.

In the 1980s, the TNCs had already become significant in terms of the volume of world trade, as several large scale company operations continued to cross national boundaries and perform beyond the national legislation of one or two countries. United Nations Centre on Transnational Corporations (UNCTC) studies found that "the largest 600 industrial companies accounted for between one-fifth and one-fourth of the value-added in the production of goods in the world's market economies". The sales of the 56 largest TNCs range between $10 billion and $100 billion US $; larger than the GDP of several developing countries. However, UNCTC has estimated that most TNCs are medium-sized corporations having sales below US $1 billion, and employing a maximum of two or three thousand employees.[19]

Multinational Corporations (MNCs) are another actor in FDI. Richard R. Caves (1982)[20] used "enterprise" instead of "company" to direct attention to the top level of coordination in the hierarchy of business decision-making; the type of

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[18] Patel, Krishna Ahooja. "Transnational Corporations and the Impact of the Employment of Women", Working Paper no. 93.4, p.1, IDS-Saint Mary's University, May 1993.

[19] Ibid., p. 2.

[20] Caves, Richard E. "The Multinational Enterprise as an Economic Organization", p. 146. In The Multinational Enterprise as an Economic Organization by Richard E Caves, Cambridge University Press, 1982.

company itself is multinational, and may be the controlled subsidiary of another firm. Caves divided MNEs into three groups broadly based on the 3 part classifications developed earlier for the foreign investor. These were the horizontally integrated, vertically integrated, and diversified company. The first type of MNEs establish plants in different countries to produce the same or similar goods based on the geographic market. The second type of MNEs produce output in some of their plants that serve as input to other plants. The third type of MNEs are both vertically and horizontally integrated.

Recently, the United Nations Trade and Development Conference (UNCTAD) predicted that MNCs in 1996 will boost the economies of Third World countries by injecting capital, opening export markets and raising efficiency. UNCTAD states in the *United Nations Investment Report 1995* that multinational corporations will create five trillion dollars of wealth outside their home countries in 1996, and will invest heavily in poor nations. The report also argues that the global reach of companies such as Royal Dutch Shell, Exxon, IBM and General Motors is a major factor in particular for countries struggling to catch up. With cross-border capital flows expected to continue to expand to developing countries, the United Nations argues that international investment by multinationals has overtaken trade as the driving force behind the global economic integration.[21]

### 2.1c Regionalism Theory and Neo-Liberal Perspectives

[21] Iskandar, Bakri. United Nations Lauds Multinationals' Assistance to Third World, January 1996, Internet: Http://www.worldbank.org

In Chapter 1, the growth of international regionalism and its impact on the world economy were commented on in the 1980s in Western Europe, North America, Latin America, Africa, and Asia. However, the future effects of regionalism will also depend on the world economy, especially with trade liberalization and investment from the former General Agreement on Tariff and Trade (GATT) policies (now the World Trade Organization), especially those on Trade Relating to Investment Measurements (TRIMs). The maintenance of an open global trading framework is of the utmost importance to all nations. All countries have an interest in ensuring that regional trade arrangements are part of the global trend toward openness and trade liberalization, since global welfare will be increased more through non-discriminatory than discriminatory reductions in protectionism.[22]

Modern trade liberalization and investment internationally were discussed in 1944 at the Bretton Woods Conference, which established the institutional framework for the post-war economic order. Its purpose was to facilitate multilateral free trade and the adoption of liberal trade policies. Bretton Woods also formulated an institutional infrastructure of three international organizations:

- The International Monetary Fund (IMF), for macroeconomic policy;
- The World Bank[23], for helping developing countries;
- International Trade Organization (ITO), for trade.

Bretton Woods began with 50 countries drafting the ITO charter. The original

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[22] United Nations, Regional Trading Blocs: A Threat to the Multilateral Trading System: Views and Recommendations of the Committee for Development Planning, p.3, Department of International Economic and Social Affairs, United Nations, New York, 1990.

[23] In the beginning was the World Bank not intended more for the reconstruction of Europe, and only later did it become a "development" bank -hence the official name is International Bank for Reconstruction and Development (IBRD).

draft provided provisions on employment, international investment, services, and commodity agreements. Meanwhile, the USA suggested a need for a body for commercial policy, which subsequently become known as the General Agreement on Tariffs and Trade (GATT). The ITO did not materialized as the proposals contained in the Havana Chapter (March 1948) were rejected by the American congress.

As the only international institution for trade, GATT was mainly used for negotiating tariff reductions. Eight rounds of GATT negotiations have taken place: in Geneva (1947); in Annecy (1949); in Torquay (1951); in Geneva (1956); in Geneva again (1960-61), and known as the Dillion Round; once more in Geneva (1964-67), known as the Kennedy Round; in Tokyo (1973-79), known as the Tokyo Round; and in Uruguay (1986-1993), known as the Uruguay Round. From 1947 until 1967, all of the GATT negotiations were focused on the reduction of tariffs. The Tokyo Round extended its scope to anti-dumping initiatives. The longest round of negotiation was the Uruguay Round, which dealt with both tariff and non-tariff reductions and included services and investment flows as well as addressing the framework of the WTO.

In a parallel structure to the multilateral nature of GATT, regional trading blocs developed. The question we can now pose is whether trade blocs and regionalism are contractory to the GATT principles now enshrined in WTO?. The latter will contribute to a necessary strengthening of the global trading system, with stronger procedures for settling disputes, a mechanism for reviewing country trade policies, and greater involvement in decision making.[24] Martin and Winterrs (1995) state that the largest gain will accrue to East Asian WTO members, such as Indonesia, the Republic of Korea, Malaysia, and Thailand. These countries have established themselves as being competitive in world market and have committed themselves to domestic structured reforms including fairly rigorous liberalization in both agriculture and manufacturing.

As we stated before, the new regional economic cooperation in the Asia-Pacific region has been developing since the 1980s. Thus far, regionalism has been dealt with as a single homogeneous entity. However, the arrangement of regional trade can take several forms as the objectives can differ. Schott (1994) argue that this such regional forums: (i) promote welfare gains through income and efficiency with greater international division of labour and flexible specialization; (ii) enhance negotiating capacity among Third World countries; and (iii) augment regional political cooperation.[25]

Richard Gibb and Wieslaw Michalak (1994) divide regionalism into six categories:

1. Regionalism in sectoral cooperation deals with the partial removal of internal quota and tariff barriers.
2. Regionalism in free trade association deals with the removal of internal quota and tariff barriers.
3. Regionalism in customs union removes quotas, tariffs, and establishes common external customs tariffs barriers.
4. Regionalism in common market is broader not only eliminating quotas, tariffs, and common external customs tariffs, but also including agreement on the free movement of land, labour, capital and services.

[24] Martin, Will and Winterrs, L. Alan. The Uruguay Round Widening and Deeping the World Trading System, The World Bank, p. 1, Washington D.C, 1995.

[25] As quoted in Gibb, Richard. "Regionalism in the world economy". In Continental Trading Blocs: the Growth of Regionalism in the World Economy, edited by Richard Gibb and Wieslaw Michalak, p.22, John Wiley & Sons, Chichester-England, 1994.

5. Regionalism in an Economic Union involves point 1,2, 3, 4 and harmonization of economic policies and development of supra national institutions.
6. Regionalism in a Political Union is 1-5 with the addition of the unification of and political and powerful supra-national institutions.[26]

However, such views are challenged. New trade theorists: Dixit and Norman (1980), Either (1980), and Krugman (1994) for example, argue that given widespread government regulation and protection, the free trade system is a myth or at best a distant objective. New trade theory focuses on the significant principle of increasing returns as a source of trade, and also stresses the importance of imperfect competition in international markets.

The core argument declares that a country does not necessarily specialize in trade mainly because of its comparative advantage, but also because of increasing returns. The most significant assumption of new trade theory is that most goods and services which are traded internationally are not produced by perfectly competitive industries. According to the theory, government intervention in the policy of certain key sectors and industries could achieve better results; therefore, some strategic regulation or temporary protection could promote exports and the result could also improve competitive advantage. Consequently, by promoting certain industries, a country will raise its living standard at the expense of other countries. As Krugman writes,

> the new trade theory is probably the piece of that trend that has received the most attention, but intellectually it goes along with the revival of ideas that linkages play a key role in development, that increasing returns play a key role in growth and that co-ordination failures play a key role in business.[27]

[26] Ibid., p. 23.
[27] Ibid., p. 64.

Furthermore, the neo-liberal perspective claims that the analytical difficulty posed by regionalism is that it could be simultaneously trade diverting and trade creating for both participatory and non-participatory states. In short, the neo-liberal perspective defines regionalism so that it has the potential not only to support, but also to erode the multilateral free trade system.[28]

The two theoretical frameworks; neo-classical theory and regionalism theory form the basis of my literature review of broader development theories. These issues are important as regards trade as an engine of growth and as our approach will explore the regional economic development of the Pacific Rim.

## 2.2 RESEACH DESIGN

### 2.2a METHODOLOGY

The objective of this study is to study and analyze the correlation between foreign direct investment and foreign trade among APEC members. In order to achieve this objective we will study and analyze APEC countries in terms of their mutual relationship between foreign direct investment and foreign trade and more particularly in the case of Indonesia.

We will test the robustness of the Ashfaq Ahmad formula, which involves a simple regression model. Using this model, we will analyze the relationship between the two independent variables and one dependent variable. The two independent variables are the Indonesian foreign direct investment (FDI) and Indonesian trade. The dependent variable is the Indonesian Gross Domestic Product (GDP).

[28] Ibid., p. 251

The model proposed by Ashfaq Ahmad, Someshwar Roo and Collen Barnes can be expressed as

$$(YGDPG) = \alpha_0 + \alpha_1(PCFDI / GDP) + \alpha_2(X + M / GDP)$$

where

YGDPG = The average annual growth rate of GDP of each of the fifteen APEC member economies between 1980 and 1992.

PCFDI/GDP = The percentage change in the ratio of inward and outward FDI stock to GDP of each of the fifteen APEC member economies between 1980 and 1992.

X+M/GDP = The ratio of total trade (exports plus imports) to GDP of each of the fifteen APEC member economies for 1992.[29]

$\alpha_0$ = Intercept which if there is a change of independent variables, the fluctuation will be merely $\alpha_0$.

$\alpha_1, \alpha_2$ = Slopes of independent variables or simply the elasticity of investment and trade.

### 2.2b The Research Data

The main source of research material has been library resources and the Internet. The latter sources include the APEC home page, Pusdata (industry and trade Department) home page and BPS (Central Bureau of Statistic) home page from the Indonesian web, Jetro home page and University of Nagoya home page from the Japan web, and University of Washington home page and some others American university webs have been good sources of recent, up-to-date information.

The research data were mainly collected from United Nations collections such as the International Monetary Fund (IMF) publications, *the Direction of Trade Year Book*; World Bank publications such as *World Tables*; United Nations Trade and Development (UNCTAD) publications, including *Handbook of International Trade*

[29] Ashfaq Ahmad, Someshwar Roo and Collen Barnes, Foreign Direct Investment and APEC Economic Integration, p. 35, Working Paper Number 8, Industry Canada, February 1996.

*and Development Statistics*; United Nations Industrialization and Development (UNIDO) publications; from various books; and Internet World Wide Web. Moreover, we also used data from the *Trade Statistics book* from the Indonesian Trade Department. These data were adjusted for consistency as much as possible, therefore, the responsibility for these data remains with the author.

The data cover the years 1968 to 1995. Such as extensive time period covers pre and past APEC membership and also covers the Indonesian trade and investment policies in the era of the New Order.

We experienced difficulties in compiling these data, especially from the fact that Indonesian GDP is not given in US dollars, but in local currency (billions of rupiah). It was necessary to convert the data into US dollars using the US dollar market price. Since the investment and trade data were already provided in US dollars, it is hoped that the consistency of those data can be maintained.

The second difficulty resulted from the volatility in the data. The collected data varies over the time period of the study. For example in 1968, the value of the Indonesian GDP in US dollars was 155 billion, but in 1993 it has roughly the same value (153 billion), even though the value of Indonesian GDP in Rupiah increased more than 4 times, from 47 trillion Rupiah in 1968 to 170 trillion Rupiah in 1988. In addition, the characteristics of investment, especially foreign direct investment are not stable. Many factors could influence the investment in one country including the political situation and government incentives for investment. The collected data on Indonesian investment clearly shows that investment in Indonesia is strongly dominated by domestic investors rather than by foreign investment. These factors could influence the result of data analysis. (see Chapter 5)

# CHAPTER 3

# THE ASIA PACIFIC ECONOMIC COOPERATION (APEC)

This chapter studies the historical background of APEC and explains the dynamic development of APEC in terms of intra-APEC trade and investment.

## 3.1 THE EVOLUTION OF APEC

APEC, brimming with diversity in the history, culture, social structures and economic development of its member countries, has achieved spectacular economic success in recent years and has asserted itself as an engine for global economic growth. APEC as we have already discussed consists of sixteen countries and two non-countries. To assist the reader at this time, we can classify its members by regions, as follows:

1. Asia region:
   - Japan
   - The People's of Republic of China (PRC)
   - New Industrializing Economies/NIEs: Republic of Korea, Hongkong, Taiwan and Singapore
   - ASEAN 5: Indonesia, Malaysia, Thailand, Philippines and Brunei

2. Pacific region:
   - ANZ: Australia and New Zealand
   - Other Pacific-APEC: Papua New Guinea

3. American Region:
   - NAFTA: United States of America, Canada and Mexico
   - Latin America-APEC: Chile.

Despite the different performance of APEC members especially in economic growth, in 1991 on Seoul, APEC members agreed to declare common and specific objectives, as follows:

a. to sustain the growth and development of the region for the common good of its peoples and, in this way, to contribute to the growth and development of the world economy
b. to enhance the positive gains, both for the region and the world economy, resulting from increasing economic interdependence, including by encouraging the flow of goods, services, capital and technology.
c. to develop and strengthen the open multilateral trading system in the interest of Asia-Pacific and all other economies; and
d. to reduce barriers to trade in goods and services among participants in manner consistent with GATT principles, where applicable, and without detriment to other economies.[1]

The notion of Asia-Pacific regional cooperation was identified by Japan as a concept of cooperation for "promoting regional cohesion"[2] and we can recognize three significant phases in the evolution of economic cooperation in the Pacific region, as follows:

(i) Pacific Economic Cooperation in the 1960's,

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[1] __________, Internet: http://apecsun.apecsec.org.sg/apecnewinfo.html

[2] Soesatro, Hadi. The Pan-Pacific Movement: An Interpretative History, In Barbara K Bundy, Stephen D. Burns, and Kimberley V. Weichel. The Future of The Pacific Rim: Scenarios for Regional Cooperation, p.11, Praeger, Connecticut - London, 1994.

(ii) The Pacific Economic Cooperation Council and

(iii) The formation of APEC in 1989.

Pacific Economic Cooperation (PEC), the first phase, came about through the development of PAFTA (Pacific Free Trade Area) and PBEC (Pacific Basin Economic Council). In November 1965, Kiyoshi Kojima and Hiroshi Kuimoto, Japanese researchers at the Japan Economic Research Center (JERC) and Hitotsubashi University, argued at an international conference on Measures for Trade Expansion of Developing Countries that PAFTA, with five Pacific developed countries (Australia, Canada, Japan, New Zealand and the United States) had posted the necessary conditions for effective regional integration. If PAFTA would welcome developing countries that hoped to join as members with preferential treatment, they argued that the result would be a huge expansion of Pacific trade.[3]

The PBEC's founded in 1967 had the mission of achieving a business environment in the region that ensured open trade and investment and encouraged competitiveness based on the capabilities of individual companies. It was an association of business leaders from throughout the Pacific that promoted the expansion of trade and investment through open markets. It was a forum through which regional business leaders created new business relationships and addressed emerging issues in the Pacific and global economies. PBEC also supported open markets, advocated the reduction of trade and investment barriers, and encouraged economic cooperation based

[3] Ibid., p.11

upon the shared interests of its members. PBEC included more than 1,100 corporate members in nineteen economies and countries.[4]

PBEC committees conducted a wide range of programs, including conferences, seminars, training programs, and regular meetings with senior government officials. It provided information, networking fora, and services to its members to increase their business opportunities. It supported cooperative business efforts to address the economic well-being of citizens in the region. PBEC's activities promoted an improved business climate in the region for all PBEC members by its involvement in the following key issues:

- advising governments
- generating foreign investment
- reducing international trade barriers
- stimulating new technology development and implementation
- balancing economic development with a clean environment.[5]

The second phase in the evolution of regional cooperation was the Pacific Economic Cooperation Council (PECC). It was a tripartite, non-governmental organization committed to promoting economic cooperation in the Pacific Rim. PECC was initiated by the Prime Ministers of Japan and Australia in 1980. They called for the establishment of an independent regional mechanism to advance economic cooperation and market-driven integration. They asserted that an important characteristic of the new institution would be an independent, unofficial status. This would permit it to address economic issues and measures

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4 These countries include Australia, Canada, Chile, People's Republic of China, Colombia, Fiji, Hong Kong, Indonesia, Japan, the Republic of Korea, Malaysia, Mexico, New Zealand, Peru, the Philippines, Russia Federation, Chinese Taipei, Thailand, and the United States.

5 _________. Internet :http://www.pbec.org/

free of the constraints of formal governmental policies and relationships, thereby fulfilling the need for an informal process involving businesses and independent research institutions alongside governments. PECC comprised of representatives from 22 Asia-Pacific economies who met regularly to work on practical government and business policy issues to increase trade, investment and economic development in the region[6].

PECC was the only organization in the region that brought business, government and researchers together on an equal footing to address key trade and investment issues. Although it had an independent agenda, PECC maintained direct links to governments in the region to enable its work to be channeled to ministers and policy makers. PECC also anticipated emerging economic opportunities and problems for business and governments. In addition PECC established task groups to address issues in individual sectors on a regional level as well as on the level of individual member economies. It became a clearing house for policy and business research, serving as a catalyst for new initiatives in policy change[7].

After the formation of PEC and PECC, discussions about further Asia-Pacific economic development took place continually until 1989, when APEC was formed as a forum for economic growth in this dynamic region. APEC was first announced by the Prime Minister of Australia, Bob Hawke, at the Ministerial

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[6] The members of PECC includes Australia, Brunei Darussalam, Canada, Chile, China, Colombia, Hong Kong, Indonesia, Japan, the Republic of Korea, Malaysia, New Zealand, Pacific Island Nations, Mexico, Peru, Philippines, Russian Federation, Singapore, Chinese Taipei, Thailand, United States, and Vietnam.

[7] ________. Internet: http://www.pecc.org/

meeting on November 6-7, 1989. In the 1990s it has developed as a new model of economic cooperation, especially since the 1993 APEC summit at Blake Island, USA. On November 20, 1993, the leaders of APEC endorsed an agreement on developing initiatives on political impetus. They agreed to concentrate on further integrating APEC's trade and investment environments.

One year after the Blake Island summit, another APEC summit was held in Bogor, Indonesia, on November 15, 1994. In the Bogor Declaration, the APEC leaders committed themselves to an ambitious agenda to create trade and investment liberalization in the Asia-Pacific region by 2010 for industrialized economies and by 2020 for developing economies. Since the Bogor Declaration was announced, the members of APEC have been enthusiastically implementing trade liberalization and investment. Some disputes have, however, appeared on the surface between the states over disagreements regarding certain sectors, especially the agriculture. For example, there has been a resistance to implement liberalization of this sector because of its dominance in many Asia APEC economies. However, the US and Australia strongly supported agricultural trade liberalization because of their high concentration of agricultural exports in the Asia region.

A year after the Bogor summit, the next APEC summit was held in Japan on November 19, 1995. The Osaka summit had as its initial objective the implementation of the Bogor Declaration, as well as a broader vision of economic reform and deregulation across Asia, now referred as Japan's "Action Agenda". The central vision of this summit still concentrated around the importance of trade liberalization and investment, and on the action to be taken by 2020 by all APEC members.

The most recent APEC summit, known as MAPA (Manila Action Plan for APEC) was held in Manila in November 1996. On November 16, 1996 the leaders of APEC declared the spirit of community in the Asia-Pacific region and affirmed their commitment to sustainable growth and equitable development. Furthermore, the leaders of APEC also committed themselves to launching the implementation phase of their free and open trade and investment agenda; to delivering business facilitation measures; to agreeing to advance common goals in the World Trade Organization (WTO); and to engaging the business sector as a full partner in the APEC process. The MAPA was implemented January 1, 1997.[8]

## 3.2 THE DYNAMICS AND VARIETIES OF APEC MEMBERS

As a forum for regional economic cooperation, APEC deals with a variety of issues relating to economic matters. Multi-dimensional interests exist among APEC members and while the single goal should be to achieve trade liberalization and investment, it is recognized that there will be differences among countries.

The differences among APEC members can be understood by noting that APEC comprises a large share of both the world's population and the world's

[8] The 1997 APEC summit will take place in Vancouver - Canada.

economic activity. In terms of population, APEC includes three of the world most populous countries, The People's of Republic of China, the United States of America, and Indonesia. The PRC, with around 1.2 billion people, is the most populous country. The USA is the third most populous with 225 million people and Indonesia is the fifth most populous with 180 million people.

The potential economic power of APEC can be described by the remarkable growth and development of trade and investment among its members. Table 3.1 shows that in 1950 the total trade of APEC members reached roughly 34 % of world trade, APEC trade being worth $42,264 million and world trade $125,617 million. In 1990, the growth in trade of APEC members was faster than the growth in world trade. In 1990 the total trade from APEC members increased to $2,720,643 million, a growth rate of 63 times; meanwhile, the growth rate of world trade was only 55 times, from $125,617 million in 1950 to $7,074,606 million in 1990.

APEC's significant performance in trade can also be seen by the fact that in the 1990s APEC's share of world trade had replaced the European trade share. Having increased from 38 % in 1990 to 46 % in 1993; meanwhile, the European trade share decreased from 46 % in 1990 to 40 % for the same year. The African region remained steady at three percent of the share. The rest of the world decreased by two percent from 13 % in 1990 to 11 % in 1993.

Generally, the most significant part of this growth happened during 1970s and 1980s. In that period, the world economy was typically booming from the oil revenue and from the declining price of some non oil-commodities such as agricultural exports and light manufactured exports on which some APEC members' economies, such as Indonesia, were based. Indonesia also profited from the oil boom. Hodder (1994) states that in 1990 total exports from the West Pacific region (covering East Asia, Australia and New Zealand excluding North Korea and Vietnam) reached $695,153 million or 22 percent of total world trade. Of this 43 percent was dominated by Japan. Imports in the West Pacific Rim also accounted for 21 percent of total world trade, with 33 percent from Japan.[9]

[9] Hodder, Rupert. "The West Pacific Rim". In Richard Gibb and Wieslaw Michalak. Continental Trading Blocs: the Growth of Regionalism in World Economy, p. 234, John Wisley & Sons, Chichester-England, 1994.

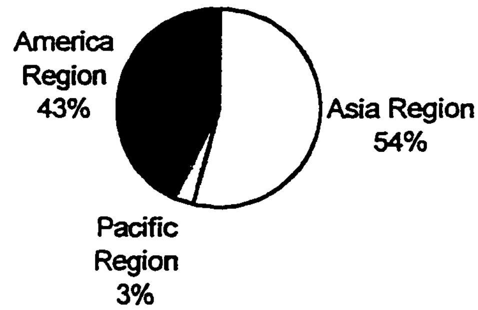
Table 3.1 The Structure of APEC Trade (millions US $)

| Region/Countries | 1950 | 1960 | 1970 | 1980 | 1990 | 1993 |
|---|---|---|---|---|---|---|
| Asian Region: | 10,668 | 24,597 | 67,667 | 545,936 | 1,358,804 | 1,835,425 |
| Japan | 1,789 | 8,546 | 38,198 | 271,737 | 522,949 | 603,868 |
| P.R. of China | 1,130 | 5,219 | 4,586 | 38,040 | 113,792 | 194,058 |
| NIES: | 3,661 | 5,021 | 15,211 | 144,730 | 535,075 | 763,288 |
| - ROK | 77 | 376 | 2,820 | 39,804 | 134,860 | 166,036 |
| - Hongkong | 1,313 | 1,715 | 5,420 | 21,999 | 164,634 | 273,906 |
| - China Taiwan | 196 | 461 | 2,956 | 39,544 | 121,930 | 164,100 |
| - Singapore | 2,075 | 2,469 | 4,015 | 43,383 | 113,651 | 159,246 |
| ASEAN 5: | 4,088 | 5,811 | 9,672 | 91,429 | 186,988 | 274,211 |
| - Indonesia | 1,240 | 1,415 | 2,109 | 32,743 | 47,511 | 64,911 |
| - Malaysia | 1541 | 2,098 | 3,098 | 23,778 | 58,674 | 92,779 |
| - Thailand | 513 | 858 | 2,009 | 15,719 | 56,449 | 82,858 |
| - Philippines | 707 | 1,339 | 2,277 | 14,036 | 21,109 | 29,843 |
| - Brunei | 87 | 101 | 179 | 5,153 | 3,245 | 3,820 |
| Pacific Region: | 4,235 | 6,443 | 12,698 | 57,443 | 103,110 | 112,263 |
| Papua New Guinea | 39 | 98 | 404 | 2,207 | 2,337 | 3,790 |
| ANZ: | 4,196 | 6,345 | 12,294 | 55,236 | 100,773 | 108,473 |
| - Australia | 3,240 | 4,712 | 9,826 | 44,343 | 81,784 | 88,300 |
| - New Zealand | 956 | 1,633 | 2,468 | 10,893 | 18,989 | 20,173 |
| America Region: | 27,361 | 50,961 | 122,221 | 658,360 | 1,258,729 | 1,491,435 |
| Chile | 528 | 1,113 | 2,312 | 10,502 | 15,988 | 20,327 |
| NAFTA: | 26,833 | 49,848 | 119,909 | 647,858 | 1,242,741 | 1,471,108 |
| - USA | 19,624 | 36,007 | 85,048 | 482,550 | 910,579 | 1,068,211 |
| - Canada | 6,128 | 11,891 | 30,998 | 130,278 | 250,873 | 284,213 |
| - Mexico | 1,081 | 1,950 | 3,863 | 35,030 | 81,289 | 118684 |
| APEC | 42,264 (34%) | 82,001 (31%) | 202,586 (32%) | 1,261,739 (31%) | 2,720,643 (38%) | 3,439,123 (46%) |
| Europe | 45,126 (36%) | 107,259 (40%) | 284,584 (44%) | 1,703,367 (42%) | 3,242,689 (46%) | 3,024,568 (40%) |
| Africa | 8,997 (7%) | 15,928 (6%) | 31,239 (5%) | 214,974 (5%) | 198,292 (3%) | 189,900 (3%) |
| Rest of World | 29,230 (23%) | 81,253 (23%) | 123,626 (19%) | 902,989 (22%) | 9,129,882 (13%) | 835,243 (11%) |
| World | 125,617 (100%) | 266,441 (100%) | 642,035 (100%) | 4,083,069 (100%) | 7,074,606 (100%) | 7,488,834 (100%) |

Sources: UNCTAD. Trade Statistics Year Books, Geneva, 1994,

Within APEC, in 1993 the ASIAN led in trade, followed by the America region, as seen in Figure 3.3 below.

Figure 3.3 The Share of APEC trade in 1993




As trade development and trade growth are dynamic and important economic drivers for APEC members, the development and growth of investment, especially Foreign Direct Investment (FDI), follows a similar pattern. Not only does FDI facilitate effective resource allocation, it also enhances the growth of both individual economies and the APEC region as a whole. In Chapter 2 we indicated that FDI could be looked at two standpoints: from the host countries and from the investing countries.

FDI plays an important role in *host* APEC members through capital formation, including assisting the development of financial markets, export expansion, and improvement in employment and balance of payments. FDI can also be an important influence in upgrading the technology of production, management and marketing skills in host APEC members. For APEC member *investors*, FDI is a foreign income source which is an important influence on both its national income and accelerating its industrial upgrading, thereby, strengthening its international competitiveness.

Based on UNCTAD's, *World Investment Report 1993*, in 1990 world FDI was worth $203 billion, but decreased sharply in 1991 to $148 billion. APEC regions followed a similar pattern: the total capital investment dropped from $85 billion in 1990 to $43 billion in 1991.[10] The dynamic development of FDI in APEC developing countries could be clarified by Table 3.2 below:

Table 3.2 The Dynamic Development of FDI
in some APEC members (billions US $)

| Country | 1982 | 1983 | 1984 | 1985 | 1986 | 1987 | 1988 | 1989 | 1990 | 1991 | 1992 | 1993 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| ASIA: | 3.6 | 3.8 | 4.1 | 3.6 | 4.6 | 6.1 | 6.9 | 4.5 | 8.9 | 14.0 | 18.7 | 34.1 |
| NIEs: | 1.3 | 1.2 | 1.4 | 1.3 | 2.1 | 3.1 | 1.1 | -3.0 | -0.1 | 2.4 | 3.0 | 2.3 |
| ROK | -0.1 | -0.1 | 0.1 | 0.2 | 0.3 | 0.4 | 0.7 | 0.5 | -0.1 | -0.2 | -0.5 | -0.5 |
| Singapore | 1.3 | 1.1 | 1.2 | 0.8 | 1.5 | 2.6 | 3.5 | 1.9 | 3.9 | 3.2 | 4.3 | 4.3 |
| Taiwan | 0.1 | 0.1 | 0.1 | 0.3 | 0.3 | - | -3.2 | -5.3 | -3.9 | -0.6 | -0.8 | -1.5 |
| ASEAN-4: | | | | | | | | | | | | |
| Indonesia | 0.2 | 0.3 | 0.2 | 0.3 | 0.3 | 0.4 | 0.6 | 0.7 | 1.1 | 1.5 | 1.8 | 2.0 |
| Malaysia | 1.4 | 1.3 | 0.8 | 0.7 | 0.5 | 0.4 | 0.7 | 1.7 | 2.3 | 4.0 | 4.5 | 4.3 |
| Philippines | - | 0.1 | - | - | 0.1 | 0.3 | 0.9 | 0.6 | 0.5 | 0.5 | 0.2 | 0.8 |
| Thailand | 0.2 | 0.3 | 0.4 | 0.2 | 0.3 | 0.2 | 1.1 | 1.7 | 2.3 | 1.8 | 2.0 | 1.5 |
| Other: | | | | | | | | | | | | |
| PR-China | 0.4 | 0.5 | 1.1 | 1.0 | 1.4 | 1.7 | 2.3 | 2.6 | 2.7 | 3.5 | 7.2 | 23.1 |
| Pacific: | | | | | | | | | | | | |
| PNG | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.2 | 0.1 | 0.2 | 0.2 | 0.1 |
| America: | | | | | | | | | | | | |
| Chile | 0.4 | 0.1 | 0.1 | 0.1 | 0.1 | 0.2 | 1.0 | 1.3 | 0.6 | 0.4 | 0.3 | 0.4 |
| Mexico | 1.7 | 0.5 | 0.4 | 0.5 | 1.2 | 1.8 | 0.6 | 2.6 | 2.5 | 4.8 | 4.4 | 4.9 |

Source: Mohsin S. Khan and Carmen M. Reinhart. Capital Flows in the APEC Region, IMF Publication Service, Washington, 1995, p. 59.

For APEC developing countries, FDI has been an important capital source financing its development. FDI inflows to APEC developing countries grew significantly in 1980 and 1990 when other NIEs implemented economic policies and structural reformations which led to an improved investment climate. The most significant FDI increase in China came mainly come from Taiwan, and other South East Asia nations such as Indonesia, Malaysia and Thailand. In these Asian APEC members, FDI increased annually since 1987 until 1993 (see

[10] APEC Ad Hoc Group on Economic Trends and Issues. APEC Economies: Recent Developments and Outlook, p.13, the APEC Secretariat, Singapore, 1994.

Table 3.2 above). Mexico also experienced an increase in FDI, but to a lesser extent.[11]

In the terms of intra-regional investment, it is believed that FDI in APEC flows from the industrializing countries to developing countries but the fact is that the FDI does not mainly describe that scheme. Since the 1980s, the development of intra-regional FDI in APEC increased significantly from $8,245 billion in 1980 to $23,346 billion in 1991; more than 2.8 times, despite annual fluctuations in FDI. The FDI in APEC members increased sharply from $9,700 billion in 1985 to $39,882 billion in 1989, and decreased sharply to $28,296 billion in 1990 and to $23,346 billion in 1991.

Between 1980 and 1991 the United States and Canada together were the major recipients of FDI from APEC members. The inflow of intra-regional FDI to the United States and Canada in 1980 was $4,769 billion or 59 % of the total APEC FDI. In 1989, its was $23,560 billion or 59 % of intra regional APEC FDI, and in 1990 the United States and Canada still dominated the inflow of intra-regional FDI with $6,608 billion or 23 %. In 1991, they received $7,828 billion or 34 % of intra-regional flows. From these figures it is clear that the United States and Canada together received the most regional capital flow from APEC. The second largest recipient of intra-regional FDI in APEC is the ASEAN-4 (Indonesia, Malaysia, Thailand and the Philippines), which received $10,106 billion or 25 % of total APEC FDI in 1989; $10,138 billion or 36 % in 1990; and

[11] Mohsin S. Khan and Carmen M. Reinhart. Capital Flows in the APEC Region, p.4, IMF Publication Service, Washington, 1995.

$7,172 billion or 31 % in 1991 (see Table 3.3 below).

Japan was the largest investor within APEC in 1985, with $5,539 billion or 57 %, and the biggest recipient of Japanese investment was the United States and Canada together with $3,478 billion or 63 %. In 1989 Japan supplied intra-regional FDI to APEC members worth $27,510 billion or 69% and the biggest recipient again the United States and Canada with $18,262 billion or 66 %. One year later, in 1991, Japan was again the biggest investor with $10,059 billion or 43 %, and the major recipient the United States and Canada with $5,542 billion or 55 %. (see Table 3.3 and also Figure 3.1 below).

The recipient of the second most Japanese FDI is the ASEAN-4. In 1989 Japanese FDI supplied ASEAN-4 with $5,444 billion or 20%, and in 1991 with $2,173 billion or 22 %. The ASEAN-4 is also the major recipient from the four NIEs from 1989 until 1991. In 1990 the inflow of FDI from the four NIEs was $3,139 billion or 68 %.

The flow of Foreign Direct Investment among the members of APEC can be seen in Figure 3.1 below:

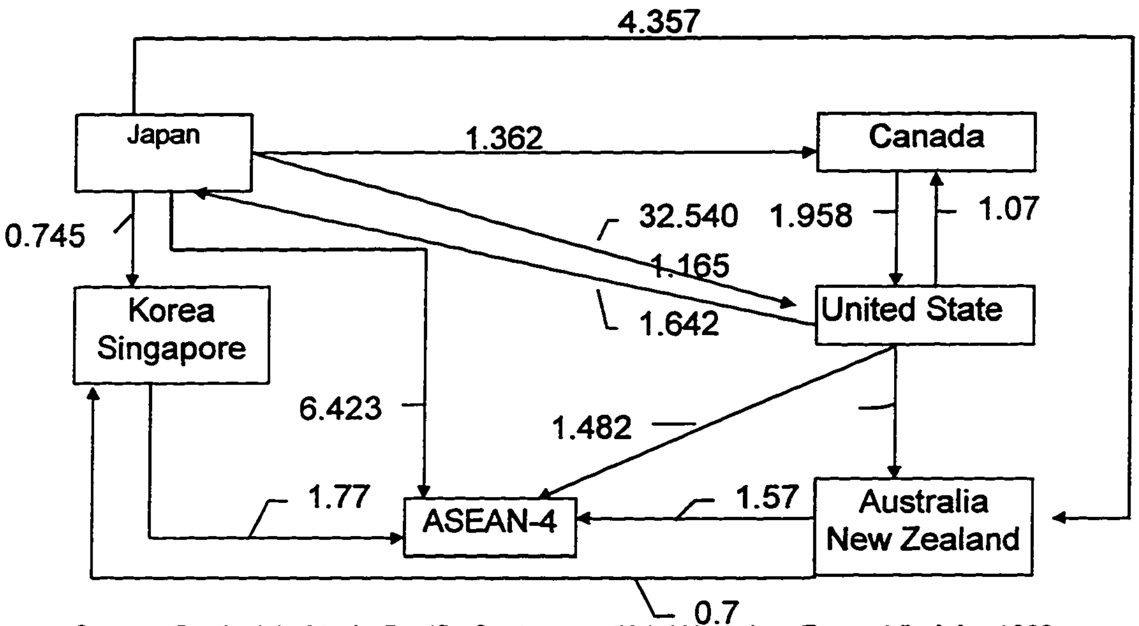
# Table 3.3 Intra-Regional FDI in APEC (1980-1991)

| Country | Year | USA and Canada | | | ASIA - APEC | | | | | Pacific | APEC | EU | Others | World |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | USA | CND | SUM | Japan | PRC | NIEs | ASEAN-4 | SUM | SUM | SUM | SUM | SUM | SUM |
| USA & CND | 80 | 238 | - | 3516 | 978 | 2 | 224 | -16 | 118 | 65 | 4769 | 8928 | 3905 | 17602 |
| | 85 | -2142 | - | -1231 | 3478 | 1 | 70 | 20 | 3564 | 1299 | 3562 | 9671 | 3738 | 16971 |
| | 89 | 1055 | - | 4267 | 18262 | 90 | 608 | 64 | 19024 | 269 | 23560 | 37513 | 13026 | 74099 |
| | 90 | 3473 | - | 3473 | -2142 | 3738 | 74 | 54 | 1724 | 1411 | 6608 | 21011 | 24334 | 51953 |
| | 91 | 2797 | - | 1473 | 5542 | 0 | 547 | -15 | 6174 | 181 | 7828 | 8947 | 985 | 17760 |
| Asia- APEC: | 80 | 1037 | - | 1033 | 476 | 5 | 273 | 9 | 763 | 7 | 1808 | 641 | 975 | 3424 |
| | 85 | 1977 | - | 1988 | 1299 | 28 | 1530 | 45 | 2902 | 59 | 4949 | 699 | 659 | 6307 |
| | 89 | 1000 | - | 1048 | 7551 | 80 | 3713 | 198 | 11452 | 222 | 12312 | 3634 | 4365 | 20311 |
| | 90 | 3636 | | 3676 | 6700 | 87 | 7102 | 251 | 14140 | 239 | 18055 | 3214 | 4006 | 25275 |
| | 91 | 3035 | - | 3802 | 4517 | 194 | 6437 | 183 | 11331 | 385 | 15518 | 3697 | 6180 | 25395 |
| Japan | 80 | 111 | - | 111 | - | NA | NA | NA | 0 | -1 | 110 | 67 | 101 | 278 |
| | 85 | 514 | - | 514 | - | NA | NA | NA | 0 | NA | 514 | 54 | 74 | 642 |
| | 89 | -1530 | - | -1529 | - | 0 | 88 | NA | 88 | 16 | -1425 | 327 | 44 | -1054 |
| | 90 | 598 | - | 573 | - | 1 | 83 | NA | 84 | 5 | 662 | 1106 | -15 | 1753 |
| | 91 | -39 | - | 647 | - | -1 | 9 | NA | 8 | 3 | 658 | 630 | 80 | 1368 |
| P.R.C | 80 | NA | - | NA | NA | - | NA | NA | 0 | NA | NA | NA | NA | NA |
| | 85 | 357 | - | 366 | 315 | - | 966 | 12 | 1293 | 14 | 1673 | 165 | 117 | 1955 |
| | 89 | 28 | - | 45 | 356 | - | 121 | 16 | 493 | 44 | 582 | 172 | 591 | 1345 |
| | 90 | 456 | - | 464 | 503 | - | 1931 | 11 | 2445 | 34 | 2943 | 144 | 400 | 3478 |
| | 91 | 323 | - | 334 | 533 | - | 2463 | 30 | 3026 | 16 | 3376 | 245 | 745 | 4366 |
| NIEs | 80 | 742 | - | 742 | 263 | 0 | 145 | 3 | 416 | 0 | 1158 | 303 | 335 | 1796 |
| | 85 | 923 | - | 924 | 779 | 22 | 50 | 18 | 869 | 1 | 1794 | 235 | 268 | 2297 |
| | 89 | 1356 | - | 1357 | 1751 | 41 | 365 | 18 | 2175 | 17 | 3549 | 749 | 1180 | 5478 |
| | 90 | 2059 | - | 2059 | 1901 | 62 | 192 | 110 | 2265 | -12 | 4312 | 821 | 360 | 5493 |
| | 91 | 2047 | - | 2047 | 1811 | 130 | 131 | 16 | 2088 | 177 | 4312 | 1419 | 336 | 6607 |
| ASEAN-4 | 80 | 184 | - | 185 | 213 | 5 | 128 | 1 | 347 | 8 | 540 | 271 | 589 | 1400 |
| | 85 | 183 | - | 184 | 205 | 6 | 514 | 15 | 740 | 44 | 968 | 145 | 200 | 1313 |
| | 89 | 1146 | - | 1175 | 5444 | 39 | 3139 | 164 | 8786 | 145 | 10106 | 2386 | 2550 | 15042 |
| | 90 | 523 | - | 580 | 4296 | 24 | 4896 | 130 | 9346 | 212 | 10138 | 1143 | 3261 | 14542 |
| | 91 | 754 | - | 774 | 2173 | 65 | 3834 | 137 | 6209 | 189 | 7172 | 1403 | 5019 | 13594 |
| Pacific | 80 | 950 | - | 1049 | 364 | 0 | 0 | 158 | 522 | 97 | 1668 | 1022 | 354 | 3044 |
| | 85 | 692 | - | 697 | 767 | 0 | 0 | -370 | 397 | 95 | 1189 | 844 | 716 | 2749 |
| | 89 | 1835 | - | 1491 | 1697 | 1 | 284 | 9 | 1991 | 28 | 6510 | 1068 | 1489 | 9067 |
| | 90 | 1485 | - | 1470 | 1854 | NA | NA | NA | 1854 | 309 | 3633 | 668 | 3141 | 7440 |
| | 91 | NA | - | NA | NA | NA | NA | NA | NA | NA | NA | NA | NA | NA |
| APEC total | 80 | 2225 | - | 5603 | 1818 | 7 | 497 | 151 | 2473 | 169 | 8245 | 10591 | 5234 | 24070 |
| | 85 | 527 | - | 1454 | 5539 | 29 | 1600 | -305 | 6863 | 1383 | 9700 | 11114 | 5113 | 25927 |
| | 89 | 3890 | - | 6806 | 27510 | 171 | 4605 | 271 | 32557 | 519 | 39882 | 42215 | 18880 | 100977 |
| | 90 | 8594 | - | 8619 | 6412 | 3825 | 7176 | 305 | 17718 | 1959 | 28296 | 24891 | 31481 | 84668 |
| | 91 | 5832 | - | 5275 | 10059 | 194 | 7084 | 168 | 17505 | 566 | 23346 | 12644 | 7165 | 43155 |

Source: APEC Ad Hoc Group on Economic Trends and Issues. APEC Economies: Recent Developments and Outlook, The APEC Secretariat, Singapore, 1994, p. 26.

Note: 1. In 1991 the figure of tables above is not included the APEC Pacific figure;
2. ASEAN-4 is Indonesia, Malaysia, Thailand and Philippines.

Figure 3.1 The Flow of APEC Direct Investment in 1989 (million US $)




Source: Borthwick, Mark. Pacific Century, p. 531, Westview Press, Virginia, 1992.

Although it is generally believed that the industrializing countries are the major investors in developing countries, in the case of APEC, based on these data it would appear that the industrializing countries are also reinvesting among themselves. The strengthening of interdependence within APEC members has become more important with two-way investment flows.

## 3.3 CONCLUSION

With 18 members, APEC began with the initiative from the non-government movement such as businessmen and scientists. Governments have taken a more important role recently. There are three important phases implementing the evolution of APEC, first, the beginning of Pacific Economic Cooperation (PEC) through the development of two international non-government organizations, the Pacific Free Trade Area (PAFTA) and Pacific Basin Economic Cooperation (PBEC). The second phase was the evolution of Pacific Economic Cooperation Council. The third phase was the formation of APEC in 1989.

The continued development of APEC members will depend on the continued growth of trade and investment. The increase of intra-trade flows of good/services and capital confirm the interdependence among APEC members is very strong, with the United States and Japan as the centre of APEC trade destinations. The dynamic development of capital flow especially FDI, within APEC seems to be monopolized by industrializing economies members. Not only do they reinvest among themselves, but also they are the dominant investors on the developing countries in APEC.

# CHAPTER 4

# APEC FROM ASEAN PERSPECTIVES

## 4.1 THE EVOLUTION OF ASEAN

### 4.1a The Historical Perspectives of ASEAN

ASEAN, the Association of South East Asian Nations, was established in 1967 in Bangkok, at a meeting of foreign ministers from Indonesia, Malaysia, Thailand and the Philippines. The roots of the ASEAN foundation can better understood by ASA and Maphilindo; two attempts at regional association, which failed. ASA, the Association of South East Asia, consisting of the Malaysia Federation, Thailand and the Philippines, was founded in the early 1960's. ASA failed to be an effective organization because of its limited membership and prestige, especially because of Indonesia's absence. In mid-1965, Maphilindo (Malaysia, the Philippines and Indonesia) did not succeed because of a confrontation between Indonesia and Malaysia. Moreover, In the 1960s the international political stage was being eroded by the expansion of "latent communism", especially the Vietnam War, which was believed to threaten regional security in South East Asia. Thus, it seems that ASEAN was formed to challenge the political change as well as forming a regional association in South East Asia, learning from the mistakes of ASA and Maphilindo.

The fundamental objective of ASEAN was to form an economic group in order to develop regional solidarity among the neighboring countries of South East Asia, based on regional peace and stability. The ASEAN Declaration or Bangkok Declaration of August 8, 1967 stated that the aims and purposes of the establishment of an association for regional cooperation among the countries of South East Asia should be:

1. to accelerate the economic growth, social progress and cultural development in the region through joint endeavors in the spirit of equality and partnership in order to strengthen the foundation for a prosperous and peaceful community of South-East Asian Nations;

2. to promote regional peace and stability through abiding respect for justice and the rule of law in the relationship among countries of the region and adherence to the principles of United Nations Charter;

3. to promote active collaboration and mutual assistance on matters of common interest in the economic, social, cultural, technical, scientific and administrative fields;

4. to provide assistance to each other in the form of training and research facilities in the educational, professional, technical and administrative spheres;

5. to collaborate more effectively for the greater utilization of their agriculture and industries, the expansion of their trade, including the study of problem of international commodity trade, the improvement of their transportation and communication facilities and the raising of the living standards of their peoples;

6. to promote Southeast Asian studies;

7. to maintain close and beneficial cooperation with existing international and regional organizations with similar aims and purposes, and explore all avenues for even closer cooperation among themselves.[1]

The changing shape of the world economy in the early 1990s made ASEAN realize that it needed a new approach to broaden the base of members' economies. One could say that the story of ASEAN began with the success of their trade, aid and investment since the 1970s (see Table 4.1), ASEAN also succeeded in maintaining its momentum of economic growth through the violent decade of the 1970s and the recession of the early 1980s. This success was due to the fact that most ASEAN members-Indonesia, Malaysia and Thailand- gained maximum benefits from international trade through the adoption of specially designed policies. When

[1] Rieger, Hans Christoph. ASEAN Economic Co-operation: Handbook, p.101, Institute of Southeast Asian Studies (ISEAS), Singapore, 1991.

the time of difficulties toward the end of 1970s and the beginning of 1980s began, these countries quickly realized that they could not depend on their domestic markets to provide enough outlets to sustain the growth of their emerging industrial sectors.[2] They realized they should expand their production to international markets instead of a concentration on domestic markets.

Table 4.1 Trade, Aid and Investment in ASEAN (millions US $)

| ASEAN Countries | Year | Trade* | Aid** | FDI** |
|---|---|---|---|---|
| Indonesia | 1970 | 2,109 | 449.0 | 83.0 |
| | 1980 | 32,743 | 844.2 | 183.5 |
| Malaysia | 1970 | 3,098 | 22.9 | 94.0 |
| | 1980 | 23,778 | 106.2 | 875.9 |
| Singapore | 1970 | 4,015 | 26.8 | 93.0 |
| | 1980 | 43,383 | 9.4 | 1,668.6 |
| Thailand | 1970 | 2,009 | 69.4 | 43.0 |
| | 1980 | 15,719 | 304.9 | 186.1 |
| Philippines | 1970 | 2,277 | 41.3 | -25.0 |
| | 1980 | 14,036 | 205.4 | 260.3 |
| Brunei | 1970 | 179 | - | - |
| | 1980 | 5,153 | - | - |
| Total ASEAN | 1970 | 13,687 | 609.4 | 288.0 |
| | 1980 | 134,812 | 1,470.1 | 3,174.4 |

Source: *) UNCTAD, Handbook of International Trade and Development Statistic, 1994, p. 2-9
**) AID from OECD and FDI (Foreign Direct Investment) stated from Rieger, Hans Christoph. ASEAN Economic Co-operation: Handbook, Institute of Southeast Asian Studies (ISEAS), Singapore, 1991.

Broadly speaking, since the Bangkok Declaration of 1967, the story of ASEAN has been based on economic matters among the members. There has been a widening gap between Singapore which was already categorized as undergoing stable economic development and later on became one of the Newly Industrializing

[2] Mangkusuwondo, Suhadi. "Pacific Economic Cooperation and Indonesia", The Indonesian Quarterly, Vol. XIX no. 1, first Quarter, p.83, Central for Strategic and International Studies (CSIS), Jakarta, 1991.

Countries (NICs), and the other four members, Indonesia, Malaysia, Thailand and the Philippines, which had only started their economic development processes.

In January 7, 1984, at the Jakarta meeting, Brunei officially joined as the sixth ASEAN member. Vietnam, became a member in 1995; Laos, Cambodia and Myanmar are also joining by 1999. In this Chapter, we concentrate on the ASEAN-6 (Indonesia, Malaysia, Singapore, Thailand, Philippines and Brunei) because we are discussing decisions that were made before Vietnam, Laos, Myanmar and Cambodia became full members of ASEAN.[3]

The ASEAN members in 1960 had a population of 96,194,000 people and an average annual population growth rate of 1.9 percent, Indonesia had $840 million by value of exports and imports of $574 million, mainly trading with Singapore, the USA, and Malaysia. Malaysia, with 8,205 000 people and an average annual population growth rate of 2.71 percent, exported $956 million and imported $703 million, particularly trading with Singapore, the United Kingdom and Japan. With 27,904 000 people and an average annual population growth rate of 3.06 percent, the Philippines exported $560 million and imported $604 million focusing on the USA, Japan and the Netherlands as its trade destinations. With 26,867 000 people and an average annual population growth rate of 2.79 percent, Thailand received $408 million of export value and imported $453 million concentrating on Japan, Malaysia and USA as its trade destinations. The wealthiest ASEAN nation at the time was

[3] Vietnam became a full member of ASEAN at the ASEAN Ministerial Meeting (AMM) in Brunei July 1995, although since 1992 it had been involved in ASEAN activities as being an ASEAN observer when ASEAN signed the ASEAN Treaty Of Amenity and Cooperation in Southeast Asia (ATAC). The objective of ATAC is an agreement among Southeast Asian countries not to get involved in each other's internal politics. At the Jakarta meeting in November 1996, the ASEAN foreign ministers agreed to accept Laos, Myanmar and Cambodia as full ASEAN members within the next three years.

Singapore, with a population of 1,634,000 people and a 4.69 percent average annual population growth. Singapore still had a deficit balance of trade with $1,136 million of export value and $1,332 million of import value with Malaysia, the UK and the USA as its major trading partners.

In 1980 the ASEAN members' income per capita was as follows: Singapore with $4,697 GDP was the wealthiest per capita and the other countries had lower GDP figures: $480 for Indonesia, $1,717 for Malaysia, $730 for the Philippines and $726 for Thailand.[4] The disparity of these indicators shows that a wide gap in terms of per capita income exists among ASEAN members. Generally, it was believed that these disparities were the biggest problem facing ASEAN, and that the member countries could form a strong economic cooperation until the disparities between them were reduced.

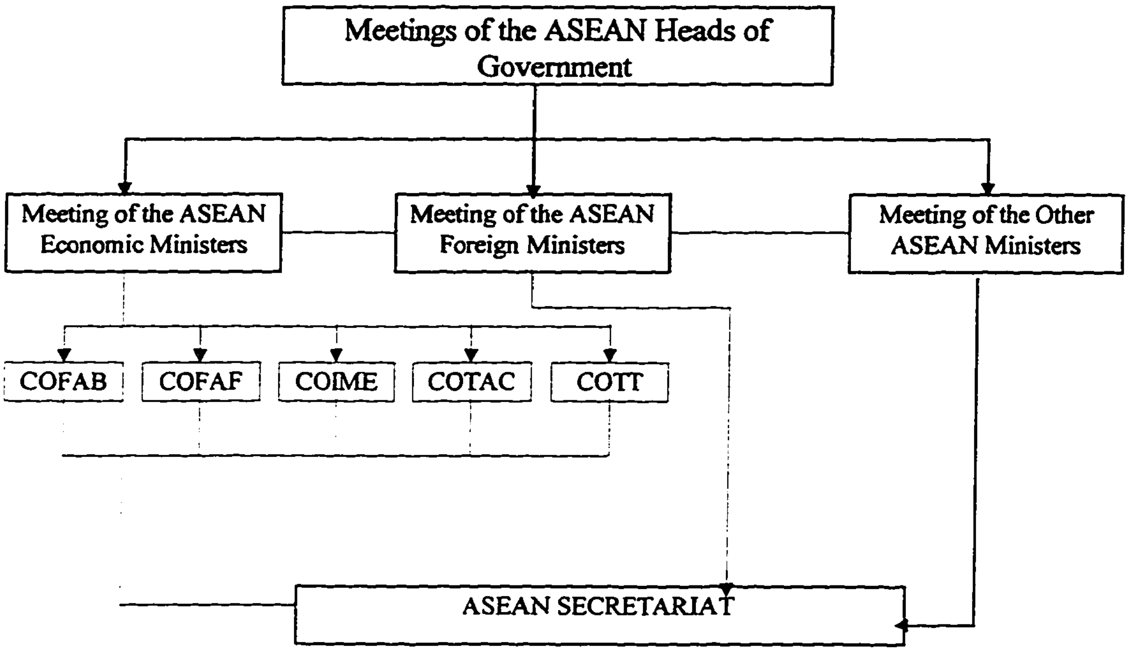
Recently, some members have stabilized their economies and supported issues that have been discussed at some recent ASEAN Ministerial Meetings. AMMs are relevant to my topic, for example, at Manila (12-13 March 1971), the principal objective of ASEAN was declared to be the creation of a limited free trade area and a payments union; Kuala Lumpur (26-27 November 1971), where the ASEAN Secretariat was established; Jakarta (7-9 May 1974) where it was decided to locate the ASEAN Secretariat in Jakarta; and finally Bali (23-24 February 1976); where the Heads of State and Foreign Ministers of ASEAN governments signed the Agreement on the Establishment of the ASEAN Secretariat. Thus, the history of ASEAN points to it being both a forum for existing cooperation among the neighbours of South

[4] Rieger (1991). Op. Cit., p. 103.

East Asia, as well as their relationships with other countries and regional trading blocs.

Having provided a chronology of development, we will examine the organizational structure of ASEAN, concentrating on the most relevant aspects. The highest level is the Meetings of the Heads of Government. The next level of ASEAN organization is the Meetings of the ASEAN Foreign Ministers, Economic Minister, and other ASEAN Ministers. The Meetings of ASEAN Economic Ministers have some committees: COFAB (Committee on Finance and Banking), COFAF (Committee on Food, Agriculture and Forestry), COIME (Committee on Industry, Minerals and Energy), COTAC (Committee on Transportation and Communication) and COTT (Committee on Trade and Tourism). COTT is sub-divided into the Sub-Committee on Tourism, the Working Group on Research and Development, the Working Group on Marketing, and the Experts Group on Trade Preference Negotiating Group (see Figure 4.1 below); also see the annex chart of the complete ASEAN organizational structure and ASEAN Secretariat.

Figure 4.1The Committee on Trade
and Tourism in ASEAN Organization




**4.1b ASEAN Free Trade Area (AFTA)**

Another significant step in the process of ASEAN becoming a mature regional association, occurred ten years after the Bangkok Declaration, at the Manila meeting (20-22 January 1977), where the foundation of economic cooperation among ASEAN members was approved by the Economic Ministers of ASEAN. They declared a draft of the Preferential Trading Arrangements (PTA). This PTA was not a new design for ASEAN economic cooperation; it had already been suggested by Filipino President Ferdinand Marcos on 12 March 1971 at the opening of fourth ministerial meeting in Manila. He suggested that

> to realize the ultimate goal of establishing an ASEAN Common Market, the association should take bold steps now by setting up at an early stage a limited free trade area on a selective

commodity basis and by establishing a payments union within the ASEAN region.[5]

Again in 1981 at the ASEAN Economic Ministers Meeting (29-30 May), the Philippines proposed that the creation of an ASEAN free trade area should be done within ten years through gradually decreasing tariffs every three years by 25 percent and finally eliminating the last 25 percent in the tenth year. Thus, it could be said that the Philippines has been a leader in tariff reduction in ASEAN.

Trade among the ASEAN members is described in Table 4.2 below:

Table 4.2 The Matrix of Intra-ASEAN Trade in 1970 and 1981 (millions US $)

| Country | Indonesia | Malaysia | Philippines | Singapore | Thailand | ASEAN |
|---|---|---|---|---|---|---|
| Indonesia | | | | | | |
| 1970 | - | 36.0 | 26.0 | 172.0 | 0.9 | 234.9 |
| 1981 | - | 63.0 | 208.0 | 2,177.0 | 30.0 | 2478.0 |
| Malaysia | | | | | | |
| 1970 | 11.0 | - | 29.0 | 364.0 | 15.0 | 419.0 |
| 1981 | 38.0 | - | 179.0 | 2,652.0 | 192.0 | 3,061.0 |
| Philippines | | | | | | |
| 1970 | 2.0 | 0.9 | - | 7.0 | 3.0 | 12.9 |
| 1981 | 204.4 | 104.1 | - | 125.2 | 22.1 | 455.8 |
| Singapore | | | | | | |
| 1970 | 0.5 | 340.0 | 4.0 | - | 51.0 | 395.5 |
| 1981 | 1,243.0 | 3,269.0 | 274.0 | - | 883.0 | 5,669.0 |
| Thailand | | | | | | |
| 1970 | 16.0 | 40.0 | 0.9 | 49.0 | - | 105.9 |
| 1981 | 113.5 | 345.0 | 17.4 | 491.7 | - | 967.6 |

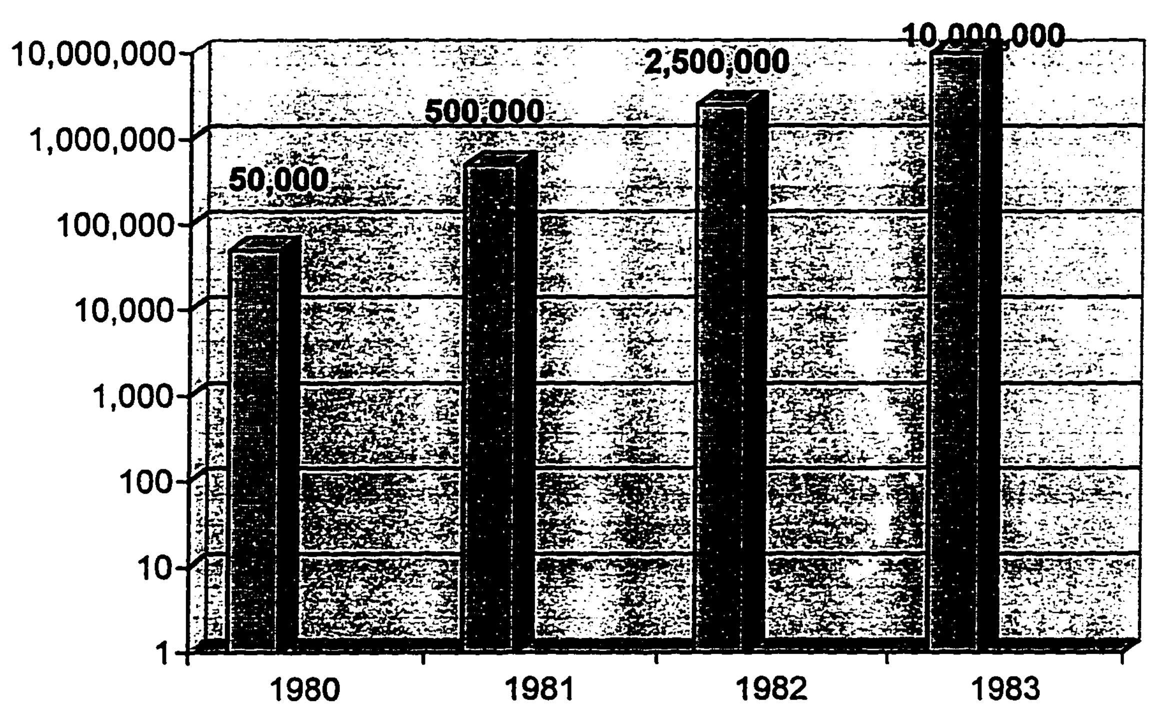
Sources: Jackson, Karl D. And Soesastro, M. Hadi. ASEAN Security and Economic Development, Institute Of East Asian Studies, University of California, California, 1984, p. 50.

Between 1970 and 1981 all ASEAN countries had increased their trade within ASEAN: Indonesia by more than ten times, Malaysia by more than seven times, Singapore by more than fourteen times, Thailand by more than nine times, and most significantly the Philippines by more than 35 times. Every ASEAN member has

[5] Ibid., p 106

increased its exports to other members since 1970, and also increased its imports from other members. The increasing intra-ASEAN trade was driven by their agreement of the Preferential Trade Arrangement (PTA). Since then, the discussion of an ASEAN Free Trade Area has been reviewed periodically, with the following results. In April 1980 the ASEAN economic ministers decided to reduce the tariff on "light items," which are commodities that have imported values of less than $50,000, since 1980, every year the tariffs have been reduced and the ceiling increased. In May 1981 the ceiling was increased to $500,000; by May 1982 it had rapidly become $2,500 million; and in 1983 the ceiling range was between $2,500 and $10,000 million, (see Figure 4.2 below).

Figure 4.2 The graph of Development value of ASEAN Preferential Trade Arrangement (PTA)



Recently ASEAN members have realized that the complex environment of international trade has moved toward a new trend of trading blocs, especially since the formation of NAFTA and a single European market. Even though Japan is ASEAN's major trading partner, NAFTA and the EU are also important trade destinations for ASEAN. Maintaining trade, aid, investment, and even the transfer of technologies from NAFTA and Europe is vital for ASEAN's development. In order to secure their economies from other potential threats, ASEAN members needed a new approach. Trading blocs threatened ASEAN trade by making it difficult for ASEAN products to cross the barriers established by the blocs. Thus, in January 1992, at the summit meeting of ASEAN heads of government in Singapore, the ASEAN members agreed to gradually reduce their tariff barriers, particularly in terms of manufacturing goods, creating the ASEAN Free Trade Area (AFTA) through an arrangement of Commonly Effective Preferential Tariff (CEPT) schemes.

The difference between PTAs and CEPT schemes is that unlike PTAs, the CEPT scheme is hoped to cover all ASEAN products, even though some ASEAN members offered some resistance in many subsectors. Generally, the tariff reductions were made in two phases; and the CEPT commenced on 1 January 1993 for products which had been subjected to a tariff rate of up to 20 percent. It was agreed to reduce them to less than 20 percent for the next eight years. The tariffs were to be decreased by between zero to five percent with the time periods individually determined by the ASEAN members. For the products for which the tariffs rate of 20 percent had been imposed gradually over seven years, the tariffs were to be reduced from zero to five percent. The ASEAN economic ministers agreed not to exceed 15 years for both phases in order to increase the opportunities for ASEAN private business to enter into new business possibilities within ASEAN members as a benefit of the AFTA scheme.

Another reason for creating AFTA, according to Soesastro, was that ASEAN member nations also realized that the strength and improvement of intra-ASEAN economic cooperation had become essential for the ASEAN's development and relevance. It was felt that closer economic cooperation had become more feasible given the changing nature of the ASEAN countries. In addition, the external shocks of the 1980s had forced the ASEAN countries to adjust by adopting outward oriented strategies and unilateral liberalization. Thus, the decision to establish AFTA seems to indicate that ASEAN need to be increasingly integrated so as to create its own internal market to counter other trading blocs. If they had not created their own market, their economies would have eventually moved away from ASEAN.[6] (see Tables 4.3 and 4.4 below). Furthermore, some manufacturers from other industrializing countries had started to move their production plants and capital investment into other parts of Asia, including India and China. ASEAN decided not to wait and watch those trends, but rather to be proactive in attracting these foreign direct investment flows.

The main impediment to greater intra-ASEAN trade through the establishment of a free trade area is rooted in the economic structures of the ASEAN countries, which are competitive rather than complementary.[7]

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[6] Soesastro, Hadi. ASEAN and APEC, p.3, Washington University, 1995, (Internet).

[7] Chan, Steve. East Asian Dynamism: Growth, Order and Security in the Pacific Region, Boulder - Oxford: Westview Press, 1993.

Table 4.3 The Value of Intra-trade of Some Regional Groups
(Exports in millions US $)

| Regional Groupings | 1970 | 1980 | 1985 | 1990 | 1992 | 1993 |
|---|---|---|---|---|---|---|
| ASEAN | 1,285 | 12,015 | 13,130 | 26,367 | 34,908 | 41,748 |
| EU | 138,459 | 844,655 | 774,823 | 1,8141,80 | 1,947,967 | 1,594,617 |
| NAFTA | 22,078 | 102,217 | 143,190 | 226,273 | 254,668 | 296,578 |
| CACM | 287 | 1,174 | 544 | 671 | 908 | 935 |
| UMA | 60 | 109 | 274 | 958 | 938 | 823 |

Source: UNCTAD, Handbook of International Trade and Development Statistic, 1994, p. 34.

Note: EU (European Union) covers Austria, Belgium, Denmark, France, Finland, Germany, Greece, Ireland, Italy, Netherlands, Luxembourg, Portugal, Spain, Sweden and United Kingdom;

CACM (Central American Common Market) consists of Costa Rica, El Savador, Guatemala, Honduras and Nicaragua.

UMA (Arab Maghreb Union) covers Algeria, Libyan Arab Jamahiriya, Mauritania, Morocco and Tunisia.

Table 4.4 Share of Intra-Trade Some Regional Groups
as percentage of total export of each group

| Regional Groupings | 1970 | 1980 | 1985 | 1990 | 1992 | 1993 |
|---|---|---|---|---|---|---|
| ASEAN | 21.1 | 16.9 | 18.4 | 18.7 | 19.1 | 20.0 |
| NAFTA | 36.0 | 33.6 | 43.9 | 41.4 | 41.9 | 45.4 |
| CACM | 26.0 | 24.4 | 14.5 | 15.4 | 19.5 | 14.2 |
| UMA | 1.4 | 0.3 | 1.0 | 2.8 | 3.2 | 3.2 |

Source: UNCTAD, Handbook of International Trade and Development Statistic, 1994, p. 35

Although the value of ASEAN intra-trade has grown significantly since the 1970s (from $1,285 million to $47,748 million by 1993), the share of ASEAN intra-trade was nevertheless relatively small compared to other developing countries groups such as NAFTA and EU. Indeed the percentage share of intra-ASEAN trade of total exports decreased from 21.1 % in 1970 to 20 % in 1993. Compared to other developed countries groups such as CACM and UMA, ASEAN's position would be better still if it had maintained its share by up to 15 % in the 1980s and 1990s.

The pattern of ASEAN trade has shifted slightly from an emphasis on primary commodities to manufactured exports. For example, manufactured exports have increased from 4.9 percent of the total export in 1978 to 12.8 percent in 1991.[8]

Supporting the ideas of AFTA, Luhulima writes that "the basic flaw in the argument of the ASEAN cooperative economic schemes is that it starts from the basic assumption that each ASEAN member state is willing to share its entire domestic market with the other members".[9] This assumption has proved to be an illusion. Such willingness may occur in later stages of economic cooperation, but not at this time. It is conceivable that in the not too distant future ASEAN countries might accept the idea of a single market. For now, however, each country is anxious to preserve an important part of its internal market for its own industries. Moreover, the size of the ASEAN market itself is still not big enough to ensure the growth of an efficient and strong industrial sector. However, an inward-looking and protective ASEAN economic policy is likely to breed inefficient industries. ASEAN may enjoy a protected market, but its members will remain unable to compete with imports from outside the region. ASEAN should thus retain its economic course of outward-looking regional economic grouping. Economic cooperation should reflect this orientation.

The basic objective of the ASEAN Free Trade Area was to set up a regional market with low effective tariffs (maximum five per cent) and without non-tariff barriers. It was also formed to meet the challenges posed by the creation of the

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[8] Naya, Seiji. "The Role of Trade Policy in Industrialization of Rapid Growth Asia Developing Countries", from Achieving Industrialization in East Asia edited by Helen Hughes, p. 76-81, Cambridge University Press, 1988.

[9] Luhulima, C.P.F. "The Performance of ASEAN Economic Cooperation". The Indonesian Quarterly, volume XXII no. 1, p. 16, Center for Strategic and International Studies (CSIS), Jakarta, 1994.

single European market and the NAFTA. Many people in the ASEAN region believed that the creation of such regional economic blocs would not only cause them to lose their market, but also could take part of ASEAN trade with that of Mexico in the terms of NAFTA and Greece and Portugal in terms of the single European market.[10]

Finally, in accordance with developing regional solidarity among the neighbors based on regional peace and stability, ASEAN will become a mature international organization which will include all South East Asian nations by the year 2000 (it is hoped it will include ten nations: the Philippines, Brunei, Indonesia, Singapore, Malaysia, Thailand, Vietnam, Laos, Myanmar, and Cambodia) and will be counted as an important organization in Asia.

Indonesia, as a member of ASEAN, has always considered ASEAN cooperation as the cornerstone of foreign policy for its members. Since its inception, ASEAN has succeeded in making the region stable and peaceful. This situation has enabled ASEAN members to continue their national development programs in order to increase their people's welfare and living standards. ASEAN was recognized as a significant strategy, because without it there could be no stability and no prosperity. Although some attempts at cooperation, such as in the areas of trade and industry have not yet met members' expectations, ASEAN is still vital in the region's foreign policy.[11]

### 4.2 THE DYNAMIC DEVELOPMENT OF INDONESIAN TRADE IN ASEAN

To enhance Indonesian trade, especially to ASEAN destinations, the Indonesian government pursued special trade policies through an understanding

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[10] Ibid., p.18.

[11] Mangkusuwondo, Suhadi. "Pacific Economic Cooperation and Indonesia", the Indonesian Quarterly, Vol. XIX no. 1, first quarter , p. 86. Central for Strategic and International Studies (CSIS), 1991.

with ASEAN members, so that trading relationships are mutually beneficial. Furthermore, we can also argue that ASEAN is important for Indonesia because maintaining ASEAN as a regional cooperation based on a stable and peaceful environment could enhance Indonesian trade in manufactured goods within ASEAN.

Table 4.5 The Value of Indonesian Exports to ASEAN
1990 and 1994 (millions US $)

| DESTINATION | 1990 | | 1994 | |
|---|---|---|---|---|
| | Value | Share (%) | Value | Share (%) |
| Singapore | 1,902.10 | 7.41 | 4,149.70 | 10.36 |
| Malaysia | 253.20 | 0.99 | 738.50 | 1.84 |
| Thailand | 188.50 | 0.73 | 401.30 | 1.00 |
| Philipines | 160.60 | 0.63 | 365.10 | 0.91 |
| Brunei | 10.70 | 0.04 | 50.20 | 0.13 |
| ASEAN | 2,515.10 | 9.80 | 5,704.70 | 14.24 |
| Total export 1980 | 25,675.30 | 100.00 | 30,359.80 | 100.00 |

Source: The Indonesia Trade Department. Trade Statistics, no. 145, p. 67,February 1996.

The value and share of Indonesian exports to ASEAN destinations has grown significantly from 1990 to 1994. The major ASEAN market destination for Indonesian exports was Singapore, where the value rose from $1,902.1 million in 1990 to $4,149.7 million in 1994.

Table 4.5 The Value of Indonesian Imports from ASEAN
1990 and 1994 (millions US $)

| DESTINATION | 1990 | | 1994 | |
|---|---|---|---|---|
| | Value | Share (%) | Value | Share (%) |
| Singapore | 1,271.50 | 5.82 | 1,877.10 | 5.87 |
| Malaysia | 325.60 | 1.49 | 578.80 | 1.81 |
| Thailand | 183.40 | 0.84 | 406.20 | 1.27 |
| Philipines | 55.00 | 0.25 | 65.30 | 0.20 |
| Brunei | 0.30 | 0.00 | 0.30 | 0.00 |
| ASEAN | 1,835.80 | 8.40 | 2,927.70 | 9.15 |
| Total export 1980 | 21,837.10 | 100.00 | 30,359.80 | 100.00 |

Source: The Indonesia Trade Department. Trade Statistics, no. 145, p. 67,February 1996.

From these tables, we can determine that Indonesia could maintain ASEAN imports below 10 percent of the import share. Compared with Indonesian exports to ASEAN destinations, the total trade between Indonesia and ASEAN gave Indonesia a surplus balance of trade in 1990 and 1994; thus, it can be seen that ASEAN is important for Indonesia.

Meanwhile, the changing structure of Indonesian exports and imports in intra-ASEAN trade in the manufacturing sector also increased since 1979. The share of export manufacturing in 1979 was 14.9 percent and increased steadily to 28.6 percent in 1984 and 48.8 percent in 1989. It seems that every five years Indonesian manufacturing exports increase more significantly - over five times. At the same time, Indonesian manufacturing imports have risen from 23.7 percent in 1979 to 28.7 percent in 1984 and 49.4 percent in 1989. Nevertheless as the percentage increase of export manufacturing is higher, the surplus manufacturing balance of trade for Indonesia is positive, as illustrated in Table 4.7 below.

The more significant products for Indonesian exports are textiles, wooden and rattan furniture (exported mainly to Singapore) and the most significant products for imports are chemicals, electronic, plastics, vegetables oils and pulp. Indonesian export products to ASEAN destinations such as pulp product increased which is classified into code of 64 (SITC, Standard International Trade Classification). Wood pulp counted for \$30,890,100 to Singapore and \$13,645,800 to Malaysia in 1990, and, in 1994 increased to \$54,820,300 to Singapore and \$54,095,000 to Malaysia.[12]

[12] The Indonesian Trade Department. Trade Statistics, no. 145/BL/96, p. 113, February 1996.

Table 4.7 The Changing Share of Indonesian Manufacturing Trade with ASEAN in 1979, 1984 and 1989 (millions US $)

| Description | 1979 | 1984 | 1989 |
|---|---|---|---|
| Export: | | | |
| Total | 2,229 | 2,487 | 2,429 |
| Manufacturing | 332 | 710 | 1,186 |
| Share | 14.9 % | 28.6 % | 48.8 % |
| Import: | | | |
| Total | 838 | 1,948 | 1,765 |
| Manufacturing | 199 | 559 | 872 |
| Share | 23.7 % | 28.7 % | 49.4 % |

Source: Mangkusuwondo, Suhadi. ASEAN: Future Directions, The Indonesian Quarterly, Centre for Strategic and International Studies (CSIS), Jakarta, volume XIX no. 2, Second Quarter 1991, p.177.

A recent phenomenon between Indonesia and other ASEAN members is the creation of growth triangles by linking their territories to create zones of close economic cooperation. The fundamental idea behind the concept of a growth triangle is for parts of national economies to concentrate their resources in certain areas and to utilize their comparative advantage to bring about mutual economic benefits. One example of this is Batam Island, set up by the governments of Indonesia and Singapore to create an industrial zone for private companies, and based on the opportunities of private investment in the island. SIJORI (Singapore, Johor and Riau), is a similar scheme of economic cooperation, between the cities of Singapore, Johor in Malaysia, and Riau in Indonesia. These three territories link to smooth the flow of goods and services among the cities. This economic cooperation was based on the natural resources of its territories. The impact of SIJORI has had two important consequences for other growth. One is in Malaysia, with the Northern Growth Triangle consisting of four northern Malaysian peninsular states, two northern Sumatra provinces of Indonesia and five southern provinces of Thailand.

The second initiative is the East ASEAN Growth Area, an initiative of the Philippines involving the southern Philippines, east Malaysia, Brunei and eastern Indonesia.[13] Although these initiatives involve ASEAN members, they were set up as bilateral arrangements with neighboring countries.

Another distinctive feature of the ASEAN program incorporates the distribution of resource-based, large-scale industries among the ASEAN members. The implementation of resource-based program is that ASEAN agree to establish plants such as a fertilizer factory in Indonesia, an urea plant in Malaysia, a soda ash plant in Thailand and a copper fabrication plant in the Philippines. In the field of large-scale industries, especially the development of industrial complementary schemes under which ASEAN member produce complementary goods within their specific sectors, Indonesia was chosen to be the center for the production of diesel engines, motorcycles axles and wheel rim for motor cycles.[14]

These ASEAN policies were decided in April 1980 when ASEAN ministers agreed to make across-the board tariff cuts on thinly-trade goods. These policies consist of three market sharing schemes: ASEAN Industrial Projects (IPs); Industrial complementary Agreements (ICs); and Industrial Joint Venture (IJVs). Under IPs, in January 1984 the urea plant was established in Aceh (western Indonesia) and $410 million was invested. The project is losing money because there is a world fertilizer glut. The project was estimated to produce 430,000 tons annually, of which 55 % would be sold domestically. Another 37 % was intended to be exported to the rest of

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[13] Kurus, Bilson. "The ASEAN Triad: National Interest, Consensus-Seeking, and Economic Co-operation", Contemporary Southeast Asia, volume 16 number 4, March, p.417, ISAS, Singapore, 1995.

[14] Poot, Huib, Arie Kuyvenhoven and Jaap Jansen. Industrialisation and Trade in Indonesia, p. 441-442, Gajah Mada University Press, 1992.

ASEAN. In the event urea production could not be sold to Malaysia and Thailand because they already have a fertilizer plant. Malaysia argued that the regional market for this product is still not big enough for such IPs. Other IP schemes were a soda-ash factory in Thailand and copper fabrication plant in Philippines. These have also been failures because of falling demand.

The ICs have been an even larger failure than IPs. The aim was to make different components of single products (or product range) which would be traded within ASEAN, for example automotive products. The idea never bore fruit, partly because of its complexity. In addition Singapore objected strongly to these.[15]

After reviewing the development of Indonesian manufacturing trade with ASEAN destinations, we can conclude that the significance of ASEAN destinations for Indonesia's exports. ASEAN, for Indonesia, is an important vehicle to secure regional stability in order to pursue and enhance its economic development. In other words, we could say that with regional peace and security, ASEAN has accommodated the economic development, particularly of Indonesia's manufacturing trade.

## 4.3 APEC FROM ASEAN PERSPECTIVES

In Chapter 1, we proposed that we would answer the question of why APEC is important to its members, particularly ASEAN. We are arguing that although ASEAN members tried to keep APEC as a dialogue partner and not as an institution for economic cooperation, ASEAN should support APEC and work with APEC

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[15] Economist, p. 73, 15 February 1986, no. 298 number 7433.

members by these mean the success and legacy of ASEAN can be maintained and developed further.

Although a new wider form of economic cooperation was needed by ASEAN, there were some different nuances among ASEAN nations about joining APEC. The strongest opposition came from the Prime Minister of Malaysia, Mahathir bin Mohamad. He argued that APEC as an institution would weaken ASEAN because the industrializing nations would dominate APEC. According to him, APEC should continue to be a free consultation forum and not be changed into a negotiation forum. Consequently, he proposed his own idea in 1990, to create an East Asian Economic Group, known as the East Asia Economic Caucus (EACC). Through the concept of EACC it was hoped that ASEAN members as well as Japan, Hong Kong, Taiwan, China, South Korea, and the countries of Indochina would join. The basic reason for the EACC was the necessity of one voice in cooperation that would speak for these countries against other economic groups. In terms of APEC, Mahathir also argued that the EACC could possibly counter the domination of the USA in the APEC forum.

Meanwhile, other ASEAN members expressed different reactions to the idea of EACC. The majority of ASEAN members were not in favor of it with Singapore as a dissenter voicing support. Indonesia, Philippines and Brunei tried to avoid Mahathir's idea because they tend to secure their market access and investment sources from NAFTA members.[16] Furthermore, Thailand argued that ASEAN should

[16] Yam, Tan Kong, Toh Mun Heng, and Linda Low. "ASEAN and Pacific Cooperation", in K.S. Sandu, et.al. (compls.), The ASEAN Reader, Singapore: Institute of Southeast Asian Studies, 1992.

strengthen intra-ASEAN cooperation before it formed other trade groups. Although the idea of EACC remains on the table, it is still very much in the future.

There are several reasons for ASEAN countries being hesitant about joining APEC. The first concern is the potential for the erosion of ASEAN by joining a wider economic grouping. The second concern is that APEC could become a forum for trade negotiation, dominated by big industrial countries, particularly the USA and Japan. ASEAN would much prefer the multilateral type of forum as used in the past by GATT.[17]

However, in accordance with the disputes of external ASEAN cooperation, Drysdale and Elek (1995) point out, an important feature of ASEAN integration was that its strength was based, ultimately, on building confident economic relations with rest of the world, not on inward-looking integration focused on intra-ASEAN trade, which has remained low (around 20 per cent share of total trade ASEAN economies).[18] (see also Table. 4.4 above)

ASEAN uses the so-called Post Ministerial Conference (PMC), as the consultation forum for APEC. At these conferences, the six ASEAN foreign ministers meet and discuss with ASEAN's dialogue partners: the USA, the EU, Japan, Canada, Australia, New Zealand and recently the Republic of Korea. From ASEAN's perspective, this forum should also serve as APEC's consultations.[19] The Jakarta Post reported that APEC members should recognize that ASEAN's has a position on the issues under consideration and that this will evolve as its members further

[17] Mangkusuwondo, Suhadi. An Indonesian View of APEC, in The Indonesian Quarterly, p. 295, no. XXII/4, fourth quarter 1994.
[18] Drysdale, Peter and Elec, APEC: Community-building in East Asia and Pacific section 1, 1995 (Internet).
[19] Mangkusuwondo (1991). Op. Cit., p. 86.

progress in their economic development. Therefore, it is important that APEC develop an agenda which addresses the issue of economic disparities among its members. President Soeharto from Indonesia had been reported to have expressed the view that APEC should remain a loose and informal forum because of disparities in the level of economic development among its members[20]. Furthermore, he also stated that by participating in the open regionalism process, ASEAN will help prevent the creation of closed economic and trade arrangements which are inconsistent with ideals of the Uruguay Round and at the same time this will put ASEAN in a more favorable position to seize the opportunities created by globalisation and free trade.[21]

It was a long journey to decide whether joining another international group forum was appropriate for ASEAN. Some ASEAN activities had already involved other international groups and they were involved in APEC meeting from the outset. The "Kunching Consensus" of 1990 reached by ASEAN members, established a series of guiding principles for membership. These were that

- ASEAN's identity and cohesion should be preserved and its cooperative relations with its dialogue partners and with third countries should not be diluted in any enhanced APEC;
- An enhanced APEC should be based on the principles of equality, equity and mutual benefit, taking fully in account the differences in stages of economic development and social-political systems among the countries in the region;
- APEC should not be directed towards the formation of an inward looking economic or trading bloc but, instead, it should strengthen the open, multilateral economic and trading systems in the world;

[20] ________, The Jakarta Post, January 24, 1994, p.1 (daily newspaper)
[21] Embassy of Indonesia. Antara News Agency, Thursday, 12 September 1996 (Internet).

- APEC should provide a consultative forum on economic issues and should not lead to the adoption of mandatory directives for any participant to undertake or implement;

- APEC should be aimed at strengthening the individual and collective capacity of participants for economic analysis and at facilitating more effective, mutual consultations to enable participants to identify more clearly and to promote their common interest and to project more vigorously those interests in the larger multilateral forums; and

- APEC should proceed gradually and pragmatically, especially in its institutionalization without inhibiting further elaboration and future expansion.[22]

Based on the arguments above, it is clear that the need for a new wider forum for cooperation for ASEAN is its first priority, even though Malaysia is still doubtful and would prefer the EACC. But the consensus had been decided among the ASEAN members to accept APEC as a single candidate and it has been considered an appropriate way for widening ASEAN cooperation.

At least two possible models of cooperation forums can be seen for widening ASEAN external cooperation:

a. ASEAN-APEC as a North-South cooperation forum

b. ASEAN-APEC as a transPacific cooperation forum.

ASEAN-APEC as a cooperation forum for North and South would mean that since APEC members comprise both industrializing and developing countries, ASEAN could guarantee a stable investment and trade liberalization in Asia-Pacific regions through an active involvement in APEC forum. ASEAN members believe that with declining dependence upon international trade, ASEAN could force a

[22] Soesastro (1995) Op Cit., p. 5.

significant play in trade cooperation between developing and industrializing countries, as well as investment.

The significance of North - South dialogue and cooperation was described by the Foreign Minister of Indonesia, Ali Alatas. He stated:

> What relevance do North-South issue have for ASEAN and what is ASEAN's stake in the North-South negotiations? I submit that not only has ASEAN a vital stake in them, but it has also crucial role to play both in the North-South dialogue and in the recovery of world economy. ASEAN direct interest is involved in at least four areas central to the New International Economic Order, namely, primary commodities, international trade, transfer of technology, and money and finance, with a fifth area, energy, being of particular concern to Indonesia.... [I] would like to stress that while ASEAN has always been vocal and firm in its support of New International Economic Order, its approach has always been a rational one. We do not seek zero-sum outcome in North-South negotiations but a global economic order of mutual and equitable benefit to all countries. While our position is inseparable from that of the Group of 77, we believe that because of particular strengths, traditions, and temperaments we can and should play a substantial, constructive, and moderating role, both within our own group as well as vis-à-vis the countries of the North. We are determined to continue to play that role in our own enlightened self-interest as well as, we would hope, in the interest of greater stability, security, and progress for the region and for the world.[23]

Since APEC was launched in 1989, it has been regarded as an important framework to support and strengthen the investment and trade liberalization system for both North and South. There is at least one important issue relating to the present discussion, namely the issue of a regional multilateral trading system. This issue was a significant opportunity for APEC to explore the basic actions necessary for further gain of interdependent trade among members based on the GATT. ASEAN members of APEC would benefit because together they could create a strong bargaining position in the APEC forum to counter the dominant position of

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[23] Alatas, Ali. "North-South Issues and their Relevance to ASEAN". In <u>ASEAN Security and Economic Development</u>, edited by Karl D Jackson and M Hadi Soesastro, p.10 and p.15 Institute of East Asia Studies, University of California, California, 1984,

industrialized countries. Trade liberalization and investment could also bring benefits to ASEAN, if the latter made APEC as a forum for channeling trade liberalization and investment, particularly with the USA and Canada. Through active participation in APEC, ASEAN could address its interest together based on the principle of give and take.

In order to enhance their intra-ASEAN trade, ASEAN members could become a strong bargaining bloc in APEC. Naya and Plummer (1992) suggest, for example, that ASEAN should stay together because

> by working together as a "bargaining bloc," ASEAN can ensure that its bargaining power will be maximized. Independently, ASEAN countries are small; together, they are a force to be reckoned with. Moreover, as ASEAN becomes more economically integrated through cooperation programs, it can act more in union in international negotiations and, hence, can increase its bargaining power. [T]he EC experience is exemplary; in international negotiations, the whole is greater than the sum of the parts.[24]

ASEAN-APEC as trans-Pacific economic cooperation forum would mean that APEC would act as a forum for economic matters and focus on trade liberalization and investment, particularly in the Pacific region. Based on the Bogor agreement, APEC members clearly showed their support of trade liberalization and investment by 2020 for developing countries and 2010 for industrializing countries. Trans-Pacific economic cooperation also means that this forum could be used by ASEAN to support ASEAN's export in the Pacific region especially to maintain intra-ASEAN trade and to widen the ASEAN's exports to the Pacific market.

The use of the APEC forum by ASEAN toward investment or capital flows

[24] Naya, Seiji, and Michael G. Plummer, "ASEAN Economic Co-operation: The New Intentional Economic Environment," in K.S. Sandhu, et.all. (compls.), p. 193, The ASEAN Reader, Singapore: Institute of Southeast Asian Studies, 1992.

from Pacific members, especially Japan, Australia, New Zealand, and the Republic of Korea is an important key to securing investment in ASEAN, in order not only to compete with South Asia and Eastern Europe, but also to maintain the major share of investment or capital flow from Japan, which is a major investor in ASEAN.

The two models above are not the final outcome from APEC for ASEAN as whole, however, ASEAN will have a positive benefit as long as they agree to move their external cooperation through active involvement in APEC. Furthermore, it can be noticed that APEC Leaders Meetings have taken place in two ASEAN members: Indonesia and Manila.

## 4.4 CONCLUSION

The Association of South East Asia Nation (ASEAN) was established to accelerate regional economic growth, social progress and cultural development based on the promotion of regional peace and stability. Although the disparity of economic performance within ASEAN members is wide, and a gap still exists between the wealthy nations with high per capita income and the lower per capita income nations, ASEAN is still needed by all its members to enhance stability and security in order to support economic development within its members.

With the growth of new regionalism, ASEAN has now been actively involved in other cooperation agreements or forums. Even though its members fear that joining other forms of cooperation might erode the solidarity of ASEAN, they agreed to join APEC as a new forum for external cooperation especially mutual economic cooperation. Initially, ASEAN members offered a dialogue to ASEAN partners such as Japan and the United States, but eventually ASEAN members agreed to join APEC in 1990.

Because APEC mainly focuses on trade liberalization and investment, joining APEC could accommodate the main interest of ASEAN members, namely achieving their economic development. Through APEC, it is believed that ASEAN members could increase their exports through widening their market in the Pacific region. By adjusting ASEAN policy toward involvement in APEC, it is hoped that ASEAN will have at least two benefits: widening ASEAN's external cooperation forum through both a North - South forum and transPacific forum. Furthermore, from ASEAN's perspective, APEC is a significant, perhaps the most significant, foundation of regional architecture for peace and prosperity in a post-Cold War Asia-Pacific region.

# CHAPTER 5

# THE DEVELOPMENT OF INDONESIAN TRADE AND INVESTMENT

## 5.1 INTRODUCTION

This Chapter presents an in depth analysis, including historical of Indonesian trade and investment policies in the era of the New Order.

## 5.2 INDONESIA AFTER INDEPENDENCE

Indonesia is a republic with twenty-seven provinces, and is headed by a President. The People's Consultative Assembly or Majelis Permusyawaratan Rakyat (MPR) is the highest government authority. All government activities are the responsibility of the national government, and are generally implemented through a system of laws, decrees, regulations and instructions. MPR and the President must approve all laws and ministry-issued Presidential decrees.

President Soekarno and Vice President Mohammad Hatta governed Indonesia from its independence, August 17, 1945, until March 11, 1966. Soekarno's programme included several distinctive trade policies, namely "Inward-looking with Import Substitution"; "Self Reliance"; and "Withdrawal from the International Capitalist System". Those trade policies did not work well and the question can be asked: why did they not work? "Inward-looking with Import substitution" often implies extended protection of products so they are not competitive in the international market. This policy is usually used in Latin

America and Asia, but in South East Asia, South Korea in the 1960's, Taiwan in the 1950's used these policies with success.

The trade policies in Soekarno's programme did not work well for a number of reasons. Economic development was based on poor macroeconomic policy, which caused economic instability ending in hyperinflation. In addition, the government controlled foreign exchange tightly and decided to nationalize all colonial companies. Government regulation also tended to strictly control private domestic and foreign investment; and the government allowed state companies to dominate the economy. In *Indonesia: A Country Study*[1], Frederick (1993) states that Soekarno abused the Indonesian economy by starting ambitious building projects, nationalizing foreign enterprise and refusing to agree to foreign donor recommendations.

Soekarno's government made the "courageous" or foolhardy decision to withdraw Indonesia from the United Nations in 1960, because according to him, the international political situation was dominated by the capitalist system. Not only did he walk out of the United Nations, but he also said, "Go to Hell with Your Aid" to Western donors. This statement angered western donors, and this was compounded by Soekarno's Russian and Chinese ties. He easily lost power in a coup on March 11, 1966. It can be said that in general Soekarno's programme was not in vain, but his personal interest in political development was bigger than his interest in economic development. This had the effect of

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[1] Frederick, William H. Indonesian: A Country Study, p.7, Washington D. C: Federal Research Division, Library of Congress, 1993.

undermining the country's economic growth in the 1960's, resulting in lower GDP and hyperinflation.

Through the Letter of President Order on March 11, 1966, SUPERSEMAR (Surat Perintah Sebelas Maret), Soeharto become acting president to continue the day-to-day duties of the president. One year later he became the second president of Indonesia and with this, Indonesia began a New Order of the national development planning, and become successful in economic development. In the 1960's Indonesia was categorized as a poor country with $ 75 GNP per capita, while in 1996 it was predicted to be $ 1,000. The inflation rate decreased drastically from 650% in 1965 to between eight and ten percent in the 1990's. Life expectancy rose dramatically from 41 years in 1965 to 61 years in 1990, and mortality and illiteracy rates fell steeply. Moreover, the number of people living below the poverty line dropped to about 15% in 1995, and nearly all of the nation's children now attend primary school. Compared with three and a half decades ago when farming households were the main centre of economic activity, the industrial sector accounted for 23% of GDP in 1994, up from 5-6 % in the 1960's.[2]

Soeharto's programme was so successful that he was declared as Father of Indonesia Development (Bapak Pembangunan Indonesia) in 1983 due to the his achievement of Indonesian development. Soeharto's programme can be divided into five periods (see Table 5.1):

[2] McBeth, John. Succession Talk Recedes, Far East Economic Reviewed, volume 158, number 20, p. 48, Jakarta.

(1) Rehabilitation and stabilization: 1967-1973;

(2) The oil boom: 1974-1981;

(3) The first external shock: 1982-1985,

(4) The second external shock: 1986-1988;

(5) And the Recovery: from 1988 until present.[3]

The central objectives under the New Order programme are the Trilogi Pembangunan (Development Trilogy), which consists of Stabiltas (stabilization), Pemerataan (equity) and kesejahteraan sosial (social justice), are always reflected in each Repelita (Rencana Pembangunan Lima Tahun or five year Plan).[4]

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[3] Base on Marie Pangestu article: The role of state and economic development in Indonesia, The Indonesian Quarterly, Volume XXI, number 3, Jakarta, p. 256, third quarter, 1993.

[4] Hill, Hall. Indonesia's New Order: The Dynamics of Socio-Economic Transformation, p. 105, Allen & Unwin, Australia, 1994

Table 5.1 Changes in Policy Direction and External Conditions

| Period | Changes in External Environment | Policy Direction: Macroeconomic Policy | Trade and Industrial Policy | Ownership and Government Regulation |
|---|---|---|---|---|
| 1958-65 Guided Economy | | Growing Instability ending in hyper-inflation; foreign exchange control | Strongly Inward Oriented | Nationalisation; state dominated economy; strict control over private domestic and foreign investment |
| 1967-73 New Order Rehabilitation & Stabilisation | | Successful stabilisation; open capital account | Moderately Outward Oriented (beginning of Import Substitution Policy) | Liberalisation of domestic and foreign investment; some rationalisation of state owned enterprises (SOE) |
| 1974-81 Oil Boom | Sharp increase in oil prices 1973; and non oil commodity boom 1975-79; second oil price increase 1979 | Maintenance of macroeconomic stability, although some inflation from lack of sterilisation of oil revenue | Growing inward orientation (increasing ISI) | Increasing share of public investment and SOE. Growing restrictions on foreign and domestic investment |
| 1982-85 First External Shock | Decline in oil prices. Decline in primary commodity prices | Macroeconomic stabilisation; fiscal austerity, devaluation and tight monet. pol. | Strongly Inward Oriented; proliferation of non-tariff barriers | Continued reliance on SOE and regulation of market economy |
| 1986-88 Second External Shock | Sharp decline in oil prices and continued decline in primary product prices. Yen appreciation; shock on external debt | Continued macroeconomic stabilisation; devaluation, tight monetary policy and balanced budget | Shift to Outward Oriented Economy | Deregulation of customs and imports; relaxation of foreign and domestic investment regulations; reduced reliance on SOE and public investment |
| 1988-present Non Oil Led Recovery | Stable oil prices. Further decline in primary commodity prices | Maintenance of macroeconomic stability | Further shift to Outward Oriented Economy | Deregulation extended to investment, finance, maritime and other areas; initial steps towards SOE reforms |

Source: Pangestu, M. The Role of the State and Economic Development in Indonesia, in The Indonesian Quarterly, p. 254, Vol. XXI No.1, Third Quarter. 1991

Table 5.2 shows that during 1965 to 1970 gross domestic investment, savings, external debt and trade as a percentage of GDP have increased. Over the same period total debt service as a percentage of exports declined almost twofold. Table 5.2 also describes that when Soeharto came to power, economic growth and development increased drastically. Economic growth was defined by the rising share of goods and services products in agriculture, manufacturing, other industry, and services while economic development was defined an increasing percentage of trade, gross domestic investment and gross national savings.

The changing share of goods production from agriculture to manufacturing and service has shown that Indonesia has been concerned with economic growth. Through the changing of the agricultural base towards manufacturing, Indonesia concentrated on pushing the growth of trade in order to achieve increasing foreign exchange. Therefore, the changing of the economic path reflects clearly that Indonesia tried to enhance economic development. Meanwhile, the changing base needed an extensive amount of investment, so the government enacted economic reforms, especially to attract investors. Through these they not only hoped to create open and wide business opportunities for domestic or international investors, but to expand export products to earn foreign exchange.

Table 5.2 [5] Economic Growth and Development Indicators

| ITEMS | 1965 | 1970 | 1980 | 1990 |
|---|---|---|---|---|
| As Percentage of GDP | | | | |
| Openness: | | | | |
| Total Trade | 14.0 | 22.2 | 46.8 | 54.7 |
| Non Oil Export | 4.0 | 7.0 | 11.5 | 15.7 |
| Imports | 7.5 | 10.6 | 15.5 | 26.3 |
| Gross Domestic Investment | 8.0 | 10.8 | 18.7 | 24.6 |
| Gross National Saving | 7.9 | 9.5 | 32.8 | 26.3 |
| Sector Shares | | | | |
| Agricultural | 55.0 | 47.5 | 24.4 | 23.0 |
| Manufacturing | 8.5 | 10.9 | 13.5 | 18.8 |
| Others Industry | 6.5 | 8.9 | 29.8 | 19.1 |
| Services etc. | 30.0 | 32.7 | 32.2 | 39.1 |
| External Debt | 50.0 | 32.5 | 30.0 | 66.6 |
| As Percentage of Exports | | | | |
| Oil and Gas Exports | 40.0 | 40.5 | 78.5 | 44.8 |
| Debt Service | 11.0 | 6.0 | 13.9 | 27.3 |
| Private Investment as Percentage of Total | n.a. | n.a. | 51.0 | 64.7 |

Soeharto shocked the people, economists and politicians in December 1995 when he decided to restructure his cabinet. The new policies enacted changed the Coordination Ministry and merged the Trade Department and Industry Department to become the Industry and Trade Department. From a political point of view, this change showed that Soeharto does not always defend his ministers because he had never deactivated any of his cabinet ministers during his administration in the past. Politicians said that this was a new era of Indonesian political openness and a new atmosphere for the future political scene. From an economic perspective, the new policies have the potential to

[5] Pangestu, Marie. The role of state and economic development in Indonesia, The Indonesian Quarterly, Volume XXI, number 3, Jakarta, p. 256, third quarter, 1993.

reduce the bureaucracy and reduce costs. Therefore, it is hoped that the new policies will push exports to compete in international markets.

## 5.3 THE DEVELOPMENT OF INDONESIAN TRADE

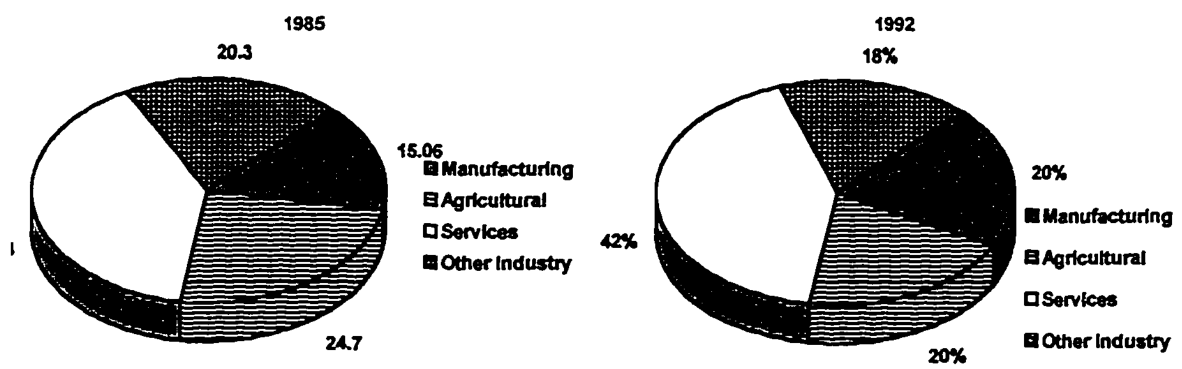
### 5.3.1 Indonesian Trade Policies

Exports are vital to Indonesian economic development. Earnings from exports give Indonesia foreign exchange, which allows it to buy the necessary machinery, or raw materials for domestic productivity and at the end provide a multiplier of economic growth. Indonesian exports were improving annually and became an engine of growth to push the development of the Indonesian economy. The government had concentrated on export promotion. The export yields are used to finance imports and the development of infrastructure, which requires revenues from exports as well as foreign aid.

During the 1980's, petroleum was the most important export commodity, and other exports included agricultural products such as rubber, coffee, and a growing number of manufactured exports. In the same period, the substantial trade reform contributed to the movement of manufactured exports from Indonesia, reflecting the shifting orientation from inward orientated to outward orientated policy. Indonesian exports were traditionally based on the country's rich natural resources and agricultural productivity. Because these types of commodities are vulnerable to changing world prices, dependence on them, could hurt an economy. As we have seen the government wanted to increase the growth of exports and broaden the base by implementing several trade reforms relating to Indonesian exports.

Hall Hill (1994) found that Indonesia relied heavily on oil as a major export, accounting for more than 70 % of total Indonesian export revenues. When oil was no longer the main source of export earnings, because of the limited reserves the government promoted an export diversification program. The policy pendulum swung back toward more liberal regimes, as economic growth during the first half of the 1980s (below 5%) and investor interest declined.[6] The changing importance of oil also followed a decrease in the agricultural sector and increasing the manufacturing and service sectors is described in Figure 5.1[7] below.

The Figure 5.1 The Share of Indonesian Sectors
In 1965 and 1992




The significant changes of the composition of Indonesian trade

[6] Hill, Hall. Indonesia's New Order: The Dynamic of Socio-Economic Transformation, p.68, Allen & Unwin, Australia, 1994.

[7] GATT Secretariat, Trade Policy Review: Indonesia 1995, p. 2, Geneva, volume 1 and 2, February 1995.

continually reduced the relative importance of petroleum and natural gas though out the late 1980's. Exports from the manufacturing sector grew fastest, increasing their export share from 15 % in 1985 to 20 % in 1992 and increasing industrial product share from 21 % in 1986 to 56 % in 1994 (see Table 4 in the Annex). Despite the inclusion of food processing, agricultural export shares actually decreased from 24.7 % in 1985 to 20 % in 1992 (see Chart 5.1).

In early 1980 the most important manufactured good was plywood, whose domestic production was facilitated by the ban on log exports; with 10 % of total merchandise exports. Although not yet significant individually, a wide range of manufactured products, including machinery, paper products, cement, tires, and chemical products, helped bring the overall manufactured exports to 39% of the merchandise export, or a total of US $ 9.9 billion in 1990, up from less than US $ 3.1 billion in 1986 (see Annex, Tables 4 in Annex).

The growth in non-oil exports helped Indonesia maintain a positive trade balance throughout the 1980s in spite of the oil market collapse. The government successfully avoided a debt crisis in the early 1980s when many developing countries, including the neighboring Philippines, were forced to temporarily halve their debt repayments. Indonesia avoided the crisis due to two main factors: heavy reliance on long-term concessionary loans and sustained high exports (see Table 5 in the Annex).

However, an increase in imports, and service costs such as interest payments on outstanding foreign debt contributed to a worsening current account deficit in the late 1980s. The deficit increased more than one and a half times from US $ 3.1 billion in 1986 to US $ 5.3 billion in 1990. By 1993 and 1994 a surplus was restored.

### 5.3.2 The Gain from Indonesian Trade

Since the surplus in trade was reached in 1993, there has been an increase in large conglomerates (see also p.105). The growing number of large conglomerates which dominate the domestic economy in manufacturing industries and owning central capital, has caused a widening income gap. According to the *Central Bank of Indonesia 1995 Report*, the number of Indonesian entrepreneurs was 35 million, of which 99.4 % were in small-scale business and 0.6 % in middle and large-scale business.[8] It would be no exaggeration to say that only 18 % of Indonesians benefit from trade. The real gain from Indonesian trade is concentrated in 50 conglomerates, out of 180 million people. The wider income gap is reflected in the composition of these 50 conglomerates as follows:

a. Chinese Indonesian = 36 conglomerates
b. Indigenous Indonesian = 11 conglomerates
c. Joint Chinese and Indigenous = 2 conglomerates
d. Indian Indonesian = 1 conglomerates

In order to equalize the distribution of the trade gains, on 27 December 1993, the government introduced special policies and a program of poverty alleviation through Presidential Instruction (Instruksi Presiden/Inpres) No. 5/1993. This program was known as IDT (Inpres Desa Tertinggal/ the

[8] Indonesian Newspaper. Republika, p.1, 06 January 1996.

Presidential Degree for "left behind villages"). The three objectives of this IDT program were:

a. To trigger and accelerate the national movement of poverty alleviation
b. To reduce social and economic disparities in the community
c. To reactivate the peoples' economy by empowering the poor.

After the IDT was introduced, the result has been a decline in the number of the poor[9], in 1996 to 22.6 million people or 11.39 %. Moreover, it has proved to be an international success story with the World Bank confirming this and stating that Indonesia has joined the unique East Asia club of countries which have maintained improved distribution incomes in presence of high growth.[10]

Table 5.3 The Proportion of Indonesian Poor

| Year | People Living Below | | Change % | |
|---|---|---|---|---|
| | Million | % | Person % | Proportion % |
| 1970 | 70.0 | 60.00 | - | - |
| 1976 | 54.2 | 40.08 | 22.57 | 33.20 |
| 1978 | 47.2 | 33.31 | 12.92 | 16.89 |
| 1980 | 42.3 | 28.56 | 10.38 | 14.26 |
| 1981 | 40.6 | 26.85 | 4.02 | 5.99 |
| 1984 | 35.0 | 21.64 | 13.79 | 19.40 |
| 1987 | 30.0 | 17.42 | 14.29 | 19.50 |
| 1990 | 27.2 | 15.08 | 9.33 | 13.43 |
| 1993 | 25.9 | 13.67 | 4.78 | 9.35 |
| 1996 | 22.6 | 11.39 | 12.74 | 16.68 |

Source: Internet, Embassy of Indonesia (indonsia@dgs.dgsys.com), Feb 6, 1997

Another gain from trade is when in the mid-1980s, the government introduced trade policy reforms directed toward market economy regulation and state-owned enterprises. State-owned enterprises had dominated major business sectors and had strong monopolized power to control vital businesses

[9] In 1970 the number were 70 million and 60 % lived below the poverty line.
[10] Hill, Hall. Op. Cit. P. 105.

in Indonesia. (See Table 5.4) Furthermore, domestic markets have been subject to various types of regulations, including the restrictive domestic trade regime (Tata Niaga) governing certain commodities that restrict domestic trade between various production units, for example in the case of cloves (cengkeh) and oranges (jeruk). Meanwhile state-owned or large, private enterprises enjoy state-sanctioned monopolistic positions without a clear economic rationale continues to operate in certain areas of productions.[11]

Table 5.4 The Main State Owned Enterprises

| State Owned enterprise/Department | Profit | Sales | Asset | Core Business |
|---|---|---|---|---|
| Department of Finance : | | | | |
| - PT. Asuransi Jasa Raharja | 59.16 | 162.72 | 196.68 | Insurance |
| - Perum Peruri | 123.85 | 266.22 | 550.41 | Valuable printing |
| - Asuransi Ekspor Indonesia | 54.29 | 78.18 | 310.60 | Insurance |
| Department of Agriculture: | | | | |
| - PT. Perkebunan XXIX | 56.06 | 14.04 | 25.41 | Plantation |
| - PT. Perkebunan II | 102.15 | 358.38 | 593.00 | Plantation |
| - PT. Perkebunan XXI-XXII | 70.51 | 314.04 | 385.06 | Plantation |
| Department of Industry and Trade: | | | | |
| - PT. Krakatau Steel | - | - | - | Steel production |
| - PT. Semen Gresik | - | - | - | Portland cement |
| - PT. Semen Kupang | 4.61 | 23.85 | 38.48 | Portland cement |
| - PT. Semen Cibinong | - | - | - | Portland cement |
| - PT. Semen Batu Raja | - | - | - | Portland cement |
| - PT. Primissima | 5.74 | 31.60 | 44.14 | - |
| - Kawasan Industri Makasar | 2.40 | 3.88 | 24.38 | Industrial zone |
| - PT. Sucofindo | 157.93 | 279.61 | 259.69 | Inspection |
| - PT. Bhanda Ghara Reksa | 5.71 | 51.09 | 49.82 | General trading |
| - PT. Sarinah | 3.85 | 79.70 | 49.66 | General trading |
| - PT. Panca Niaga | - | - | - | General trading |
| Depertment of Defence: | | | | |
| - PT. Asabri | 16.47 | 83.25 | 357.37 | Bank, Insurance |
| Department of Forestry: | | | | |
| - Perum Perhutani | 166.74 | 520.79 | 430.14 | - |
| - PT. Inhutani I | 29.73 | 73.01 | 178.57 | - |
| - PT. Inhutani II | 10.92 | 40.88 | 93.63 | - |
| Department of Information: | | | | |
| - Perum Percetakan Negara | 3.67 | 15.18 | 94.08 | Printing |

[11] Wie, Thee Kian. Economic Reform and Deregulation in Indonesia, The Indonesian Quarterly, Volume XXIII, number 2, p. 145, CSIS, 1995

| State Owned enterprise/Department | Profit | Sales | Asset | Core Business |
|---|---|---|---|---|
| - PT. Pradya Paramita | 0.02 | 0.63 | 5.53 | Printing |
| Department of Mining and Energy: | | | | |
| - Pertamina | - | - | - | Oil producer |
| - PLN | - | - | - | Electricity producer |
| - PT. Tambang Timah | 119.22 | 424.09 | 477.23 | Mining |
| - PT. Tambang Bukit Asam | 163.97 | 443.91 | 1,436.75 | Coal mining |
| - PT. Aneka Tambang | 35.25 | 232.49 | 666.64 | Mining |
| Department of Public Work: | | | | |
| - PT. Jasa Marga | 276.23 | 449.83 | 1,731.7 | Road & toll construction |
| - Perum Jasa Tirta | 3.25 | 14.64 | 25.56 | - |
| - Bina Karya | 1.22 | 15.12 | 8.79 | - |
| Department of Transportation: | | | | |
| - PT. Angkasa Pura I | 62.23 | 168.73 | 1,499.00 | Airport management |
| - PT. Pelabuhan II | 130.93 | 313.94 | 2,822.01 | Sea management |
| - PT. Garuda Indonesia | 191.23 | 3,584.73 | 3,602.04 | Air transportation |
| - Perumka | - | - | - | Railway transportation |
| - Damri | - | - | - | Bus transportation |
| Deprt. Of Tourism, Post, Telecommunication | | | | |
| - PT. Indosat | 429.40 | 909.25 | 1,629.00 | Telecommunication |
| - PT. Telkom | 689.69 | 3,696.44 | 7,721.35 | Telecommunication |
| - PT.Pengembangan Pariwisata Bali | 4.78 | 9.62 | 117.44 | Tourism |
| Department of Health: | | | | |
| - PT. Askes | 85.49 | 268.80 | 436.02 | Health insurance |
| - PT. Indonesia Farma | 16.75 | 79.86 | 91.76 | Pharmacy |
| - PT. Kimia Farma | 30.89 | 421.87 | 209.90 | Pharmacy |
| Department of Manpower: | | | | |
| - PT. Astek | 99.40 | 978.36 | 2,750.47 | Employment insurance |
| Department of Education and Culture: | | | | |
| - Perum Balai Pustaka | 0.45 | 19.58 | 42.50 | Book printing |
| State Secretary: | | | | |
| - PP. Berdikari | 2.18 | 139.31 | 65.60 | - |
| Strategic Industries Management Agency: | | | | |
| - PT. Dahana | 7.08 | 48.84 | 41.84 | Explosion industries |
| - PT. Inka | 23.95 | 65.05 | 90.40 | Rail and train industries |
| - PT. Inti | 39.28 | 239.32 | 406.20 | Technology industries |

Sources: Compiled from various issue and Internet :http://www.indobiz.com/

Meanwhile, some manufacturing industries are designed as strategic commodities industries under the supervision of the Industrial and Trade Department or the Strategic Industries Management Agency (Badan Pengelola Industri Strategis/ BPIS). BPIS was established in 1989 to control some strategic industries such as aircraft, shipping, locomotive industries and the Batam industrial zone. State-owned companies dominated these industries, of which there are over 180 types, counting for some 15 percent of GDP.

State-owned companies have been characterized as having relatively poor performance as a result of inefficiencies. They have been sheltered from competition by the government regulation over investment and trade controls. Precise details of sectoral policies consisting of financial support, applied to strategic industries remain obscure and their effects largely non-transparent. State-owned, PT. IPTN (Industri Pesawat Terbang Nurtanio, Bandung), an airplane manufacturer, for example, benefits from the re-afforestation fund. Aid to state-owned companies is justified by the government as a means of promoting high-technology R&D. However, many strategic industries are characterized by non-competitive behavior, often sanctioned by the government regulation and controls restricting entry, including both domestic and private investments.[12]

The Indonesian experience has indicated that the government intervention has, more often than not been market-impeding rather than market-conforming. The Japanese government, however, in its industrial policies, has attempted to preserve domestic competition in line with its priorities.[13]

Even though some gains from trade have been achieved, in view of restrictive environmental policies Indonesia by managing domestic and international trade are limiting competition in the domestic product and factor markets.

[12] General Agreement on Tariffs and Trade. Trade Policy Review: Indonesia, p. xxi, vol. I, GATT Publication Services, Geneva, 1995.
[13] Wie, Thee Kian. Op. Cit. P. 147.

### 5.3.3 Indonesian Trade and APEC

In recent years, the Indonesian government has been concerned with two international bodies of economic cooperation; the Asia Pacific Economic Cooperation (APEC) and the negotiations of the General Agreement on Tariffs and Trade (GATT). As noted in Chapter 4, in the 1990s a new model of economic cooperation was developed in the Asia-Pacific region by APEC through trade and investment liberalization by 2010 and 2020 for APEC economies, especially after the 1994 APEC summit in Bogor. Therefore, the central question to be addressed is what are the implications of the Bogor summit for Indonesian policies on trade commodities? To answer this question we must first understand why Indonesia became a member of APEC and continues to honor its APEC and GATT commitments.

Indonesia became a member of APEC for the reasons outlined in the previous chapter particularly the importance of trade flows with APEC member countries. Reducing the barriers in trade and investment in APEC members will be important for Indonesia's main non-oil trade commodities. By adhering to the free multilateral trade and investment principle, APEC will represent the Asia Pacific area's interest by following the general principles of trade and investment.

A free trade system will give Indonesia's main non-oil export commodities opportunities to access bigger markets. The Indonesian market will also become wider for the other APEC members. This could threaten Indonesia's domestic market, so the government must carefully anticipate the open market trend. The government must constantly continue its deregulation policy, which reduces or cuts the production costs and eliminates barriers to entrepreneurs.

Indonesia was an active member of GATT and always attended the GATT meetings. In November 1994, Indonesia acknowledged the World Trade Organization (WTO) with the Indonesia Law No. 7, 1994 and this acknowledgment was agreed to by the Indonesian Parliament. This decree came into force on January 1, 1995, and was announced to the public media. Based on this regulation, Indonesia must now prepare for a new era in free trade for all WTO and also APEC members

Before the WTO began, Indonesia tried to receive special and differential treatment as a developing country from the GATT negotiations. Indonesia did not commit to the 1988 "Montreal Agreement," which stipulates that all GATT members must reduce their tariffs to 33 1/3%. Indonesia's commitment to tariff regulations was based on the guidance of GATT 1991, which states that a developing country has fulfilled the Montreal Agreement if it is already binding its tariffs at less than 40 % and eliminating the import commerce system.

In order to implement the Indonesian commitment to the WTO and APEC, Indonesia offered to reduce its tariffs and non-tariff barriers to a certain level of import tariffs. Before the implementation of Indonesia's commitment, some of the import tariffs in Indonesia were above 40 %. Starting with March 1985, tariffs were rationalized by an across the board reduction in the level and range of nominal tariffs. In addition the number of tariff levels was reduced from twenty-five to eleven. Meanwhile, the range of tariffs was also reduced from the previous level of zero to 225 % to zero to 60 % with most tariff rates ranged from five to 35 %.[14]

In order to support the rationalization of tariffs, there was one important institutional reform undertaken by the government in 1985. Most economic observers recognized this as an important step to encourage non-oil exports. The policies were implemented to improve customs clearance by removing the function of import clearance from the inefficient Indonesian customs to the professional Swiss surveyor company, SGS (Societe General de Surveillance). This decision caused more than half of customs employees to become unemployed.

Since 1986 trade liberalization has tended to proceed rapidly, with one or two deregulation packages per year. This has eliminated many of the non-tariff barriers that had been put into place from 1983 to 1986 and replaced them with tariff equivalents. Meanwhile, tariffs themselves have been reduced gradually. The government policies have declined average tariffs by almost half from 37 % before 1985 to 20 % in 1994. And we also see that the coverage of non-tariff barriers had declined from 41 % of total production in 1986 to 22 % of total production in 1993.[15]

According to the 1989 Indonesia Import Tariff Book, revised in October 1993, there are 9,381 types of import tariffs in Indonesia and Indonesia offered 94.6 % of its import tariffs at certain levels. Those tariff levels cover 8,877 tariffs,

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[14] Pangestu, Mari. Indonesia in a changing World Environment Multilateralism vs Regionalism, in The Indonesian Quarterly, 291-299, Vol. XXIII, no.2, 1995

[15] Ibid. P. 291

of which 7,536 are industrial product tariffs and 1,341 are agricultural product tariffs. From the 7,536 industrial product-binding tariffs, which are served by the government of Indonesia, 6,848 import tariff values are bound to a level of 40 %, whereas 688 tariffs are bound to less than 40 %. Indonesia's binding tariffs for agricultural products include 1,014 tariffs that are tied at a level 40 %, and 300 tariffs that are tied to more than 40 %. Several commodities in these tariffs had ceiling binding offers. The commodities using the ceiling binding offer are rice, soybeans, and wheat. The remaining 27 agricultural product tariffs are bound to less than the 40 % level. The remaining the 504, half of which are for chemical products and guns, are not bound at these levels. This tariff situation can develop the sectors that have a good comparative advantage by improving opportunities for market access.

The October 1993 Indonesian Import Tariffs Book was revised again in the May 23, 1995 government policy package. The most important point is that the total of the new import tariffs is less than the import tariffs of 1993. Other important points about 1995 package are that first, the import tariffs that are available at more than 20 % now will be reduced to 20 % in 1998 and to a maximum of 10 % in 2003; second, that the tariffs that are available at 20 % or less now will be reduced to a maximum of 5 % by the year 2000; and third, that other tariffs will be reduced by 5 to 20 %. These figures show that by 2003, Indonesia will have a maximum tariff of 10 % and most tariffs will be in the range of zero to 5 %. This is the first time that Indonesian import tariff policies have a time-bound schedule for further reductions in tariffs. The package also covers five main sectors: lowering import duties and surcharges; reducing import restrictions; opening up investment in previously closed sectors; reducing business licensing procedures and business restructuring; and trading of goods in export processing zones[16].

The June 4, 1996 packet of deregulation reduced the tariffs for 1,497 post- tariffs from 7,288 post-tariffs available, therefore, the Indonesian structure of tariffs is becoming as Table 5.5 below shows.

Table 5.5 1996 Indonesian Tariff Structures

| Before June 1996 | | After June 1996 | |
|---|---|---|---|
| Tariff Values | Post tariffs | Tariff Values | Post tariffs |
| 0 – 5 % | 3,369 (46.23%) | 0 – 5 % | 3,465 (47.54%) |
| 0 – 10 % | 4,017 (55.12%) | 0 – 10 % | 4,071 (55.86%) |
| 0 – 20 % | 5,041 (69.17%) | 0 – 20 % | 5,721 (78.50%) |
| 25 – 35 % | 2,155 (29.57%) | 25 – 35 % | 1,472 (20.20%) |
| ≥ 40 % | 96 (1.32%) | ≥ 40 % | 95 (1.30%) |

Source: June 4, 1996 Deregulation packet from Internet: http://www.pusdata.co.id

Along with the reduction in the nominal tariff rate, Indonesia has also implemented economic deregulation in the finance and tax sectors since 1983. In 1985 Indonesia also began trade deregulation. One purpose of this deregulation was to eliminate the high cost economy by reducing import costs, which will increase exporters' capabilities to become competitive in the

[16] The Report of the Pacific Business Forum 1995. The Osaka Action Plan: Roadmap to Realising the APEC Vision, p.15, the APEC Secretariat, 1995.

international market. Since consumers can buy imported goods at a lower prices, it is hoped that these low prices will push domestic producers to improve production efficiency by decreasing their costs of production. The other effect of this economic deregulation is that consumers can improve their living standards and national saving will be increased.

According to the 1995 package's guidebook, with larger exports and an increase in national savings, the Indonesian economy grew more than six percent annually since 1985. Even in 1994, the rate of economic growth was seven percent. Based on the tariff reduction policies described above, it seems that Indonesia has pursued neo-classical theories which encourage economic development by exploring tariff and non-tariff measures that affect the imports of manufactured products.[17]

Furthermore, the Presidential speech in January 1995 shows the government's commitment to the principle of the trade liberalization:

> ".... We should hesitate to build upstream and mid stream industries, if it is really needed... Protection is just one of the mechanisms we can create if necessary, but it must meet certain conditions. First, protection may be given for a limited period and to be gradually reduced. Second, protection must not be contrary to international agreements, such as GATT, AFTA, and APEC. Third, ...protection must not ... hinder the growth of down stream industries."[18]

In our opinion, this economic deregulation is important to the non-oil trade commodities because total Indonesian trade increased from $14,805 billion in

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[17] Balassa, Bela. Comparative Advantage, Trade Policy and Economic Development, New York Press, New York, 1989.

[18] Osada, Hiroshi. APEC and Indonesia: Impact of Liberalization Policies on the Manufacturing Industries and the Problem in the Future, p.9, APEC Study Center, Graduate School of International Development, Nagoya University, 1996.

1986 to $40,053.4 billion in 1994 (see Tables 4 and 5 in the Annex). The average rate of the increasing balance of trade was 11.11 %. This average growth rate is equal to the growth rate of the balance of APEC destination trade (see below). From this calculation, we can assume that the APEC trade destinations are very important to Indonesia's economic growth.

An examination of Table 5.6, the Indonesian Balance of Trade of Main Non-Oil Trade Commodities in APEC 1986 – 1994, reveals that in Indonesia the total trade of non-oil trade commodities to APEC members increased annually, from $10,837.7 billion in 1986 to $41,702.4 billion in 1994. The average percentage rate of trade growth is 11.11 % per year. Since 1993, the Indonesian balance of trade has had a surplus. This means that the export of non-oil commodities to APEC destinations has had a positive effect on Indonesian economic growth. A deficit balance of trade would have decreased economic growth.

## Table 5.6: Indonesian Balance of Trade of Main Non-Oil Commodities in APEC 1986-1994 (Billion US $)

| Country of Destination | 1986 | 1987 | 1988 | 1989 | 1990 | 1991 | 1992 | 1993 | 1994 | TOTAL |
|---|---|---|---|---|---|---|---|---|---|---|
| Indonesia Export Values: | | | | | | | | | | |
| Japan | 1,253.4 | 1,862.3 | 2,645.4 | 3,509.1 | 3,060.8 | 3,613.1 | 3,917.8 | 5,144.6 | 5,493.9 | 30,520.4 |
| Hongkong | 341.1 | 418.8 | 515.8 | 546.5 | 599.8 | 697.5 | 853.6 | 895.9 | 1,316.3 | 6,165.3 |
| The Republic of Korea | 76.8 | 137.7 | 320.7 | 435.6 | 484.3 | 694.0 | 707.3 | 997.8 | 1,108.4 | 4,962.6 |
| Taiwan | 208.6 | 302.9 | 316.9 | 379.7 | 385.3 | 495.4 | 737.9 | 904.3 | 1,126.6 | 4,857.6 |
| The People's of Rep. of China | 133.7 | 143.0 | 469.5 | 337.7 | 574.9 | 674.5 | 767.7 | 695.2 | 787.1 | 4,583.3 |
| Thailand | 83.0 | 85.2 | 146.7 | 230.8 | 183.9 | 228.2 | 327.6 | 422.1 | 359.0 | 2,066.7 |
| Singapore | 811.5 | 1,127.1 | 1,559.8 | 1,653.5 | 1,631.5 | 2,268.2 | 3,160.9 | 3,197.3 | 3,547.6 | 18,957.1 |
| Philippines | 42.9 | 42.3 | 86.5 | 126.5 | 138.3 | 139.3 | 154.7 | 241.7 | 317.2 | 1,289.4 |
| Malaysia | 67.9 | 86.6 | 172.9 | 219.9 | 239.5 | 337.7 | 485.0 | 585.4 | 738.2 | 2,933.3 |
| Brunei Darussalam | 2.3 | 2.4 | 4.2 | 7.8 | 10.7 | 10.3 | 25.3 | 35.1 | 50.2 | 148.5 |
| Papua New Guinea | 1.7 | 2.6 | 3.8 | 7.0 | 7.9 | 10.1 | 32.2 | 23.2 | 23.6 | 112.1 |
| Australia | 57.7 | 85.6 | 131.2 | 176.4 | 193.7 | 247.6 | 335.6 | 397.2 | 465.7 | 2,090.9 |
| New Zealand | 82.1 | 11.8 | 14.7 | 18.9 | 18.2 | 23.6 | 34.8 | 45.0 | 51.6 | 300.7 |
| United States of America | 1,295.8 | 1,660.8 | 1,842.2 | 2,042.0 | 2,387.1 | 2,732.5 | 3,856.7 | 4,622.2 | 5,190.2 | 25,629.5 |
| Canada | 59.9 | 94.4 | 100.6 | 107.8 | 138.5 | 172.0 | 289.2 | 304.2 | 321.6 | 1,588.2 |
| Mexico | 6.5 | 10.6 | 18.3 | 25.7 | 36.0 | 56.7 | 87.3 | 140.4 | 144.3 | 526.0 |
| Chile | 0.0 | 0.1 | 0.3 | 1.6 | 5.0 | 8.6 | 20.9 | 32.4 | 47.7 | 116.6 |
| Total Export to APEC | 4,524.9 | 6,094.6 | 8,349.5 | 9,826.5 | 10,095.4 | 12,409.3 | 15,794.6 | 18,684.0 | 21,089.2 | 106,868.0 |
| Total Indonesia Trade | 6,528.4 | 8,579.4 | 11,536.9 | 13,480.1 | 14,604.2 | 18,247.5 | 23,296.1 | 27,077.2 | 30,359.8 | 153,709.6 |
| % of export share | 69.3 | 71.0 | 72.4 | 72.9 | 69.1 | 68.0 | 67.8 | 69.0 | 69.5 | 69.5 |
| Indonesia Import Values: | | | | | | | | | | |
| Japan | 2,627.7 | 3,114.6 | 3,368.7 | 3,752.6 | 5,281.9 | 6,275.8 | 5,980.1 | 8,234.0 | 7,732.2 | 44,367.6 |
| Hongkong | 52.4 | 93.8 | 132.1 | 178.4 | 265.9 | 229.7 | 227.2 | 246.0 | 239.7 | 1,665.2 |
| The Republic of Korea | 200.8 | 157.2 | 374.6 | 560.4 | 983.2 | 1,400.9 | 1,874.5 | 2,082.8 | 2,146.9 | 9,781.3 |
| Taiwan | 280.9 | 397.5 | 620.1 | 974.6 | 1,333.4 | 1,316.7 | 1,279.9 | 1,307.6 | 1,444.2 | 8,956.9 |
| The People's of Rep. of China | 244.4 | 332.8 | 434.6 | 523.0 | 641.5 | 827.9 | 744.9 | 696.1 | 1,274.7 | 5,919.9 |
| Thailand | 58.6 | 72.2 | 95.3 | 208.2 | 182.8 | 275.4 | 340.8 | 230.8 | 405.0 | 1,869.1 |
| Singapore | 470.5 | 552.5 | 623.0 | 741.1 | 832.2 | 913.0 | 849.2 | 1,158.4 | 1,135.8 | 7,375.7 |
| Philippines | 22.5 | 28.2 | 32.3 | 62.9 | 54.8 | 80.6 | 52.1 | 51.4 | 65.1 | 449.9 |
| Malaysia | 0.6 | 50.3 | 227.9 | 267.9 | 158.2 | 186.3 | 370.1 | 383.3 | 454.4 | 2,099.0 |
| Brunei Darussalam | 0.0 | 1.4 | 1.1 | 1.5 | 0.3 | 0.3 | 0.7 | 1.0 | 0.3 | 6.6 |
| Papua New Guinea | 0.3 | 0.5 | 0.1 | 0.3 | 1.0 | 1.2 | 3.3 | 2.0 | 3.2 | 11.9 |
| Australia | 412.9 | 459.3 | 561.6 | 686.2 | 962.8 | 1,126.5 | 1,200.3 | 1,208.1 | 1,362.1 | 8,177.6 |
| New Zealand | 68.8 | 70.9 | 96.1 | 97.9 | 114.6 | 106.8 | 136.0 | 161.0 | 158.2 | 1,010.3 |
| United States of America | 1,691.0 | 1,457.7 | 1,700.7 | 2,177.1 | 2,484.6 | 3,276.9 | 3,763.6 | 3,111.6 | 3,482.6 | 23,146.2 |
| Canada | 196.1 | 214.2 | 272.8 | 309.1 | 402.9 | 354.3 | 459.2 | 405.0 | 471.6 | 3,087.2 |
| Mexico | 63.9 | 5.7 | 21.2 | 51.9 | 63.1 | 81.3 | 56.1 | 58.2 | 41.6 | 443.0 |
| Chile | 19.4 | 24.3 | 39.6 | 69.4 | 87.3 | 117.5 | 112.6 | 134.7 | 197.6 | 802.6 |
| Total Import to APEC | 6,412.8 | 7,033.1 | 8,601.6 | 10,862.5 | 13,850.5 | 16,575.1 | 17,551.0 | 17,670.2 | 20,613.2 | 119,170.2 |
| Total Indonesia import | 8,987.5 | 9,632.0 | 12,339.4 | 15,164.4 | 19,916.6 | 23,558.5 | 25,164.8 | 26,157.3 | 29,616.1 | 170,536.4 |
| % of import share | 71.4 | 73.0 | 69.7 | 71.6 | 69.5 | 70.4 | 69.7 | 67.6 | 69.6 | 69.9 |
| Total APEC trade | 10,937.7 | 13,127.7 | 16,951.3 | 20,689.0 | 23,945.9 | 28,984.4 | 33,345.6 | 36,354.2 | 41,702.4 | 226,038.2 |
| Deficit /surplus of trade | (1,887.9) | (938.5) | (252.3) | (1,036.0) | (3,755.1) | (4,165.8) | (1,756.4) | 1,013.8 | 476.0 | (12,302.2) |

Source: The Indonesian Trade Department, Trade Statistics, and various issues from number. 104/BL/92 - 134/BL/95, Jakarta-Indonesia.

Last, but by no means least, according to *The Journal of Trade Information*, the opportunities for APEC members are larger than for other countries because in 1991 the GDP of APEC members reached 52 % of the world GDP, and APEC had 39 % of the total value of world trade. Other opportunities for APEC members are the economic potential that can play an important role in liberalizing the international investment and trade system. From

APEC's point of view, Indonesia has an opportunity to increase its exports because of the decrease in tariffs in its APEC trading partners. The decrease of industrial product tariffs in APEC's industrial countries is 38 %. The average import tariffs on industrial products of 6.3 % will decrease to 3.9 %. The average industrial product tariff in Japan before GATT was 6.9 % and after GATT is 3.6 %. In the USA and Canada, average import tariffs before GATT were 8.8 % and 16.8 % respectively and after GATT 6.5 % and 11 % respectively[19]. Therefore, in the President's speech of early January 1996, he addresses APEC:

> "An expanded cooperation within the framework of APEC opens new opportunities. The second APEC economic leaders' summit in Bogor has produced the "Bogor Declaration". They met again recently in Osaka, Japan; and reaffirmed their commitment.... Indonesia will not wait until the year 2020 to start its free trade."[20]

By sticking to GATT and APEC commitments especially with the deregulation and debureacratization in its economic policies, Indonesia has an opportunity to increase its economic development through the reduction of its tariffs below 40 % for some manufacturing and agricultural sectors. This deregulation has an impact for on economic growth by reducing import costs, increasing exporters' capabilities, improving domestic production efficiency, improving living standards, and increasing national saving.

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[19] The Trade Information Bulletin, number 80 TH XV, p. 6-13, the Affair Bureau of Trade Department, Jakarta; Indonesia, 1994.

[20] Osada,. Op. Cit. P. 9

## 5.4 THE DEVELOPMENT OF INDONESIAN INVESTMENT

### 5.4.1 Indonesian Investment Policies

Since the Law of Foreign Investment was enacted on 10 January 1967 through Law no. 1/1967, foreign direct investment grew significantly. Broadly speaking, the 1967-investment law offered incentives for foreign investors to invest and operate in Indonesia for a maximum for 30 years (Article 18). This law also contained some government incentives such as repatriation of capital, tax holidays especially for investments where capital lead to an advancement of technology, and management skill that could not be provided domestically. The following is a list of investment options not open to foreign investors (Article 6): ports, electric power transmission and distribution, telecommunications, shipping, airline/aviation, water sanitation, trains, atomic power, the media, weapons, ammunition, explosives and the war related productions.[21]

Due to the increasing oil revenue in 1970's, the government gradually reduced investment incentives. The motivation of FDI in this period was to obtain access to the domestic markets. Some characteristics of this period were the establishment of joint ventures through FDI for import substitution industries. Joint ventures were necessary because on 22 January 1974, the government passed a new regulation for foreign investment, prohibiting 100 % of foreign ownership.[22]

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[21] Unofficial translation from Foreign Investment Law No.1 /1967.

[22] Unofficial translation from Rajagukguk, Erman SH, LL.M. Indonesianisasi saham, p.12, PT. Bina Aksara, Jakarta, 1985.

After a sharp decrease in oil revenue and the price of some non-oil export commodities in 1983, structural adjustment neglected the deregulation of FDI. The tight budget made the government abolish tax incentives, place sizable restrictions on the fields for FDI, and imposed strict regulation on employment of foreigners. The divestment clause was implemented and a complex procedure for application was imposed.[23] A year later, In September 1984, the government decided to give the Investment Coordinator Board (BKPM) the sole administration of the FDI process. After that, the development of FDI policies shifted drastically, loosening regulations for foreign investors to send their staff from the head office, simplifying the application procedures, opening certain closed industrial sectors to FDI, and lowering the cost of access to input materials.

With continuing decreasing government revenue from oil, an important deregulation was set up in December 1987, when the government reduced the upper limit of the capital payment share for export-oriented foreign companies and prolonged the period for equity divestment in export industries from ten to fifteen years. In terms of equity divestment, instead of 20 %, foreign investors were allowed to operate 5 % domestic ownership. After ten years, the domestic ownership must increase to 20 %, and to 51 % after 15 years. These incentives were applied to joint ventures where 65 % of the production is for export; to companies located in remote areas and; to investments valuing over $ 10 million.

[23] Osada,. Op Cit., p. 15.

In the 6 May 1989 deregulation package, the government further expanded foreign investor ownership and announced the list of closed foreign investment (negative list methods/Daftar Negatif). The minimum requirement for local ownership was reduced to a minimum of 5 % without obligation to increase in the future. The foreign investor was allowed to export 100% of its product and was allowed to build plants in a bonded area.

In the same year, international events such as APEC's formation and the emergence of China and Vietnam as competitors for FDI influenced Indonesia in liberating its trade and investment policies. The FDI boom in China and Vietnam made Indonesia to further deregulate its foreign direct investment policies. Through a Presidential Decree, the government reduced the number of closed businesses for foreign investors. In order to attract more foreign investors, again the government announced a new policy of FDI in April 1992 through Government Regulation No. 50/1992, which allowed foreign investors to have 100 % company ownership in some industrial sectors.

The deregulation of investment continued in 1993 No. 50 with the aim to bring fresh (offshore) capital, in the form of funds, machinery, and/or intellectual property rights. As a result of deregulation, profits gained from previous FDI may be reinvested up to US $1 million (consisting of equity and debt), but could be decreased to as low as US $ 250,000. The joint venture may be at least 20 % owned by the local (Indonesian) partner(s) of total share at the time of company formation. Incentives are available for foreign investors to own a majority share holding or 100 % ownership for export or domestic marketing in export processing and bonded zones and project locations.[24]

A special event for investment policy was announced on 19 May 1994 when for the first time the government reduced the minimum capital requirement, which was previously set at one million US dollars. In terms of joint venture, a foreign investor could hold shares of up to 95 % and equity divestment is no longer required. Under the new regulation No. 20/1994, the government allowed foreign investors to establish 100 % foreign companies under the condition of part divestment in 15 years. Besides that, the foreign companies could also operate their business activities anywhere in Indonesia and in all kinds of opened business sectors. The most interesting part of this regulation is that some strategic industries were opened for FDI, including the newly opened strategic industries: port facilities, airline/aviation, railway transportation, transmission and distribution of electricity for public use, atomic electricity generation, water supply, telecommunications, sea transport/shipping, and mass media.

A new package on June 1996 offered tax holidays for foreign investment project which meet certain requirements and further reforms, occurred on July 8 1996. This deregulation was to improve the taxation climate and corporate business performance, Indonesia issued a new deregulation on corporate tax of newly established companies in certain promoted industries. Some important

[24] The Investment Coordinating Board (BKPM). Investment Deregulation 1993, p.1-2, PT. Puncak Ardimulia Realty, Jakarta, 1993

issues contained in these new policies are:

- lower income tax rate (maximum 30 %),
- losses that can be carried forward to up 10 years,
- accelerated depreciation of fixed assets and corporate tax of newly established companies in certain promoted industries will be born by the government (up to 10 years + an additional 2 years if the project is located outside the island of Java and Bali).[25]

With several investment policies, Indonesia investment continues to grow fast every years as described in Tables 5.3 and 5.4 to guarantee a stable growth of exports, therefore, Indonesia will need to continue efforts to attract more foreign direct investment.

### 5.4.2 The Impact of Investment Growth in Indonesia

The results of Indonesian investment policies from 1967 until March 1995 has lead to growth in FDI from APEC and domestic investment as described in Tables 5.7 and 5.8. These tables also describe the disparity of regional investment in Indonesia. For example, some provinces in Java and Sumatra still dominate foreign and domestic investment compared to other provinces.

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[25] Economic & Business Review Indonesia Magazine, Dec 11, 1996 (Internet: "http://www.indobiz.com)

## Table 5.7 Cumulative Foreign Direct Investment by Province (Excluding Oil and Gas, banking, non-banking, insurance and leasing)

| NO | PROVINCE | No. of Projects | INVESTMENT VALUE (US$000) | EMPLOYMENT Indonesia | Foreign |
|---|---|---|---|---|---|
| I | Java and Madura | 1545 | 24,675,705.8 | 479,506 | 9,321 |
| 1. | Jakarta | 656 | 10,869,401.7 | 182,726 | 4,651 |
| 2. | West Java | 619 | 10,924,018.6 | 194,869 | 3,390 |
| 3. | Central Java | 64 | 797,712.8 | 37,123 | 356 |
| 4. | The Special Region of Yogyakarta | 9 | 74,599.6 | 1,183 | 32 |
| 5. | East Java | 197 | 2,009,973.1 | 63,605 | 862 |
| II | Sumatra | 182 | 5,415,905.2 | 83,070 | 1,306 |
| 6. | The Special Region of Aceh | 8 | 72,3315.7 | 1,627 | 27 |
| 7. | North Sumatra | 54 | 2,878,631.8 | 33,049 | 223 |
| 8. | West Sumatra | 15 | 21,8942.0 | 3,699 | 66 |
| 9. | Riau | 66 | 1,168,838.4 | 18,585 | 806 |
| 10. | Jambi | 6 | 32,868.0 | 1,368 | 21 |
| 11. | Bengkulu | 5 | 73,027.7 | 1,474 | 8 |
| 12. | Lampung | 14 | 192,734.2 | 7,870 | 64 |
| 13. | South Sumatra | 14 | 127,547.4 | 15,398 | 91 |
| III | Borneo | 103 | 2,456,412.9 | 32,095 | 904 |
| 14. | West Borneo | 19 | 59,634.0 | 1,272 | 74 |
| 15. | East Borneo | 31 | 1,264,169.7 | 12,474 | 422 |
| 16. | Central Borneo | 26 | 760,886.9 | 8,492 | 209 |
| 17. | South Borneo | 27 | 371,722.3 | 9,857 | 199 |
| IV. | Celebes | 45 | 1,597,836.8 | 11,846 | 249 |
| 18. | North Celebes | 17 | 90,523.6 | 1,190 | 46 |
| 19. | Central Celebes | 5 | 31,505.3 | 569 | 70 |
| 20. | South East Celebes | 6 | 128,957.2 | 3,444 | 72 |
| 21. | South Celebes | 17 | 1,346,850.7 | 6,643 | 61 |
| V. | Other Provinces | 79 | 3,122,943.8 | 74,336 | 2,814 |
| 22. | Maluku | 8 | 91,370.4 | 1,252 | 78 |
| 23. | Bali | 43 | 651,707.1 | 5,205 | 231 |
| 24. | West Nusa Tenggara | 6 | 40,566.0 | 200 | 18 |
| 25. | East Nusa Tenggara | 7 | 7,008.5 | 545 | 43 |
| 26. | Irian Jaya | 15 | 2,332,291.8 | 67,134 | 2,444 |
| 27. | East Timor | 0 | 0 | 0 | 0 |
| | Total | 1954 | 37,268,804.5 | 680,853 | 14,594 |

Source: the Central Data of Industrial and Trade Department (Internet: http://WWW.pusdata.co.id)

Table 5.8 Cumulative Domestic Investment by Province
(Excluding Oil and Gas, banking, non-banking, insurance and leasing)

| NO | PROVINCE | NO. OF Projects | INVESTMENT VALUE (US$000) | EMPLOYMENT Indonesia | Foreign |
|---|---|---|---|---|---|
| I | Java and Madura | 3,954 | 80,335,488 | 1,523,536 | 3,573 |
| 1. | Jakarta | 970 | 20,528,814 | 328,776 | 1,388 |
| 2. | West Java | 1,759 | 38,895,486 | 491,247 | 1,395 |
| 3. | Central Java | 472 | 7,505,388 | 263,519 | 286 |
| 4. | The Special Region of Yogyakarta | 132 | 3,556,494 | 37,903 | 28 |
| 5. | East Java | 621 | 9,849,306 | 402,091 | 476 |
| II | Sumatra | 1,022 | 17,242,797 | 404,178 | 1,043 |
| 6. | The Special Region of Aceh | 69 | 1,423,857 | 21,495 | 42 |
| 7. | North Sumatra | 253 | 2,825,757 | 130,852 | 86 |
| 8. | West Sumatra | 94 | 1,180,775 | 39,286 | 129 |
| 9. | Riau | 200 | 4,294,577 | 73,398 | 223 |
| 10. | Jambi | 60 | 2,553,003 | 35,368 | 424 |
| 11. | Bengkulu | 29 | 196,541 | 2,193 | 11 |
| 12. | Lampung | 144 | 1,671,063 | 22,035 | 56 |
| 13. | South Sumatra | 173 | 3,097,224 | 79,551 | 72 |
| III | Borneo | 599 | 8,641,546 | 238,700 | 1,000 |
| 14. | West Borneo | 159 | 2,440,202 | 89,463 | 148 |
| 15. | East Borneo | 201 | 3,665,483 | 73,009 | 430 |
| 16. | Central Borneo | 106 | 1,009,725 | 35,484 | 169 |
| 17. | South Borneo | 133 | 1,526,136 | 40,744 | 253 |
| IV. | Celebes | 270 | 3,932,512 | 130,114 | 91 |
| 18. | North Celebes | 61 | 741,740 | 13,016 | 21 |
| 19. | Central Celebes | 54 | 252,182 | 55,946 | 37 |
| 20. | South East Celebes | 14 | 845,661 | 5,609 | 15 |
| 21. | South Celebes | 141 | 2,092,929 | 55,543 | 18 |
| V. | Other Provinces | 327 | 3,791,550 | 68,816 | 570 |
| 22. | Maluku | 88 | 691,276 | 29,105 | 235 |
| 23. | Bali | 109 | 2,132,937 | 18,392 | 94 |
| 24. | West Nusa Tenggara | 54 | 323,865 | 5,164 | 24 |
| 25. | East Nusa Tenggara | 28 | 72,341 | 1,816 | 12 |
| 26. | Irian Jaya | 45 | 570,628 | 14,330 | 205 |
| 27. | East Timor | 3 | 503 | 9 | 0 |
| | Total | 6,172 | 113,943,893 | 2,365,344 | 6,277 |

Source: the Central Data of Industrial and Trade Department (Internet: http://WWW.pusdata.co.id)

Java Island absorbs 66%[26] of Indonesian FDI. The other islands absorb far less; Sumatra has 15%, Borneo has 7%, Celebes has 4%, and the other islands including Maluku, Bali, West and East Nusa Tenggara, and Irian Jaya

[26] The calculation comes from the investment value of each island divided by the total Indonesian FDI in Table 5.7

have the remaining 8%. Similarly, Indonesian domestic investment is mainly invested on Java, which absorbs 71%[27] of the share. Sumatra absorbs 15%, Borneo 8%, Celebes 3%, and the other islands 3%.

Even though Java receives the most capital investment both from foreign and domestic sources, it still has the biggest poverty problem. Until the mid 1970s, the poverty problem in Indonesia was predominantly a Javanese problem. World Bank calculations indicated that although Java made up 65 percent of Indonesia's population, 70 percent of the urban poor and 74 per cent of the rural poor were located there. Only after renewed and more sustained efforts undertaken through the 1970s, did the incidence of poverty began to decrease.[28]

Before Indonesia's independence, Java was the central source for the Dutch colonialists, when the Dutch colonial government introduced the cultivation system in Java in 1830. It was a classic example of colonial exploitation and its sustaining goal was to increase forcibly the productive capacities of Java agriculture for the benefit of the Dutch treasury. In these terms, it was an outstanding success, producing large quantities of tropical export goods for Europe which provided progressively greater sums of money to prop up Holland's beleaguered financial situation.[29]

The urban inequalities in Java increased between 1970 and 1976, as the

[27] The calculation comes from the investment value of each island divided by the total Indonesian domestic investment in Table 5.8

[28] Booth, Anne. The Oil Boom and After: Indonesian Economic Policy and Performance in the Soeharto Era, p. 28-29, Oxford University Press, Singapore, 1992

[29] Booth, Anne, W.J. O' Malley and Anna Weidemann. Indonesian Economic History in the Dutch Colonial Era, p. 26, Yale University Southeast Asia Studies, Connecticut, 1990.

rich were becoming richer and the poor poorer. In rural Java, this was not the case: the relative position of the poor improved rather than decreased.[30] Further study by Wade C. Edmundson (1994) in East Java showed that

> "Some people who were rich have grown richer in terms of relative status, and some have stayed the same, but more richer become relatively poorer. Many who were poor have grown richer and some have stayed the same in absolute terms, becoming relatively poor, but very few have become absolutely poorer. Thus the equity gap between the original (1971) rich and poor cohorts has decreased over time, mainly because the majority of those who were poor have improved their relative status."[31]

Another impact of investment growth in Indonesia is the series of policy reforms to restore and maintain macro-economic stability that Indonesia has pursued since 1983. These policies, referred to as the 3-D policies (devaluation, deregulation and decontrol), were quite successful in helping Indonesia to cope with the external shocks it faced at the time. These adjustment and structural reform policies, however, have turned out to be more beneficial to modern sector activities, such as the export-oriented manufacturing industries, banking and other modern service industries, rather than traditional sector activities, including the food-crop-growing farmers. In fact, these farmers often had to pay higher interest rates on loans while the prices of agricultural commodities they sold often rose less rapidly than the processed commodities. In the long run the real

[30] Ibid., P. 336.

[31] Edmundson, Wade C. Do the rich get richer, do the poor get poorer? East Java, two decades, three villages, 46 people, in Bulletin of Indonesian Economic Studies, volume 30 no 2, p.135, the Research School of Pacific and Asian Studies, The Australian National University, 1994.

possibility arises that the income gap between the modern and traditional sectors will widen even more.[32]

Table 5.9 (below) describes a different kind of widening income gap in Indonesia, where Chinese Indonesians dominate almost all of the major industries.

TABLE 5.9 the 1995 Ranking of 50 Indonesia's largest conglomerates
(Assets estimated in trillion Rupiah)

| Rank | Group Name | Owners | Status | Assets | Main Line of Business |
|---|---|---|---|---|---|
| 1. | Salim Group | Sudono Salim (Liem Sioe Liong) | NI | 40.50 | Cement, Wheat, Food, Automotive, Finance, Steel, Agroindustry, Property, Textile |
| 2. | Sinar Mas | Eka Tjipta Widjaja | NI | 39.30 | Finance, Pulp & Paper, Agroindustry, Property |
| 3. | Gajah Tungal | Sjamsul Nursalim | NI | 18.70 | Tire, Pipe, Cables, Finance, Property |
| 4. | Kalbe Farma | Fransiscus Bing Aryanto and Benyamin Setiawan | NI | 18.70 | Pharmacy, Property, Banking |
| 5. | Astra International | Pt. Delta Mustika , Nusamba and Public | NI | 15.60 | Automotive, Electronics, Finance, Agroindustry |
| 6. | Danamon | Usman Admadjaja | NI | 14.60 | Finance, Property |
| 7. | Lippo | Mochtar Riady | NI | 12.70 | Finance, Property, Electronics |
| 8. | Ongko | Kaharuddin Ongko | NI | 6.90 | Finance, Property |
| 9. | Tahija | Julius Tahija | NI | 6.60 | Finance, Mining Industry Processing |
| 10. | Bank Bali | Djaja Ramli | NI | 6.30 | Finance, Property |
| 11. | Dharmala | Soehargo Gondo Kusumo | NI | 6.20 | Property, Agroindustry, Finance, Electronics |
| 12. | Ometraco | Ferry Teguh Santoso | NI | 6.10 | Finance, Industry, Trade, Property |
| 13. | Panin | Mu'min Ali Gunawan | NI | 5.80 | Finance and Property |
| 14. | Gunung Sewu | Dasuki Angkosubroto | NI | 5.00 | Agroindustry, Foodstuff, Property |
| 15. | Bakrie | Bakries Family | I | 4.60 | Steel, Agroindustry, Property, Finance |
| 16. | Gudang Garam | Rahman Halim Family | NI | 4.50 | Cigarettes and Supporting Industries, Property |
| 17. | Bob Hasab | Bob Hasan & Sigit Harjojudanto | NI & I | 4.00 | Wood Industry, Agroindustry |
| 18. | Barito Pacific | Prajogo Pangestu | NI | 3.90 | Integrated Wood-Based Industry, Bank, Chemicals, Agroindustry, Pulp & Paper, Property |
| 19. | Roda Mas | Tan Siong Kie Family | NI | 3.50 | Property, Finance, Chemicals, Glass |
| 20. | Texmaco | Marimutu Sinivasan | NI* | 3.40 | Textile, Engineering |
| 21. | Jan Darmadi | Jan Darmadi | - | 3.40 | Property |
| 22. | Era Persada | Hasim Djojohadikusumo | I | 3.40 | Cement, Chemicals |
| 23. | Harapan Motor | Hendra Rahardja | I | 3.30 | Automotive |
| 24. | Raja Garuda Mas | Sukanto Tanoto | NI | 3.10 | Pulp and Paper, Wood-Based Industry, Bank |
| 25. | Modern | Samadikun Hartonos | NI | 3.00 | Fotography Industry, Finance, Trade, Property |
| 26. | Mulia | Eka Tjandra - negara | NI | 3.00 | Property, Ceramics, Glass, Contractor |
| 27. | Ciputra | Ciputra Family | NI | 2.80 | Property |
| 28. | Bimantara | Bambang Trihatmodjo and Indra Rukmana | I | 2.70 | Finance, Automotive, Animal Feeds, Property, Textile, Chemical |
| 29. | Putra S Perkasa | Trijono Gondokusumo | NI | 2.40 | Property, Finance, Fast Food |
| 30. | Arseto | Sigit Harjojudanto | I | 2.30 | Finance, Chemicals, Oil, Transportation |
| 31. | Tamara | Pek Tek Beng, Atang Latief | NI | 2.20 | Banking |
| 32. | Surya Raya | Soeryadjaya Family | NI | 2.00 | Property, Agroindustry, Trading |
| 33. | Djarum | Robert & Michael B Hartono | NI | 1.90 | Clove Cigarettes, Electronics, Agroindustry |
| 34. | Pembangunan Jaya | Pemda DKI, Ciputra,Sukrisman, E. Samola | I & NI | 1.80 | Property, Finance, Various Industries |
| 35. | Argo Manunggal | The Ning King | NI | 1.70 | Textile, Chemicals, Finance, Steel, Property |
| 36. | Citra Lamtoro G | Siti Hardijanti Indra Rukmana | I | 1.70 | Toll Road Contractor |

[32] Susanto, Hari. Masyarakat Indonesia, Asia Pacific Economic Literature, p. 119, Volume 7, number 2 November 1993, Australia National University.

| Rank | Group Name | Owners | Status | Assets | Main Line of Business |
|---|---|---|---|---|---|
| 37. | Sampoerna | Putera Sampoerna | NI | 1.70 | Clove Cigarette |
| 38. | Humpuss | Hutomo Mandala Putera | I | 1.60 | Transportation, Automotive, Oil, Chemicals |
| 39. | Djajanti | Burhan Uray | I | 1.50 | Wood Industry |
| 40. | Dwi Golden G | Sudwikatmono | I | 1.40 | Retail, Finance |
| 41. | Metropolitan | Ciputra, Ismail S, Budi Brasali | NI/I | 1.40 | Property |
| 42. | Napan | Henry Pribadi, Henry Liem | NI | 1.30 | Retail |
| 43. | Nugra Santana | H. Ibnoe Sutowo | I | 1.30 | Hotels, Shipping |
| 44. | Krama Yudha | H. Sjarnoebi Said | I | 1.30 | Automotive |
| 45. | Soedarpo | Soedarpo Sastrosatomo | NI | 1.30 | Shipping, Pharmacy, General Trade |
| 46. | Lakop | Karta Widjaja | NI | 1.20 | Textile |
| 47. | Surya Damai | Martias Parto | - | 1.10 | Wood Industry |
| 48. | CCM/Berca | Murdaya Widyawimarta P | NI | 1.10 | Electric Energy, Electronic |
| 49. | Maspion | Alim Husien | NI | 1.10 | Home Appliances Industry |
| 50. | Pakuwon Jati | Alexander Teja, Suhardi P | NI | 1.00 | Property |

Source: Adapted from Warta Ekonomi, November 25, 1996
Note : I= Indigenous ; NI= Non Indigenous/ Chinese Indonesian; NI*= Non Indigenous/India Indonesian.

Robison (1986) estimated that Chinese Indonesians own 70 to 75% of private domestic investment and this Chinese Indonesian business groups go further to dominate middle and large-scale corporate capital.[33] The most prominent conglomerate in Indonesia is the Salim group. This group is owned by Indonesians as well as Chinese Indonesians, and also has contacts with the major security power base in Indonesia. In short, the development of this group is mainly due to its close ties to the government.[34] The core business of this group is primarily from cement and food products. These two products pose two main dilemmas in Indonesian economic development due to their monopolistic characteristics. The Salim group accounted for more than 60 % of Indonesian cement production and also dominates the cement marketing system, from cement resources to the transportation system. In food production, under the Indofood group, this group acccounted for more than 90 % of the

[33] Robison, Richard. Indonesia: The Rise of Capital, p. 276, Asian Studies Association of Australia, Southeast Asia Publication Series, 1986.
[34] William, F.H. Indonesia: A Country Study, p. 145, Washington D C: Federal Research Division, Library Congress, 1993.

domestic instant noodle market, marketing 10 out of 20 brands of instant noodles available, and like cement it also dominates the noodle system from the source to the marketing system. The strategy of Indofood in controlling the market is to sell its products at varying prices (price discrimination) within reach of every market segments, with the middle and upper segments contributing almost 85 % of the total instant noodle sales. Some of their brandnames are Indomie, Supermie, Sarimie, Top Mie and Pop Mie. As of December 1995, the company posted a combined net income of US $ 908.7 millions, which was 55 % increase from 1994 and the net profit was reportedly at US $ 132.6 million.[35]

Robison also explained that the problem of capital access for indigenous Indonesia between 1965 to 1974 was one of unequal access to state-bank credit, particularly in the textile industry. The old indigenous producers faced a crisis when the industry was reconstructed on basis capital intensive, fully integrated mills owned by Japanese and Chinese investors. The development of state-bank credit for this industry showed that indigenous producers could not secure their credit shares. It was reported that in 1971, from forty-nine textile companies which received credits of Rp. 13 billion, only seven indigenous companies received a total of Rp. 1.7 billion credits. In October 1972, the Chinese monopolized the structure of domestic investment. Of the domestically invested companies, 47 % were Chinese-owned, 15 % joint Chinese and indigenous-owned, and 38 % indigenous-owned. Meanwhile former Chief of Board of Investment Coordinator (BKPM), Ir. Soehoed predicted that the share

[35] Economic & Business Review Indonesia Magazine, Op. Cit,. Dated February 3, 1996

indigenous domestic investment as a whole was only 26 %. By the end of 1972, more than 80 % of state-bank credit went to Chinese capitalists, a value of Rp. 200 billion.[36]

The Chinese already dominated the Indonesia economy in the era of Dutch colonialization. The Dutch also benefited from Chinese trading companies because of their degree of economic organization and efficiency, and their dedication to the process of accumulation. The Chinese trading family was a resilient institution situated within a wider clan/kinship-based economic association, which was an exclusive and mutually supportive network of supply, credit and distribution. Not surprisingly, due to the quantity of Chinese capital, the Chinese were empowered to dominate rural trade and monopolize road tolls, bazaar fees, salt collection and sale, slaughter fees, customs duties, and tax farming.[37]

Interestingly Chinese Indonesian's are involved in international politics as was illustrated by the contributions to the 1992 and 1996 Clinton campaigns. The donations were made in the hope that Bill Clinton's victory would assist Riady's businesses. There were fund donations from Riady's associates of at least US $ 175.000 to Clinton's 1992 election and US $ 425.000 in 1996 Clinton's elections. The Mochtar Riady family owns the Lippo group, which has holdings in banking, real estate, commercial and industrial sectors, including

[36] Robinson, Op. Cit., P. 325.
[37] Ibid., P. 9.

some companies in the United States, with a total value estimated at nearly US $ 10 billion.[38]

Growing foreign and domestic investment also provides the increased employment opportunities for low-skilled labour. Foreign and domestic investment absorb 3,046,197 indigenous workers (680,853 workers from foreign investment and 2,365,344 workers from domestic investment). The highest employment rate is in Java, which has 2,003,042 of the 3,046,197 workers employed through investment; almost 66 %. The Indonesian Central Bureau of Statistics reported in 1993 that 8.6 million people were engaged in labour-intensive industries, up from 4.9 million workers in 1979. From these figures, we may say that Java is still the highest absorption place of employment in Indonesia.

### 5.4.3 Indonesian Investment and APEC

Between the end of 1980's and the 1990's, the government had to change its investment policies because of the decline in government revenues from oil. Relaxation of foreign and domestic investment regulation had a positive impact with the increasing number of Indonesian foreign investment approvals, as described in Table 5.10.

[38] The Riady Connection in Economic & Business Review Indonesia, p. 30, No. 237, PT. Press Perdana Nusantara, Jakarta, 30 October 1996.

Table 5.10 Cumulative Foreign Direct Investment by Country Origin
(Excluding oil and gas, banking, non-banking, insurance and leasing)

| NO | [illegible] PROVINCE | No. Of Projects | INVESTMENT VALUE (US$000) | EMPLOYMENT Indonesia | Foreign |
|---|---|---|---|---|---|
| I | APEC: | 1,464 | 24,601,136.9 | 512,751 | 11,763 |
| 1. | USA | 127 | 3,729,765.6 | 84,400 | 2,713 |
| 2. | Canada | 10 | 22,281.8 | 541 | 20 |
| 3. | Japan | 515 | 10,413,747.2 | 170,285 | 3,333 |
| 4. | South Korea | 173 | 1,194,688.6 | 81,070 | 1,354 |
| 5. | China | 6 | 68,066.4 | 135 | 31 |
| 6 | Hongkong | 211 | 3,477,500.0 | 83,687 | 1,654 |
| 7. | Taiwan | 131 | 971,239.5 | 26,842 | 689 |
| 8. | Singapore | 154 | 2,733,564.7 | 33,049 | 698 |
| 9. | Malaysia | 19 | 180,703.9 | 3,749 | 77 |
| 10. | Thailand | 10 | 81,718.7 | 1,096 | 26 |
| 11. | Philippines | 2 | 28,796.7 | 62 | 30 |
| 12. | Brunei | 1 | 11,394.0 | - | - |
| 13. | Australia | 102 | 1,676,508.0 | 26,983 | 1,064 |
| 14. | New Zealand | 3 | 11,161.9 | 852 | 74 |
| 15. | Mexico | - | - | - | - |
| 16. | Papua New Guinea | - | - | - | - |
| II. | Europe | 327 | 7,413,642.2 | 100,856 | 2,170 |
| III. | Africa | 9 | 31,032.8 | 1183 | 38 |
| IV. | Other America | 30 | 210,248.1 | 17,677 | 215 |
| V. | Other Asia | 11 | 83,790.6 | 7,196 | 64 |
| VI. | Other Country and Joint country | 113 | 4,928,953.9 | 41,190 | 344 |
| | Total | 1,954 | 37,268,804.5 | 680,853 | 14,594 |

Source: the Central Data of Industrial and Trade Department (Internet: http://WWW.pusdata.co.id)

As we have indicated earlier, since 1967, APEC has dominated FDI in Indonesia with a total of US $24,601,136.9 (as of March 1995) and has 66% of all Indonesian foreign investment. The major investors come from Japan, USA, Hong Kong, Singapore, South Korea, Australia and Taiwan. Europe is the second largest regional investor, contributing 20% share with a value of US $7,413,642.2

American companies accounted for nearly $154 million worth of investment commitments approved in 1995. Since the introduction of the Indonesian Foreign Investment Act in 1967, which reopened Indonesia's economy to new investment from overseas, to the end of December 1990, American enterprise had cumulatively committed nearly $2.2 billion of investment in the country, making the US the fourth largest source of foreign investment over the years. Today, there are no fewer than 600 multinational companies belonging to the American Chamber of Commerce (AMCHAM). A 1990 survey among member firms carried out by AMCHAM in Indonesia clearly showed that these companies plan to take greater advantage of the opportunities in Indonesia. More than 70 % of those responding to the survey indicated they were meeting their profitability requirement, while 84 % planned to expand their businesses within the following three years and 24 % rated the Indonesian investment climate as among the best in Asia.[39]

One of the major investment sectors in Indonesia from APEC member investors such as Japan, the USA and Republic of Korea is the automotive sector. Indonesia has hesitantly tried to decrease the number of car-manufacturing companies to achieve an internationally competitive economy of scale. Building a motor industry is an important part of Indonesia's current five-year plan. But the car industry is running at less than half capacity and has too many companies, all of which are importing knock-down kits to assemble. The government is keen to manufacture commercial vehicles, which outsell cars six to one.[40]

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[39] Djiwandono, J. Soedradjad. Indonesia: The Business and Investment Opportunity, The Indonesian Quarterly, Volume XIX, Number 3, p. 210, Centre for Strategic and International Studies (CSIS), Jakarta, 1993.

[40] Economist, p. 71, no. 296 number 7412, 21 September 1985.

Even though Japanese companies such as Toyota, Mitsubishi and Honda monopolize all vehicles sold in Indonesia, other APEC members are still interested in investing in the car industry. The problem of car industry policy has been not only non-import barriers, but also high import tariffs. The new government policy allows the importing of Completely Built Up vehicles with a high tariff. The import tariff could be decreased if the carmakers are required to use a certain portion of local content. 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 vehicles assembler. These arrangements continue to provide high protection to domestic component suppliers.[41]

The newest government policy in the car industry was announced February 19, 1996 when the government decided to liberalize its car policy through Presidential Instruction (Inpres) No. 2/1996. This policy allowed the licensing holder to import Completely Built Up vehicles with zero import tariffs and certain conditions such local content. Despite the negative impact of this policy, national car companies developed rapidly, with the emergence of national cars such as Timor car which KIA of South Korea, Bimantara Cakra and Bimantara Nenggala which joined Hyundai Motor Company of South Korea,

[41] GATT, Op. Cit. P. xxi.

Bakri which joined English car companies, and the BPPT national car; see the development of automotive licensed agents in 1995 before the deregulation below.

Table 5.11 1995 Indonesian Licensed Sales Agents

| Group | Company Name | Brand Name | Country of Origin | Category*) |
|---|---|---|---|---|
| Astra Group | PT. Astra Daihatsu Motor | Daihatsu | Japan | I,II,IV, sedan |
| | PT. Toyota Astra Motor | Toyota | Japan | I, II, sedan |
| | PT. United Imer Motor | Nissan | Japan | III |
| | Multi France Motor | Peugeot | France | Sedan |
| | PT. Tjahaya Sakti Motor | BMW | Germany | Sedan |
| | PT. Pantja Motor | Isuzu | Japan | I, II, III |
| Indomobil | PT. Indomobil Group International | Suzuki | Japan | I, IV, sedan |
| | PT. National Motor Co. | Hino | Japan | I, III, sedan |
| | | Mazda | Japan | I, sedan |
| | PT. Central Sole Agency | Volvo | Sweden | Sedan |
| | PT. Indotruck Utama | Volvo | Sweden | V |
| | PT. Wahana Wirawan | Nissan | Japan | Sedan |
| Krama Yudha Group | PT. Krama Yudha Tiga Berlian Motor | Mitsubishi | Japan | I,II,III, sedan |
| Imora Group | PT. Prospect Motor | Honda | Japan | Sedan |
| Bimantara group | PT. Star Motors Indonesia | Mercedes | Germany | III,IV, sedan |
| | PT. Citra Mobil National | Hyundai | S. Korea | Sedan |
| Humpuss Group | PT. Federal Mustika Motor | Fiat | Italy | Sedan |
| Rajawali Group | PT. IRMC | Ford | UK | Sedan |
| Mercu Buana Group | PT. Garmak Motor Buana Indonesia | Chevrolet | USA | I, IV |
| | | Opel | Germany | I, IV |
| Alun Group | PT. Alun | Citroen | France | Sedan |
| | | Renault | France | V |
| Indauda Group | PT. Indauda | Holden | Australia | Sedan |
| Hasjim Ning Group | PT. Djakarta Motor Co. | Wrangler | USA | IV |
| | | Cherokee | USA | IV |
| Java Motor Group | PT. Java Motor | Land Rover | UK | Sedan |
| | | Layland | UK | Sedan |
| Wanandi Group | PT. Gemala Pawitra Mulya | Special | - | Various |
| | PT. Starssauto Dinamika | Daewoo | S. Korea | Sedan |
| | PT. Wjiragulfindo Sarana | Special | - | Various |
| | PT. Harapan Mandiri Utama | Scania | Sweden | V |
| | PT. Mekasindo Dharma Int'l | Kenworth | USA | V |
| | PT. Allbest | Mack | USA | V |

*)Category I : Gross Vehicle Weight (GVW) less than 2.5 tons
Category II : GVW 2,5 to 9 tons
Category III : GVW 9 to 24 tons
Category IV : Jeeps
Category V : GVW more than 24 tons
Sources: Economic & Business Review Indonesia Magazine, April 10, 1996.

A new feature is observed in the increased diversity in sectors by which more APEC members interested in investing their investment into manufacturing industries. Among manufacturing industries, chemical and pharmacy received largest share because it included big petrochemical projects. Following with rapidly developing in paper industry and textile industry as a leading sector for exports. The APEC members such as Japan, NIES and ASEAN are the majors driven for this type of investment. Every year, investment tends to continue grow with a new trend in the share of metal products including machinery and electric appliances and foodstuff manufacturing.[42]

With the increasing investment every year, a new phenomena of prominent figure appears for example the growth of investment in cement for booming construction activities and the accelerated expansion of domestic investment into food industries. This is also proving that Indonesia has been developed rapidly.

## 5.6 CONCLUSION

We have illustrated in this chapter the growth of the Indonesian economy. Tremendous strides have been made, but the gains from Indonesia's trade are still concentrated in Java and certain elite groups. There is also still strong government intervention in state owned companies. We showed that capital is still dominated by Chinese Indonesian and monopolized certain major economies.

We think that Indonesia has the potential to enjoy positive benefits from its membership in APEC since the majority of Indonesian trade is with APEC

[42] Osada, Hiroshi. Op. Cit. P. 17

members and the major investment in Indonesian also comes from APEC members. APEC provides many opportunities for Indonesian trade and capital inflows and it is this issue we examine empirically in the next chapter.

# CHAPTER 6

# THE DYNAMIC DEVELOPMENT OF ASIA PACIFIC ECONOMIC COOPERATION (APEC): THE CASE OF INDONESIAN TRADE AND INVESTMENT

## 6.1 INTRODUCTION

This Chapter examines the impact of Asia-Pacific Economic Cooperation (APEC) on Indonesian Trade and investment.

## 6.2 THE RESULTS OF DATA ANALYSIS

The research data are contained in three tables: Indonesian GDP performance, Indonesian investment performance, and Indonesian trade performance (see Annex).

We can refer back to Chapter 2 where we presented the Ashfaq Ahmad et al (1996) formulation to test the relationship between FDI and foreign trade and GDP for APEC members, the result they found was[1]:

$$YGDPG = 2.8009 + 0.0039\ (PCFDI/GDP) + 0.0157\ (X+M/GDP)$$

One of their conclusions about investment, trade and GDP in APEC members, is that

> The trade and investment patterns of all APEC members economies showed a strong and positive correlation in both 1980 and 1992, suggesting trade and FDI are complements rather than substitutes. The trends is trade flows and the two direct investment stocks in APEC members economies in the 1980's also imply complementarity between trade and investment linkages. Furthermore, between

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[1] Ashfaq Ahmad, Someshwar Roo and Colien Barnes, Foreign Direct Investment and APEC Economic Integration, Working Paper Number 8, Industry Canada, February 1996, p. iii and 3.

> 1980 and 1992, the trade linkages between Asia APEC and non-Asia APEC member economies strengthened considerably. Intra-APEC increased from 58 percent in 1980 to 70 percent in 1992. Overall, investment linkages between APEC countries also strengthened. In addition, trade and investment patterns among APEC member economies showed a strong and positive correlation. Investment appears to lead trade in the APEC region. Clearly, as APEC members economies become increasingly integrated over time, there will be pressures toward policy convergence and harmonization.[2]

Utilizing our own data set we can now test the model in the context of Indonesia. Using Microsoft Excel, the regression results, based on the Ashfaq Ahmad et al formulation are

| *Regression Statistics* | |
|---|---|
| Multiple R | 0.349641114 |
| R Square | 0.122248909 |
| Adjusted R Square | 0.052028821 |
| Standard Error | 0.286863634 |
| Observations | 28 |

ANOVA

| | *Df* | *SS* | *MS* | *F* | *Significance F* |
|---|---|---|---|---|---|
| Regression | 2 | 0.28652638 | 0.14326319 | 1.740939287 | 0.195948628 |
| Residual | 25 | 2.057268611 | 0.082290744 | | |
| Total | 27 | 2.343794991 | | | |

| | *Coefficients* | *Standard Error* | *t Stat* | *P-value* | *Lower 95%* | *Upper 95%* | *Lower 95.0%* | *Upper 95.0* |
|---|---|---|---|---|---|---|---|---|
| Intercept | 1.573055328 | 0.780727775 | 2.014857647 | 0.054794032 | -0.034882498 | 3.180993154 | -0.034882498 | 3.1809931 |
| FDI/GDP | 0.599242902 | 0.508718425 | 1.177946134 | 0.249909913 | -0.448481572 | 1.646967376 | -0.448481572 | 1.6469673 |
| Trade/GDP | 1.386017561 | 0.848856178 | 1.632806117 | 0.115043129 | -0.36223324 | 3.134268361 | -0.36223324 | 3.1342683 |

In summary form, therefore we find that

Indonesian GDP= 1.5732+0.5992 (Investment/GDP) +1.3860 (Trade/GDP).

From the regression above, we can interpret the following, that

- Investment, especially foreign direct investment, in Indonesia is positively correlated with the Gross Domestic Product. This means that a one percent

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[2] Ibid., P. iii and 3.

increase of foreign direct investment in Indonesia will raise income by 0.5992 percent.

- Indonesian trade is also positively correlated with the Gross Domestic Product. This means that all Indonesian trade has had a positive impact on development in Indonesia.

Based on the results of the data analysis above, it is no exaggeration to say that Indonesian trade and investment has a positive correlation with Indonesian growth. Because of this positive correlation between trade and investment with Indonesia's development, the step next is to examine impacts of this result. The impact of Indonesian trade and investment can be understood by tracing the history of its development.

# CHAPTER 7

# CONCLUSION

A new regional model, Asia Pacific Economic Cooperation (APEC) was established in Canberra 1989 involving 18 members. There are three important phases that have led to the evolution of APEC: PAFTA and PBEC phase, PECC phase and finally the APEC in 1989. The steps of APEC towards trade and investment liberalization, particularly since the 1993 Seattle meeting, seem to be more promising. This meeting agreed to build an economic community of Asia-Pacific. Following in the Bogor declaration 1994, APEC economic leaders had come to an agreement to dismantle all barriers to trade and investment in the region. At the Osaka meeting in 1995, APEC leaders agreed, by consensus, individual and collective action plans for implementing the Bogor Declaration's. Finally in 1996 at the Manila meeting, the APEC leaders were expected to present its actions plans in the form of medium-term programs of proposed reforms beginning with the initiative from the non-government movement such as businessmen and scientists which is the major approach to force the government to have a level playing field.

The creation of APEC follows a series of other regional initiatives particularly ASEAN. The latter is still expanding its membership and it is hoped that by the year 2000, all South East Asian countries will be members.

The new regionalism in the Asia-Pacific region has forced ASEAN to change its external cooperation in order to widen market shares. Even though the some ASEAN members joined APEC with reluctance in 1989 because some ASEAN members were afraid of the erosion of ASEAN "spirits", eventually ASEAN members agreed to join in 1990. This author feels that ASEAN is still needed by all its members to enhance stability and security in order to support economic development within its members. It is still useful and relevant in the wider scheme of things, and external economic relations has been one of the successes achieved by ASEAN. Therefore, ASEAN can form a caucus within the larger organization to pursue their common interest. In APEC, ASEAN would able to push non-discrimination trade liberalization rather than the conditional trade liberalization or institutionalization of APEC, which has been recommended.

The main interest of APEC from ASEAN perspective is trade liberalization and investment; therefore, by involving in APEC agreements might accommodate ASEAN interests. Widening ASEAN external cooperation forum through APEC could enhance ASEAN trade and investment.

During the 1970's until 1980's, the Indonesian economy has continued to develop, but this development has been followed by import substitution and dominant government role in infrastructure and productive sectors. However, manufacturing production grew rapidly during these periods with investment flowing to export sector plants.

Since the early 1980's, Indonesia has undertaken economic reforms, especially when the price of oil collapsed. For example, the policies were put in place to encourage diversification to the export of non-oil commodities. The result of this policy was for Indonesian non-oil exports to grow faster. The reform process has been very much driven by the need for adjustment in order to response to adverse external conditions. The result of these economic reforms has been to increase trade and investment and therefore, a positive impact on gross domestic product. Of course concerns over protection continue since there are some products that continue to have high tariffs protection such as vehicles. Furthermore, while there has been a significant reduction in non-tariff barriers in manufacturing sectors such as steel engineering products, non-tariff barriers are still high in food crops, food, beverages and tobacco. While further deregulation measures in Indonesia are meant to open up markets, which were formerly heavily regulated or restricted by monopolistic forces, to competitive pressure, it is certainly not meant to imply a full withdrawal of the state from intervention in the economy.

In the era of APEC, Indonesia welcomed this initiative because it was hoped that APEC would bring a new era for open trade and investment in the region. APEC has been important to Indonesia since the majority of its trade is with APEC members and the major investment in Indonesian also come from APEC members. APEC provides many opportunities for trade and capital inflows. The decision of APEC Leaders Meeting in Bogor to realize trade and investment liberalization in Asia-Pacific no later than the year 2020 for developing members and the year 2010 for industrializing members was the most ambitious goals of recent economic agreements. If the Bogor decision is implemented, the APEC model could be the most successful example of international cooperation in the future.

It is important for Indonesia to encourage the principle of trade liberalization because some of Indonesia's major export markets are in Europe and APEC members. Indonesia's commitment to realize the principle of trade liberalization could be seen from the lower tariffs and its deregulation packages. Given the empirical results we find which indicate the importance of trade and investment to Indonesia, it is important to maintain the consistency of APEC objectives. These are to explicitly reject the creation of an inward-looking trading bloc. Continuing deregulation will be the main factor to develop Indonesian trade in the future and this will include reducing government intervention in some state owned enterprises.

Another important aspect for Indonesia from APEC is more liberalized FDI. The vision of an open region to investment flows will eventually mean that its procedures for approving foreign investment will have to be continually deregulated. The rapid growth of FDI will also have an influence on domestic investment. The impact will mainly comprise of demonstration effects by increasing joint venture activities, and raising the demand for domestic inputs. Other major factors, which can influence domestic investment, are the government deregulation policies on investment, a rapidly growing economy, and easier fund-raising caused by the liberalization of the financial sector. However, the increase of investment has some impacts especially for certain groups. The impact of investment development to workers is still debatable because the distribution of investment is mainly concentrating on Java Island. Java Island has monopolized the absorption of investment and therefore, has seen the greatest gains. Apart from regional disparities, Chinese Indonesias still dominate the capital power in Indonesia and also monopolize some strategic industries.

Finally, the positive experience opening up its economy makes Indonesia confident that it can continue to move forward, together with other APEC partners, toward the ultimate goal of trade and investment liberalization. It is hoped that Indonesia will continue its Bogor commitment to develop the ultimate goal of "trade and investment liberalization" in the future.

# ANNEX

Table 1. The Development of Indonesian Gross Domestic Product (GDP) (millions US $)

| Year | GDP (Rupiah) | Conversion to US $ | GDP (US $) |
|---|---|---|---|
| 1968 | 46,643,000.0 | 300.100 | 155,400.0 |
| 1969 | 49,445,000.0 | 326.000 | 151,700.0 |
| 1970 | 53,170,000.0 | 365.000 | 145,700.0 |
| 1971 | 56,895,000.0 | 393.400 | 144,600.0 |
| 1972 | 62,257,000.0 | 415.000 | 150,000.0 |
| 1973 | 69,298,000.0 | 415.000 | 167,000.0 |
| 1974 | 74,588,000.0 | 415.000 | 179,000.0 |
| 1975 | 78,301,000.0 | 415.000 | 188,700.0 |
| 1976 | 83,693,000.0 | 415.000 | 201,700.0 |
| 1977 | 91,026,000.0 | 415.000 | 219,300.0 |
| 1978 | 98,163,000.0 | 442.050 | 222,100.0 |
| 1979 | 104,304,000.0 | 623.060 | 167,400.0 |
| 1980 | 114,609,000.0 | 626.900 | 182,800.0 |
| 1981 | 123,694,000.0 | 631.760 | 195,800.0 |
| 1982 | 126,473,000.0 | 661.420 | 191,200.0 |
| 1983 | 131,776,000.0 | 909.260 | 144,900.0 |
| 1984 | 140,967,000.0 | 1,025.900 | 137,400.0 |
| 1985 | 144,439,000.0 | 1,110.600 | 130,100.0 |
| 1986 | 152,925,000.0 | 1,282.600 | 119,200.0 |
| 1987 | 160,450,000.0 | 1,643.800 | 97,600.0 |
| 1988 | 169,732,000.0 | 1,685.700 | 100,700.0 |
| 1989 | - | - | 118,200.0 |
| 1990 | - | - | 126,800.0 |
| 1991 | - | - | 135,500.0 |
| 1992 | - | - | 144,200.0 |
| 1993 | - | - | 153,500.0 |

Sources: IMF, Financial Statistics Year Book 1994, IMF Publication Services, Washington USA.

Table 2. The Development of Indonesian
Domestic and Foreign Investment (in millions US $)

| Years | Domestic Investment | Foreign Investment | Total Investment |
|---|---|---|---|
| 1967 | 125.0 | 0.0 | 125.0 |
| 1968 | 13.0 | 230.0 | 243.0 |
| 1969 | 101.0 | 682.0 | 783.0 |
| 1970 | 319.0 | 345.0 | 664.0 |
| 1971 | 939.0 | 426.0 | 1,365.0 |
| 1972 | 718.0 | 522.0 | 1,240.0 |
| 1973 | 1,465.0 | 655.0 | 2,120.0 |
| 1974 | 554.0 | 1,417.0 | 1,971.0 |
| 1975 | 593.0 | 1,757.0 | 2,350.0 |
| 1976 | 672.0 | 449.0 | 1,121.0 |
| 1977 | 1,386.0 | 328.0 | 1,714.0 |
| 1978 | 1,715.0 | 397.0 | 2,112.0 |
| 1979 | 1,242.0 | 1,320.0 | 2,562.0 |
| 1980 | 2,086.0 | 914.0 | 3,000.0 |
| 1981 | 2,676.0 | 1,092.0 | 3,768.0 |
| 1982 | 2,949.0 | 1,800.0 | 4,749.0 |
| 1983 | 7,707.0 | 2,882.0 | 10,589.0 |
| 1984 | 1,873.0 | 1,121.0 | 2,994.0 |
| 1985 | 2,883.0 | 859.0 | 3,692.0 |
| 1986 | 19,209.0 | 23,188.0 | 42,397.0 |
| 1987 | 6,333.0 | 1,502.0 | 7,853.0 |
| 1988 | 8,545.0 | 4,411.0 | 12.956.0 |
| 1989 | 10,985.0 | 4,716.0 | 12,956.0 |
| 1990 | 29,994.0 | 8,751.0 | 38,745.0 |
| 1991 | 21,069.0 | 8,778.0 | 29,847.0 |
| 1992 | 14,235.0 | 10,323.0 | 24,558.0 |
| 1993 | 18,894.0 | 8,144.0 | 27,038.0 |

Sources: 1968-1985 taken from Hal Hill, Foreign & Industrialization in Indonesia, Oxford University Press, New York, p.36.
1986-1993 taken from National Development Information Office. Indonesian Source Book 1994, PT. Bina Rena Priwara, Jakarta, p.71.

Table 3. The Development of Indonesian
Trade Performance (millions US $)

| Year | Exports | Imports | Total Trade |
|---|---|---|---|
| 1968 | 730.8 | 715.8 | 1,446.6 |
| 1969 | 853.7 | 780.7 | 1,634.4 |
| 1970 | 1,152.3 | 1,001.5 | 2,153.8 |
| 1971 | 1,246.7 | 1,102.8 | 2,349.5 |
| 1972 | 1,534.0 | 1,561.7 | 3,095.7 |
| 1973 | 3,061.4 | 2,729.1 | 5,790.5 |
| 1974 | 7,449.2 | 3,841.9 | 11,291.1 |
| 1975 | 7,103.2 | 4,769.8 | 10,945.1 |
| 1976 | 8,546.5 | 5,673.0 | 14,219.5 |
| 1977 | 10,853.0 | 6,230.0 | 17,083.0 |
| 1978 | 11,643.0 | 6,690.0 | 18,333.0 |
| 1979 | 15,590.0 | 7,202.0 | 22,792.0 |
| 1980 | 23,950.0 | 10,834.0 | 34,784.0 |
| 1981 | 25,260.0 | 13,272.0 | 38,532.0 |
| 1982 | 22,293.0 | 16,859.0 | 39,152.0 |
| 1983 | 21,152.0 | 16,352.0 | 37,504.0 |
| 1984 | 21,902.0 | 13,882.0 | 35,784.0 |
| 1985 | 18,590.0 | 10,262.0 | 28,852.0 |
| 1986 | 16,075.0 | 10,718.0 | 26,793.0 |
| 1987 | 17,135.0 | 12,891.0 | 30,026.0 |
| 1988 | 19,465.0 | 13,249.0 | 32,714.0 |
| 1989 | 22,160.0 | 16,360.0 | 38,520.0 |
| 1990 | 25,675.0 | 21,837.0 | 47,512.0 |
| 1991 | 29,142.0 | 25,869.0 | 55,011.0 |
| 1992 | 33,967.0 | 27,280.0 | 61,247.0 |
| 1993 | 36,823.0 | 28,328.0 | 65,151.0 |
| 1994 | 40,054.0 | 31,985.0 | 72,039.0 |
| 1995 | 45,417.0 | 40,918.0 | 86,335.0 |

Sources: Compiled from various issues of Direction of Trade Statistics Yearbook 1968-1996, International Monetary Fund (IMF) Publication Services, Washington, USA.

## Table 4 Indonesian Export Performance 1986 - 1994

(Billions US $)

| NO | DESCRIPTION OF GOODS | 1986 | % | 1987 | % | 1988 | % | 1989 | % | 1990 | % |
|---|---|---|---|---|---|---|---|---|---|---|---|
| I. | Crude Materials | 11,666.0 | 79 | 12,319.3 | 72 | 12,533.2 | 65 | 13,797.0 | 62 | 15,726.7 | 61 |
| 1. | Oil and Gas | 8,276.6 | 56 | 8,556.0 | 50 | 7,681.6 | 40 | 8,678.7 | 39 | 11,071.1 | 43 |
| | - Crude Oil | 4,593.3 | 31 | 5,040.5 | 29 | 4,234.5 | 22 | 5,140.4 | 23 | 6,219.9 | 24 |
| | - Oil Products | 907.7 | 6 | 1,116.4 | 7 | 954.5 | 5 | 919.9 | 4 | 1,183.9 | 5 |
| | - Natural Gas and Gas Products | 2,775.6 | 19 | 2,399.1 | 14 | 2,492.6 | 13 | 2,618.4 | 12 | 3,667.3 | 14 |
| 2. | Mining Products excluding oil & gas | 360.2 | 2 | 361.7 | 2 | 711.5 | 4 | 823.2 | 4 | 832.4 | 3 |
| 3. | Other Crude Materials | 3,029.2 | 20 | 3,401.6 | 20 | 4,140.1 | 22 | 4,295.1 | 19 | 3,823.2 | 15 |
| | | | | | | | | | | | |
| II. | Industrial Products | 3,139.0 | 21 | 4,816.3 | 28 | 6,685.3 | 35 | 8,361.8 | 38 | 9,948.6 | 39 |
| 4. | Plywood and other manufactures | 1,139.7 | 8 | 1,922.8 | 11 | 2,297.4 | 12 | 2,539.0 | 11 | 3,064.6 | 12 |
| 5. | Textile and garment | 828.8 | 6 | 1,064.5 | 6 | 1,477.1 | 8 | 2,008.7 | 9 | 2,887.8 | 11 |
| 6. | Base metals not containing of iron | 346.8 | 2 | 412.1 | 2 | 542.7 | 3 | 679.0 | 3 | 454.9 | 2 |
| 7. | Vegetable oil and fat | 124.9 | 0 | 234.3 | 1 | 460.1 | 2 | 409.0 | 2 | 330.6 | 1 |
| 8. | Iron and steel | 68.4 | 0 | 189.1 | 1 | 272.0 | 1 | 407.0 | 2 | 236.5 | 0 |
| 9. | Glass and glassware | 12.7 | 0 | 30.7 | 0 | 93.6 | 0 | 76.6 | 0 | 79.5 | 0 |
| 10. | Paper and paper products | 33.3 | 0 | 97.9 | 0 | 138.6 | 0 | 166.4 | 0 | 154.4 | 0 |
| 11. | Other industrial products | 584.4 | 4 | 864.9 | 5 | 1,403.8 | 7 | 2,076.1 | 9 | 2,740.3 | 11 |
| | | | | | | | | | | | |
| III. | Non oil and gas (2 up to 11) | 6,528.4 | 44 | 8,579.6 | 50 | 11,536.9 | 60 | 13,480.1 | 61 | 14,604.2 | 57 |
| | | | | | | | | | | | |
| IV. | Total Export | 14,805.0 | 100 | 17,135.6 | 100 | 19,218.5 | 100 | 22,158.8 | 100 | 25,675.3 | 100 |

| NO | DESCRIPTION OF GOODS | 1991 | % | 1992 | % | 1993 | % | 1994 | % |
|---|---|---|---|---|---|---|---|---|---|
| I. | Crude Materials | 16,328.9 | 56 | 16,678.6 | 49 | 16,199.4 | 44 | 17,693.8 | 44 |
| 1. | Oil and Gas | 10,894.9 | 37 | 10,670.8 | 31 | 9,745.4 | 26 | 9,693.6 | 24 |
| | - Crude Oil | 5,695.7 | 20 | 5,415.0 | 16 | 4,778.4 | 13 | 5,071.6 | 13 |
| | - Oil Products | 1,018.7 | 3 | 1,203.8 | 4 | 914.3 | 2 | 932.9 | 2 |
| | - Natural Gas and Gas Products | 4,180.5 | 14 | 4,052.0 | 12 | 4,052.7 | 11 | 3,689.1 | 9 |
| 2. | Mining Products excluding oil & gas | 1,113.4 | 4 | 1,632.5 | 5 | 1,647.9 | 4 | 2,085.8 | 5 |
| 3. | Other Crude Materials | 4,320.6 | 15 | 4,375.3 | 13 | 4,806.1 | 13 | 5,914.4 | 15 |
| | | | | | | | | | |
| II. | Industrial Products | 12,813.5 | 44 | 17,288.3 | 51 | 20,623.5 | 56 | 22,359.6 | 56 |
| 4. | Plywood and other manufactures | 3,289.6 | 11 | 3,826.0 | 11 | 5,129.0 | 14 | 4,832.9 | 12 |
| 5. | Textile and garment | 4,020.2 | 14 | 6,001.7 | 18 | 6,138.9 | 17 | 5,703.7 | 14 |
| 6. | Base metals not containing of iron | 383.9 | 1 | 406.1 | 1 | 295.3 | 0 | 405.0 | 1 |
| 7. | Vegetable oil and fat | 468.3 | 2 | 669.5 | 2 | 708.4 | 2 | 1,132.4 | 3 |
| 8. | Iron and steel | 288.3 | 0 | 269.1 | 0 | 309.8 | 0 | 308.6 | 0 |
| 9. | Glass and glassware | 91.2 | 0 | 100.7 | 0 | 127.9 | 0 | 132.2 | 0 |
| 10. | Paper and paper products | 266.0 | 0 | 340.8 | 1 | 494.3 | 1 | 593.8 | 1 |
| 11. | Other industrial products | 4,006.0 | 14 | 5,674.4 | 17 | 7,419.9 | 20 | 9,251.0 | 23 |
| | | | | | | | | | |
| III. | Non oil and gas (2 up to 11) | 18,247.5 | 63 | 23,296.1 | 69 | 27,077.5 | 74 | 30,359.8 | 76 |
| | | | | | | | | | |
| IV. | Total Export | 29,142.4 | 100 | 33,966.9 | 100 | 36,822.9 | 100 | 40,053.4 | 100 |

Source: The Department of Trade, Trade Statistics, number. 104/BL/92, September 1992 and 134/BL/95, March 1995.

## Table 5 Indonesian Balance of Trade 1986 - 1995

(Billions US $)

| Year | Export Oil and Gas | Export Non-oil and Gas | Total Export | Import Oil and Gas | Import Non-oil and Gas | Total Import | Balance of Trade Oil and Gas | Balance of Trade Non-oil and Gas | Total Surplus/deficit |
|---|---|---|---|---|---|---|---|---|---|
| 1986 | 8,276.6 | 6,528.4 | 14,805.0 | 1,086.4 | 9,632.0 | 10,718.4 | 7,190.2 | (3,103.6) | 4,086.6 |
| 1987 | 8,556.0 | 8,579.6 | 17,135.6 | 1,068.0 | 11,302.3 | 12,370.3 | 7,488.0 | (2,722.7) | 4,765.3 |
| 1988 | 7,681.6 | 11,536.9 | 19,218.5 | 909.1 | 12,339.4 | 13,248.5 | 6,772.5 | (802.5) | 5,970.0 |
| 1989 | 8,678.8 | 13,480.1 | 22,158.9 | 1,189.5 | 15,170.1 | 16,359.6 | 7,489.3 | (1,690.0) | 5,799.3 |
| 1990 | 11,071.1 | 14,604.2 | 25,675.3 | 1,920.4 | 19,916.6 | 21,837.0 | 9,150.7 | (5,312.4) | 3,838.3 |
| 1991 | 10,894.9 | 18,247.5 | 29,142.4 | 2,310.3 | 23,558.6 | 25,868.9 | 8,584.6 | (5,311.1) | 3,273.5 |
| 1992 | 10,670.9 | 23,296.1 | 33,967.0 | 2,115.1 | 25,164.5 | 27,279.6 | 8,555.8 | (1,868.4) | 6,687.4 |
| 1993 | 9,745.4 | 27,077.6 | 36,823.0 | 2,097.0 | 26,230.8 | 28,327.8 | 7,648.4 | 846.8 | 8,495.2 |
| 1994 | 9,693.6 | 30,359.8 | 40,053.4 | 2,367.4 | 29,616.1 | 31,983.5 | 7,326.2 | 743.7 | 8,069.9 |
| 1995* | 10,464.6 | 34,953.4 | 45,418.0 | - | - | 40,628.7 | - | - | 3,789.3 |

Source: The Department of Trade, Trade Statistics, number. 104/BL/92, September 1992 and 134/BL/95, Jakarta-Indonesia, March 1995. *) Quoted from Internet://www.bp.go.id

**Chart 1 THE DEVELOPMENT OF INDONESIAN EXPORT AND IMPORT**

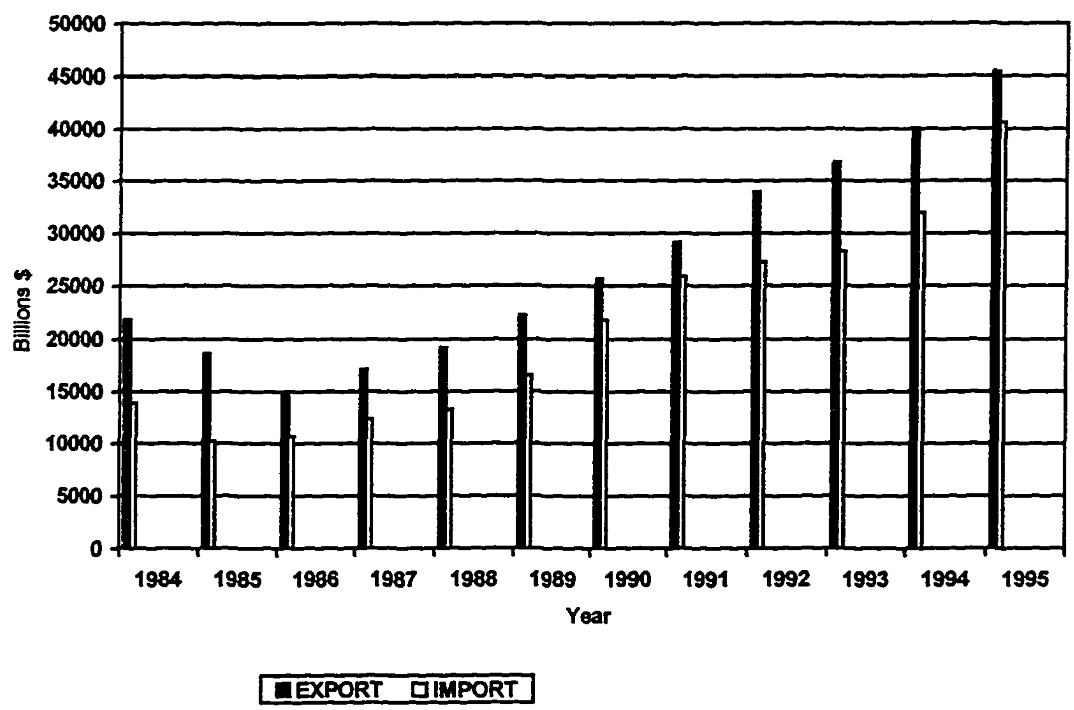


Table 6 Growth of Indonesian Exports by Country Group 1994-1995
(US $ Million)

| Country Group | 1994 | 1995 | % Changes |
|---|---|---|---|
| APEC: | 30,029.7 | 34,365.6 | 14.4 |
| ASEAN: | 5,704.8 | 6,070.5 | 6.4 |
| Malaysia | 738.5 | 986.6 | 33.6 |
| Philippines | 365.1 | 590.3 | 61.7 |
| Singapore | 4,149.7 | 3,766.7 | -9.2 |
| Thailand | 401.3 | 702.9 | 75.2 |
| Brunei | 50.2 | 24.0 | -52.2 |
| NAFTA: | 5,695.8 | 6,769.1 | 18.8 |
| USA | 5,229.8 | 6,321.7 | 20.9 |
| Canada | 321.7 | 359.0 | 11.6 |
| Mexico | 144.3 | 88.4 | -38.7 |
| Others APEC: | 18,269.1 | 21,526.0 | 15.6 |
| Taiwan | 1635.2 | 1,749.4 | 7.0 |
| Japan | 10,929.0 | 12,288.3 | 12.4 |
| Hong Kong | 1321.7 | 1,657.1 | 25.4 |
| Rep. of Korea | 2,593.0 | 2,916.7 | 12.5 |
| Peop. Rep. of China | 1,321.7 | 1,741.7 | 31.8 |
| Chile | 47.7 | 104.4 | 118.9 |
| Australia | 705.4 | 915.2 | 29.7 |
| New Zealand | 51.6 | 129.8 | 151.6 |
| Papua New Guinea | 24.0 | 23.4 | -2.5 |
| EC: | 5,949.4 | 6,757.1 | 13.6 |
| United Kingdom | 1,038.1 | 1,128.6 | 8.7 |
| Netherlands | 1,323.5 | 1,452.4 | 9.7 |
| R.F. Germany | 1,263.4 | 1,381.6 | 9.4 |
| Belgium & Luxemburg | 409.3 | 538.7 | 31.6 |
| France | 426.1 | 519.8 | 22.0 |
| Denmark | 109.7 | 111.3 | 1.4 |
| Ireland | 37.5 | 36.7 | -2.1 |
| Italy | 660.7 | 783.7 | 18.6 |
| Greece | 63.1 | 78.9 | 25.0 |
| Portugal | 40.0 | 45.5 | 13.5 |
| Spain | 453.9 | 534.6 | 17.8 |
| Austria | 45.8 | 52.6 | 14.8 |
| Sweden | 47.9 | 50.3 | 5.0 |
| Finland | 30.4 | 42.4 | 39.5 |
| Others | 4,074.3 | 4,295.3 | 5.4 |
| Total | 40,053.4 | 45,418.0 | 13.4 |

Sources: Internet ://www.bps.go.id

Table 7 Growth of Indonesian Imports by Country Group 1994-1995
(US $ Million)

| Country Group | 1994 | 1995 | % Changes |
|---|---|---|---|
| APEC: | 2,1920.2 | 27,389.8 | 24.95 |
| ASEAN: | 2,927.6 | 3,953.3 | 35.04 |
| Malaysia | 578.8 | 767.0 | 32.52 |
| Philippines | 65.2 | 81.2 | 24.54 |
| Singapore | 1,877.1 | 2,367.5 | 26.13 |
| Thailand | 406.2 | 737.1 | 81.46 |
| Brunei | 0.3 | 0.5 | 66.67 |
| NAFTA: | 4,126.2 | 5,659.0 | 37.15 |
| USA | 3,587.8 | 4,755.9 | 32.56 |
| Canada | 496.8 | 810.7 | 63.18 |
| Mexico | 41.6 | 92.4 | 122.12 |
| Others APEC: | 14,866.4 | 17,777.5 | 19.58 |
| Taiwan | 1,448.4 | 1,823.8 | 25.92 |
| Japan | 7,740.1 | 9,216.8 | 19.08 |
| Hong Kong | 240.5 | 274.6 | 14.18 |
| Rep. of Korea | 2,165.9 | 2,451.3 | 13.18 |
| Peop. Rep. of China | 1,369.0 | 1,495.2 | 9.22 |
| Chile | 197.6 | 291.3 | 47.42 |
| Australia | 1,542.0 | 2,015.5 | 30.71 |
| New Zealand | 156.2 | 205.7 | 31.69 |
| Papua New Guinea | 6.7 | 3.3 | -50.75 |
| EC: | 6,612.1 | 8,175.3 | 23.64 |
| United Kingdom | 710.0 | 902.5 | 27.11 |
| Netherlands | 563.7 | 842.1 | 49.39 |
| R.F. Germany | 2,472.7 | 2,819.2 | 14.01 |
| Belgium & Luxemburg | 292.0 | 401.1 | 37.36 |
| France | 788.3 | 1,063.6 | 34.92 |
| Denmark | 105.9 | 105.1 | -0.76 |
| Ireland | 22.5 | 40.6 | 80.44 |
| Italy | 667.8 | 791.0 | 18.45 |
| Greece | 26.4 | 61.4 | 132.58 |
| Portugal | 4.4 | 8.0 | 81.82 |
| Spain | 174.1 | 219.3 | 25.96 |
| Austria | 186.8 | 315.3 | 68.79 |
| Sweden | 356.1 | 354.1 | -0.56 |
| Finland | 241.3 | 252.0 | 4.43 |
| Others | 3,451.2 | 5,063.6 | 46.72 |
| Total | 31,983.5 | 40,628.7 | 27.03 |

Sources: Internet ://www.bps.go.id

**Figure 1 The Indonesian Export Distribution January - December 1996**

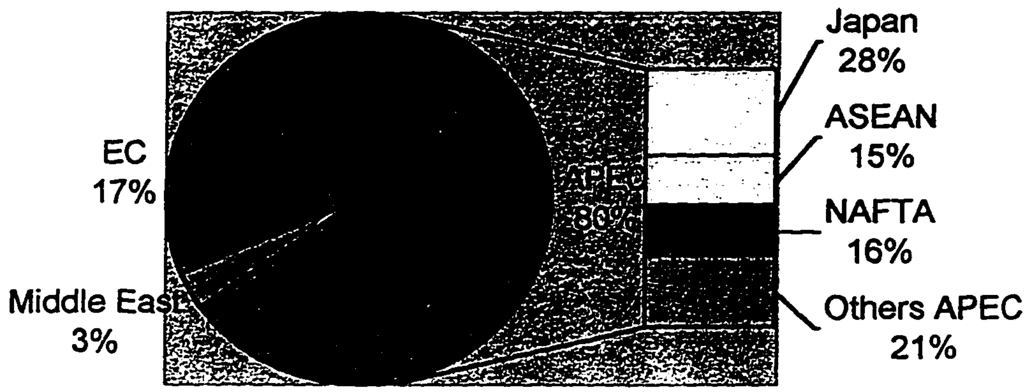
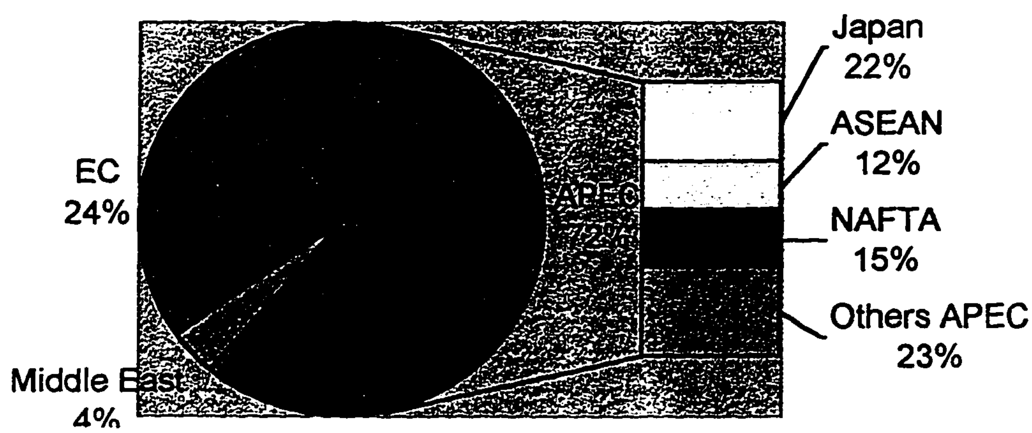
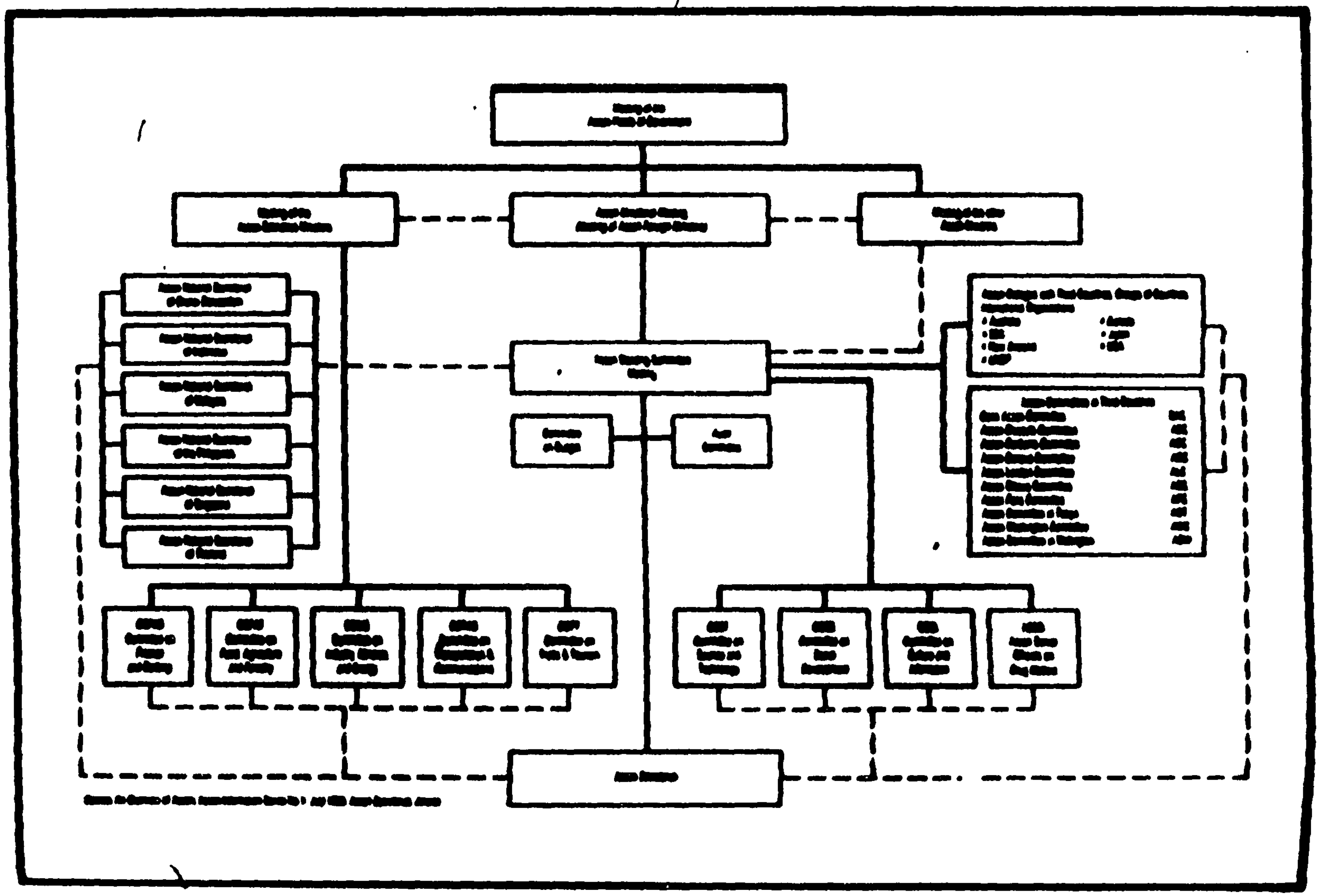



**Figure 2 The Indonesian Import Distribution January - December 1996**




Source: Internet :http://www.bps.go.id

# ORGANISATIONAL STRUCTURE OF ASEAN



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