2

Natural Resources

Like the United States, Indonesia is a leading producer and exporter of certain agricultural commodities, forestry and fishery products, minerals, and fuels. Natural resources account for about 45 percent of total Indonesian trade and establish Indonesia's role in the world economy. Although Asia is the natural market for Indonesian raw materials, trade with the United States should grow rapidly over the next decade. Natural resources are already a fundamental component of US-Indonesia commercial relations, accounting for about a quarter of two-way trade and 80 percent of US direct investment in Indonesia. Agricultural commodities currently dominate bilateral trade in natural resources; recent US trans fat regulations may boost Indonesian exports of vegetable oils. In the future, however, energy trade may prove to be far more important, as North America is slated to import large amounts of liquefied natural gas (LNG) by 2010. A US-Indonesia FTA should open new opportunities for two-way agricultural trade, as well as promote investment, production, and export of Indonesia's energy and mineral resources to the United States and other markets.

Economists have debated whether a country can join the ranks of leading world nations based on natural resource production.[1] This debate

1. The "natural resource curse" is a recurrent theme in economic history. Its older version, based on Raúl Prebisch's proposition of a secular decline in commodity prices, was discredited in the late 1970s, but Jeffrey Sachs and Andrew Warner (1995) advanced new arguments to suggest that countries that specialize in natural resources grow less rapidly. Other scholars contend that the Sachs and Warner findings are not robust to alternative specifications (e.g., Lederman and Maloney 2007).

surely resonates among Indonesian policymakers, given the country's size, potential, and leadership aspirations. Indonesia might value a US-Indonesia FTA mainly for its capacity to promote manufactured exports. However, present realities suggest that Indonesia can still make major advances by developing its natural resources.[2] A US-Indonesia FTA could strengthen the Indonesian oil, mining, and agriculture sectors by boosting foreign investment and the corollary know-how and productivity associated with foreign enterprises, increasing competition and lowering food prices for urban consumers, and increasing export opportunities for processed agricultural products as a result of both better market access and higher productivity.

Energy and Mining

In 2005 Indonesian mineral fuels—coal, oil, and natural gas—attracted one-third of total foreign direct investment (FDI) approvals in Indonesia[3] and generated exports of $24 billion, almost 30 percent of total Indonesian exports. Rising domestic oil and gas consumption, however, is curtailing Indonesia's role as an energy exporter.[4] Like many oil-producing countries, Indonesia subsidizes domestic sales of gasoline and diesel. For a variety of reasons, petroleum investment has lagged. Hence, Indonesia is in an unusual position for a member of the Organization of Petroleum Exporting Countries (OPEC): Currently it is a net importer of oil.[5] By world standards, Indonesian petroleum exports are small; valued at only $10 billion

2. Gavin Wright and Jesse Czelusta (2002) and Magnus Blomström and Ari Kokko (2003) powerfully illustrate how growth can be sustained by the expansion of natural resources (forestry and iron ore in Finland and Sweden; various minerals in the case of the United States). Wright and Czelusta conclude that if resources are developed through advanced technology and incremental knowledge, their spillover effects may be just as powerful as anything done in the manufacturing sector. Blomström and Kokko emphasize the continuous creation of skills that sustain industrial competitiveness in industries based on natural resources.

3. This estimate draws on FDI approval data from several sources, including the US Embassy in Jakarta, that complement figures published by the Coordinating Board of Investment.

4. The Indonesian authorities face a trade-off between satisfying domestic and foreign demands for oil and LNG. Oil has traditionally been the primary source for generating electricity, but reliance on gas and coal is also increasing. Foreign buyers worry that Indonesia will not meet its export commitments unless the country boosts production sharply, and within this context, the strengthening of Pertamina's role as sole agent for LNG sales to Taiwan and South Korea could worry other foreign partners.

5. Indonesia's net oil-importer status, however, did not prevent authorities from endorsing an OPEC call to reduce output to sustain prices, now around $60 a barrel. Indonesia proposed cuts from notional quotas rather than actual production.

Table 2.1 Bilateral US-Indonesia trade in natural resource–based products, 2000 and 2005 (millions of US dollars)

	US exports to Indonesia		US imports from Indonesia	
Sector	**2000**	**2005**	**2000**	**2005**
Agriculture, fisheries, and forestry	717	1,023	1,812	2,827
Bulk or semiprocessed commodities	588	788	763	1,526
Consumer-oriented agricultural products	79	168	235	176
Forest products	48	61	453	397
Seafood products	2	5	362	728
Oil, gas, and mining	28	92	587	440
Oil and gas	25	86	525	348
Mining products[a]	3	6	62	92
Total trade in natural resource–based products	745	1,115	2,399	3,267
Natural resources/total trade (share)	0.30	0.37	0.23	0.27

a. Coal, copper, gold, nickel, and tin.

Sources: USDA (2006); USITC Interactive Tariff and Trade Dataweb, dataweb.usitc.gov (accessed July 10, 2006).

annually, a figure that represents only 5 percent of annual US imports. Indonesia's LNG exports, however, are huge; valued at $9 billion annually, they make Indonesia the current top LNG exporter in the world. That said, Indonesia's share in the LNG market is declining and currently stands at around 17 percent.[6]

Bilateral trade in mineral fuels is currently small (table 2.1), but US firms are major producers and investors in the Indonesian energy sector. Energy cooperation endows the US-Indonesia relationship with a strategic dimension because the countries share an interest in promoting energy security, trade, and investment. Under the framework of the bilateral public-private Energy Policy Dialogue, the United States and Indonesia regularly discuss how to improve the business environment for private US energy investment.[7] A US-Indonesia FTA will complement this process by addressing behind-the-border barriers, particularly lack of transparency, investment security, and irregularities in tenders. An FTA could also

6. With greater foreign competition from other countries, such as Oman, Qatar, Russia, and Australia, Indonesia is increasing its gas exports to Singapore via pipeline.

7. Business environment considerations are critical in LNG projects because such projects are prone to high cost overruns, as illustrated by the Sakhalin and Gorgon projects.

remove border barriers that impede trade in refined products and supporting activities.[8]

High energy prices and rising political risks in the Middle East work in Indonesia's favor. However, oil and gas production and export volumes have stagnated, and low exploration expenditures do not reflect mineral prospects (PWC 2005). Subsidies on domestic oil and gas consumption take a toll on both government finances and new production, and regulatory changes and political instability have scared off many investors—not only US firms.[9]

Generally, US and EU energy firms are not the only game in town. Chinese, Middle Eastern, and other investors are also active in Indonesia. As the easy fields are played out and as environmental concerns become a central issue for Indonesia, the costs and technology requirements of developing new fields will rise. Undiscovered oil and gas reserves are probably concentrated in offshore deepwater fields, a domain dominated by US and EU firms such as BP, Total, Shell, Chevron, ExxonMobil, ConocoPhillips, and Hess. These firms have the financial capacity, experience with stringent environmental regulations, and technology to expand exploration, production, and transportation in old and new fields.[10]

Mining

Indonesia is a key regional producer and exporter of mining products. In 2005 Indonesia exported $7 billion in metalliferous ores and nonferrous metals, becoming the top global supplier of tin and the fourth-largest exporter of coal, copper, and nickel ores. Bilateral trade in hard minerals between the United States and Indonesia is small (tables 2.1 and 2.2), but US mining companies are important players in the Indonesian mining sector, particularly for copper and gold.[11]

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8. Indonesian tariffs on refined fuels are moderate (table 2.2), but they can reach as high as 30 percent for lubricating oils. Indonesian tariffs for capital goods used in oil, gas, and mining activities, such as mechanical shovels and excavators (HS 8429) or special-purpose or transport vehicles, range from 5 to 40 percent (HS 8704–05).

9. PricewaterhouseCoopers (PWC 2005) reports that the Indonesian government took three years to implement Law 21/2001, which modified the basic policy framework for the oil and gas sectors. The Embassy of the United States in Jakarta (2005) reports troubles in the governance of the LNG sector.

10. As an old illustration, in 1984 CPT Caltex Pacific Indonesia (CPI), a Chevron affiliate, introduced steamflood technology, a method of extracting heavy oil deposits, at the Duri field in Indonesia. The field was in decline at the time, but by 1997 its daily oil production was five times larger than the highest levels previously recorded.

11. Chapter 3 discusses tariffs affecting barriers for mineral-based articles in greater depth.

Table 2.2 US-Indonesian trade in fuels and hard minerals, selected items (millions of US dollars)

SITC code	Product description	Trade value	Average tariff
Indonesian exports			
321	Coal, not agglomerated	55	0.0
333	Petroleum oils, crude	308	0.4
334	Petroleum products	53	2.4
687	Tin	8	1.8
Indonesian imports			
334	Petroleum products	62	5.4
335	Residual petrol products	8	5.0

SITC = Standard International Trade Classification

Sources: USITC Interactive Tariff and Trade Dataweb, dataweb.usitc.gov (accessed July 10, 2006); UN Comtrade database, unstats.un.org; Indonesian tariff schedule.

The Fraser Institute (2005) ranks Indonesian mining policies as among the worst in the world. That federal and local governments have undermined the legal framework dating from the Suharto regime without establishing a clear alternative has contributed to Indonesia's poor performance.[12] The emerging legal framework has yet to integrate environmental concerns (Forestry Law) or improve the representation of local governments (Regional Autonomy Law) in ways that mining companies can accept.[13] Despite optimal mining prospects, political and legal uncertainty has depressed exploration expenditures (PWC 2006). Given this background, mining firms might welcome a move toward consolidating Indonesian authority in a single agency. Unlike the government's draft investment package, now under parliamentary consideration, foreign investors received the draft mining law coldly.

Mining investment uncertainty and risk have increased globally, despite the high prices of mineral commodities. The hardening of regulatory and land-access conditions has limited mining investment in developed countries and has served as an important "push" factor for US and

12. The established framework included a "lex specialist" clause—a standard provision in mining contracts between 1967 and 1997—assuring that, once approved by the government, the terms of a mining contract would prevail unless modified by mutual consent (Wahju 2002).

13. Mining firms complain that the Forestry Law converted areas already granted under previous work contracts into protected forest categories, making them inaccessible for private exploitation. They also charge that the law declared the best mineral belts to be protected forest, placing them off-limits to open-pit methods (Wahju 2003).

Australian companies (USITC 2006).[14] But political instability in sub-Saharan nations and Bolivia, coupled with prospects of higher taxation and royalties in many developing countries, have prompted many mining firms to be more cautious.[15]

A US-Indonesia FTA might troubleshoot some of the difficulties that mining companies face in Indonesia by improving the transparency, certainty, and predictability of the rules of the game. This could be accomplished by establishing a dispute settlement mechanism to resolve legal uncertainties arising after the FTA is ratified in areas such as divestment of foreign ownership interests and mine closures.[16] Greater certainty for foreign investors need not impede the government's ability to enact environmental regulation. As chapters 4 and 6 discuss, US FTAs recognize the need to limit private challenges against public measures that foster genuine environmental objectives.

Access conditions for future mining projects could also become a negotiating issue as the Indonesian government contemplates a new model for future contracts, requiring foreign firms to establish a joint venture with a state-owned mining enterprise or to acquire a mining license issued by the local government.[17] The absence of clarity, certainty, and predictability will weigh heavily on the future of the Indonesian mining sector, not just in the exploitation of its mining potential, but also in the prospects of creating new metal-refining plants.[18]

Agriculture, Forestry, and Fisheries

Agriculture, forestry, and fishery products account for almost a quarter of US-Indonesia two-way trade (table 2.1). Indonesia is the 15th-largest importer of

14. See also USITC Interactive Tariff and Trade Dataweb, 2005, dataweb.usitc.gov (accessed on July 10, 2006).

15. According to a USITC (2006) review of the world copper market and FDI flows, the industry is mainly meeting demand by expanding existing projects rather than starting new ones. In turn, the low level of new discoveries has put pressure on world copper prices.

16. These are areas where US firms face difficulties, as chapter 6 describes.

17. A US-Indonesia FTA could also address Indonesia's export restrictions and taxes applied to mineral products.

18. An old warning by Nicky Oppenheimer, chairman of De Beers, issued in an African policy forum has not lost its relevance: "Natural resources can be a source of great good . . . or dreadful ill. The key element is not the resource itself, but how it is exploited. An orderly mining regime, operating within a transparent and predictable legislative and fiscal framework, can be a major source of prosperity for governments and people. Without it, mineral wealth . . . will be a magnet for the greedy and corrupt to line their own pockets at the expense of the people" (OECD 2002, 1).

US agricultural products and a key market for US cotton (4th), soybeans (7th), and powdered milk (2nd). Likewise, the US market accounts for 16 percent of total Indonesian exports of agricultural, fishery, and forestry products and is a leading market for most commodities besides palm oil, such as cocoa, coffee, natural rubber, crab meat, shrimp, and pineapples.

With a current-dollar agricultural GDP that exceeds those of Brazil and Argentina combined and falls just short of those of Australia and Canada combined, Indonesia is a prominent member of the Cairns Group, a coalition of agricultural-exporting countries. Unlike the abovementioned countries, however, the vast majority of Indonesia's production goes to satisfying the needs of its immense population. Therefore, domestic considerations have typically prevailed over international objectives. Smoothing prices and achieving self-sufficiency rank high among domestic goals. Consequently, some domestic policies, such as export taxes, have directly constrained agricultural exports. Nevertheless, Indonesia remains a key exporter of selected tropical agricultural and forestry products as well as fish. Indonesia's export profile also reveals a high degree of complementarity with US agriculture. Excluding the cotton trade, US exports to Indonesia consist mostly of temperate-zone products, such as soybeans, wheat, grapes, and apples, and consumer-oriented agricultural items, such as dairy, fresh fruits, meats, and snack foods (table 2.3).

A US-Indonesia FTA could open opportunities for exporters in both countries, and contribute to a more varied diet for the Indonesian urban working class. But the key effect of an FTA on the agricultural sector lies in transforming Indonesian policy, away from old habits that hinder farm investment and limit export opportunities and toward a more decisive embrace of open markets and regulatory transparency.

Tariffs and Tariff-Rate Quotas

With few exceptions, Indonesian tariffs are low by regional and international standards. Indonesia's average applied most favored nation (MFN) tariff on agricultural imports is 8.2 percent, lower than the current US average applied rate of 9.7 percent. Tariff barriers on agricultural, fishery, and forestry products are not a leading obstacle for US exporters, who tend to stress arbitrary customs practices and nontariff barriers as more significant impediments to trade. Competition from other exporters, such as New Zealand (dairy), Australia (wheat), and Brazil and Argentina (soy meal), and unreliable cold-chain distribution infrastructure present further challenges US exporters.[19] However, tariff escalation in the US schedule is a leading concern of Indonesian exporters (table 2.4).

19. As a current example, adverse climatic conditions may result in lower exports of Australian wheat to Indonesia in 2006–07. This will translate into new opportunities for US exporters.

Table 2.3 US-Indonesia trade in agriculture, fisheries, and forestry products, selected years
(millions of US dollars)

	US exports				US imports		
Product	**1999**	**2002**	**2005**	**Product**	**1999**	**2002**	**2005**
Soybeans	202	255	302	Rubber	376	405	965
Cotton	77	194	278	Shrimp	167	153	374
Feeds and fodders	7	31	73	Other seafood	83	190	263
Dairy products	12	16	61	Panel or plywood products	289	215	197
Other intermediate	35	57	44	Other wood products	190	155	186
Fresh fruit	18	33	38	Cocoa beans	174	148	178
Wheat	54	47	27	Raw coffee	72	62	163
Logs and chips	13	21	25	Tropical oils	84	35	96
Tobacco	9	12	24	Tuna	55	56	91
Soybean meal	2	92	22	Cocoa paste or butter	57	50	68
Other consumer oriented	7	6	20	Processed fruits or vegetables	84	57	59
Red meats, fresh, chilled, or frozen	5	9	18	Spices	100	81	51
Processed fruits or vegetables	10	13	16	Roasted or instant coffee	10	11	22
Hardwood lumber	11	10	15	Essential oils	20	19	19
Soft or treated lumber	5	10	12	Snack foods	12	17	19
Snack foods	1	3	9	Hardwood lumber	9	9	14
Subtotal	469	810	983		1,783	1,665	2,766
Agriculture, fisheries, and forestry	571	859	1,023		1,834	1,711	2,827

Source: USDA (2006).

Table 2.4 Tariff escalation in the US schedule for selected Indonesian exports, 2005 (millions of US dollars)

Product category	Indonesian exports		Average US tariff[a]
	To United States	To world	
Cocoa products			
Beans	135	468	0.0
Paste, butter, fat, and oil	58	155	0.0
Powder, unsweetened	5	30	0.3
Powder, sweetened	0	1	12.6
Chocolate	0	11	16.2
Other preparations	0	2	8.6
Coffee			
Raw (roasted or not roasted)	138	505	0.0
Instant	0	0	0.0
Preparations based on coffee	0	25	12.8
Sugar			
Raw (cane and beet)	0	0	24.0
Refined	0	0	14.0
Syrups	0	21	13.4
Confectionery	4	56	13.1
Natural rubber			
Latex or rubber in primary forms	853	2,612	0.0
Tubes, pipes, and transmission belts	6	44	3.9
New pneumatic tires	72	627	2.1
Gloves	82	149	4.8
Tuna and skipjack			
Fresh or chilled, whole	11[b]	118	0.0
Prepared or preserved	50	129	11.0
Crab, shrimp, and prawns			
Fresh or chilled, whole	333	912	2.5
Prepared or preserved	100	138	3.3
Pineapple			
Fresh or dried	0	0	1.1
Otherwise prepared or preserved	25	104	0.6
Juice, not fermented or spirited	6	24	7.0

a. Averages for commodities often hide very high peaks. For example, a 3.3 average for prepared crab, shrimp, or prawn meats includes tariffs as high as 10 percent.
b. USITC data reports $30 million in Indonesian exports of these products for 2005.

Sources: UN Comtrade database, unstats.un.org; USITC Interactive Tariff and Trade Dataweb, dataweb.usitc.gov (accessed July 10, 2006).

The vast majority of products actually exchanged between the United States and Indonesia enter duty free or face tariffs below 5 percent. (All agricultural and food products not listed as sensitive items in table 2.5 are subject to either a 5 percent tariff or duty-free access in Indonesia.) The trade-weighted average US tariff on Indonesian exports of agricultural, fishery, and forestry products was less than 1 percent (table 2.6), and the analogous Indonesian figure on US exports was only 2.6 percent (table 2.7). Both figures are well below the respective trade-weighted average applied MFN tariffs of each country once preferential trade is excluded. Low applied tariffs on existing trade underscore the large degree of complementarity at the bulk commodity level. However, the low rates also reflect discouraged trade in high-duty commodities.

Indonesian exports of processed items, for which trade is low or zero, face considerably higher tariffs and tariff-rate quotas (TRQs) than do bulk commodities. The principal contribution of an FTA for Indonesian exports of agricultural, fishery, and forestry products would result from eliminating the tariff-escalation patterns ingrained in the US tariff structure. Table 2.4 shows that tariff escalation hinders nearly all current Indonesian exports of agricultural and fishery commodities.

Tariff escalation not only affects the commodities listed in table 2.4 but also prevents diversification of Indonesian exports. Nontraditional exports such as margarine, noodles and pasta products, sauces and condiments, and mushrooms also face high tariffs in the United States.[20] Some of the highest US TRQs do not apply to products that Indonesia currently exports (e.g., dairy and peanuts), but US TRQs on tuna, tobacco, coffee and cocoa preparations, mix condiments and mixed seasoning, and sugar confectionery limit Indonesia's export potential.

Indonesia's average tariff level is already low, but comprehensive tariff elimination could encourage US agricultural exports to Indonesia. Eliminating tariffs would reduce the uncertainty associated with the large gap between Indonesian bound and applied tariffs—on average, a gap of over 30 percentage points—and limit the scope for arbitrary valuation of agricultural imports, which directly affect most US exports but particularly soybeans and corn. FTA transparency requirements and trade facilitation provisions should allow US producers to question the arbitrary practices of customs officials. In the past, Indonesia has failed to honor certain commitments in its bound tariff schedule. Applied tariffs on alcoholic beverages exceed bound rates and specific tariffs apply for sensitive commodities, whereas no tariffs

20. Tuna and mushroom producers are highly protected in the United States. The United States Tuna Foundation (USTF) even opposes including tuna in FTAs, but the United States already grants preferences to Andean partners (Ecuador) and least-developed generalized system of preferences (GSP) beneficiaries.

Table 2.5 Sensitive Indonesian agriculture, fisheries, and forestry products (based on tariff treatment)

HS 4-digit	Description	Total imports[a] (millions of US dollars)	Number of tariff lines >10 percent	Representative high MFN rate	2004 CEPT rate[b]	Main nontariff barrier
4412–21	Plywood and other wooden articles	18	All	10	0	Export restrictions
2402–03	Cigars, cigarettes; tobacco or its substitutes	38	All	15	5	
2203–08	Alcoholic preparations (including HS 2106906)	1	All	40–170	—	Quantity/use limits
1701	Cane or beet sugar and pure sucrose	589	All	Rp 550–700/Kg	—	Quantity/use limits
1514–16	Certain animal and vegetable fats or oils[c]	17	Nearly all	10	5	
1512	Cottonseed oil and its fractions	0	4	10	5	
1006	Rice (including rice flour, HS 1102.30)[d]	52	All	Rp 430/Kg	—	Quantity/use limits
0601–04	Live plants, bulbs, and flowers and foliage	2	Nearly all	10–20	5	Sanitary and phyto-sanitary measures
0301	Live fish for breeding and fish products	1	8	15	5	Sanitary and phyto-sanitary measures

CEPT = common effective preferential tariff
MFN = most favored nation

a. Total Indonesian imports from the world.
b. CEPT of the Association of Southeast Asian Nations (ASEAN) Free Trade Area (AFTA).
c. Rape, colza, or mustard oil; fixed vegetable oil not chemically modified; and animal and vegetable fats or oils, hydrogenated only. A few other fats and oils, such as wool grease or fats of bovine animals, face high tariffs.
d. The World Trade Organization's *Trade Policy Review for Indonesia* (2003) reports an ad valorem equivalent of 30 percent for this specific tariff. Seasonal import bans are also applied to rice imports.

Sources: UN Comtrade database, unstats.un.org; Indonesian tariff schedule.

Table 2.6 US tariffs on top Indonesian exports of agriculture, fisheries, and forestry products, 2005 (millions of US dollars)

HS 8-digit	Product description	Import value	Share	Tariff
4001.22.00	Natural rubber, technically specified	891	0.32	Free
0306.13.00	Shrimp and prawns, frozen	324	0.11	Free
1801.00.00	Cocoa beans	178	0.06	Free
0901.11.00	Coffee, not roasted	163	0.06	Free
4412.13.40	Plywood sheets n/o 6 mm thick, tropical wood	147	0.05	8.0
1605.10.20	Crabmeat, preserved, in airtight containers	109	0.04	Free
0304.20.60	Fillets of freshwater fish, frozen	95	0.03	Free
1804.00.00	Cocoa butter, fat, and oil	66	0.02	Free
1604.14.30	Tuna and skipjack, in airtight containers, over quota	53	0.02	12.5
1605.20.10	Shrimp and prawns, prepared or preserved	49	0.02	Free
1513.11.00	Coconut oil, crude	45	0.02	Free
1513.29.00	Palm kernel or babassu oil, refined	36	0.01	Free
2008.20.00	Pineapples, prepared or preserved	34	0.01	0.6[a]
0303.42.00	Yellowfin tuna, frozen, excluding fillets	29	0.01	Free
4421.90.97	Articles of wood, not elsewhere specified or included	28	0.01	3.3
4418.20.80	Doors of wood, other than French doors	23	0.01	4.8
4001.21.00	Natural rubber, smoked sheets	23	0.01	Free
4001.29.00	Other natural rubber	22	0.01	Free
0901.12.00	Coffee, not roasted	22	0.01	Free
0904.11.00	Pepper	19	0.01	Free
4412.14.31	Plywood sheet n/o 6 mm thick, nonconiferous wood	18	0.01	8.0
4420.10.00	Wooden statuettes and other wood ornaments	16	0.01	3.2
4703.29.00	Chemical woodpulp of bleached nonconiferous wood	14	0.00	Free
4418.90.45	Builders' joinery and carpentry of wood	13	0.00	3.2
4418.30.00	Wooden parquet panels	13	0.00	Free
2003.10.01	Mushrooms, agaricus	13	0.00	12[b]
1905.31.00	Sweet biscuits	12	0.00	Free
	Subtotal	2,456	0.87	0.9
	Other products	372	0.13	n.a.
	Agriculture, fisheries, and forestry	2,827	1.00	0.7[c]

a. 2003 ad valorem equivalent to specific tariff: 0.35 cents/kg.
b. 2003 ad valorem equivalent for compound tariff rate: 6 cents/kg + 8.5 percent.
c. Estimate based on actual import duties collected.

Sources: USDA (2006); USITC Interactive Tariff and Trade Dataweb, dataweb.usitc.gov.

Table 2.7 Indonesian tariffs on top US exports of agriculture, fisheries, and forestry products

HS 6-digit	Product description	Import value (millions of dollars)	Share	Tariff
1201.00	Soybeans	256	0.25	Free
5201.00	Cotton, not carded or combed	225	0.22	Free
0402.10	Milk powder with less than 1.5 percent fat	54	0.05	5.0
2303.10	Residues of starch manufacture	53	0.05	5.0
2304.00	Soybean oil-cake and other residues	42	0.04	Free
2309.90	Animal feed preparations nesoi	38	0.04	Free
4707.10	Waste or scrap of unbleached paperboard	35	0.03	15.0
1001.90	Non-durum wheat and meslin	25	0.02	5.0
0808.10	Apples, fresh	19	0.02	5.0
4403.91	Logs, oak (quercus spp)	19	0.02	Free
2401.20	Tobacco, unmanufactured, stemmed, or stripped	18	0.02	5.0
0806.10	Grapes, fresh	18	0.02	5.0
4703.21	Wood pulp, conifer, bleached	16	0.02	Free
2106.90	Food preparations not elsewhere specified or included	16	0.02	3.0
4407.10	Softwood lumber, coniferous, thickness < 6 mm	15	0.02	Free
4707.30	Waste or scrap paper or board	15	0.01	15.0
4002.20	Butadiene rubber	13	0.01	5.0
1513.19	Coconut oil or fractions simply refined	12	0.01	Free
	Subtotal	888	0.87	1.8
	Other products	136	0.13	8.2[a]
	Agriculture, fisheries, and forestry	1,023	1.00	2.6

a. For remaining products we assume the Indonesian average applied agricultural tariff as the United States does not currently export to Indonesia large quantities of products subject to tariff peaks in the Indonesian schedule (i.e., rice, sugar, palm and coconut oil, and alcoholic beverages).

Sources: UN Comtrade database, unstats.un.org; USITC Interactive Tariff and Trade Dataweb, dataweb.usitc.gov.

are contemplated in the bound schedule. A poor record of cooperation on these relatively less contentious issues may foster doubts about Indonesia's capacity to deliver on the larger issues addressed in an FTA.

Indonesia also still applies peak tariffs, sometimes in the form of specific duties, to rice, sugar, and alcoholic-beverage imports. Other products,

such as certain animal and vegetable oils, plywood and wooden articles, and tobacco, face protection that is higher than average (table 2.7). Key US exports of soybeans and corn currently enjoy duty-free access, but the Ministry of Agriculture considers these to be "sensitive products" and has suggested increasing the tariff rate to about 30 percent.[21] Additionally, a US-Indonesia FTA would place US agricultural producers in a competitive position to take advantage of opportunities created by Indonesia's modernization.[22]

Using econometric models to estimate the magnitude of trade gains for agriculture, fishery, and forestry products under a US-Indonesia FTA produces divergent results. A gravity model suggests optimistically that two-way trade in agricultural products might increase by 140 percent. A static computable general equilibrium model (CGE) forecasts a much more conservative and meager 7 percent increase. In the CGE calculations, US agricultural exports to Indonesia increase by around 3 percent, while Indonesian agricultural exports to the United States rise by roughly 9 percent. We think these estimates are far too conservative. Among other effects, a US-Indonesia FTA would curtail significant behind-the-border barriers, recorded in the next section.

Although US tariffs, tariff escalation, and quotas are major obstacles to Indonesia's processed food exports, Indonesia would also need to improve domestic production methods to realize the gains from a US-Indonesia FTA. Indonesia might focus on grading and packaging to ensure reliable quality and improving transport and distribution infrastructure, such as roads, ports, and cold-chain distribution. Progress in each of these areas would be best undertaken simultaneously rather than sequentially.

Nontariff Barriers and Export Restrictions

A US-Indonesia FTA would also address nontariff barriers (NTBs) and export restrictions. Recent estimates (Kee, Nicita, and Olarreaga 2006) indicate that for agriculture in both the United States and Indonesia, NTBs affect average trade restrictiveness more than tariffs do and that Indonesian NTBs are on average much higher than are US NTBs.

21. The Ministry of Trade opposes this measure, as it is mindful of the adverse effect that it could have on the access of low-income households to protein. Still, corn and soybeans already face higher tariffs if imported in crushed or flour form, as domestic millers constitute a powerful lobby.

22. US food producers could enjoy rising demand from urban consumers in Jakarta and other cities. At the same time, some US producers could profit from partnerships with Indonesian food producers and distributors.

The Indonesian government heavily regulates its rice trade through a combination of seasonal import bans, import licensing, and a quasi-state trading enterprise, Bulog.[23] A complete ban on rice imports has been in place since January 2004 and recently extended until the end of 2006. Import licensing requirements for sugar and cloves also operate as quantitative restrictions.[24] Cloves, rice, and sugar can be imported only for further processing in Indonesia; they are not permitted as part of normal trade.

The United States is a major rice exporter and the bulk of US rice exports cater to markets in the Western Hemisphere, though US producers have occasionally shipped rice to Indonesia through food aid programs. A more liberal rice policy in Indonesia might indirectly stimulate US production through higher world demand and prices. Other countries might also benefit directly from rice liberalization in Indonesia. Before Indonesia could grow enough rice to satisfy domestic demand in the early 1980s, it ranked among the world's top rice importers. Since 1985, Indonesia has returned to world markets to cover shortages and purchased significant shares of world exports. Indonesian rice policy is thus more than a domestic issue; like US rice subsidies, Indonesian policy may affect world prices.[25]

Sugar is also seriously protected in both countries. The United States will not address its domestic subsidies in bilateral FTAs, and the US sugar lobby has minimized liberalization in prior FTAs. The United States excluded sugar in FTA negotiations with Australia and offered only minimal liberalization in the Central American Free Trade Agreement–Dominican Republic (CAFTA-DR). It thus seems unlikely that the United States would liberalize sugar in a US-Indonesia FTA. Similarly, Indonesia did not grant preferences in sugar or rice to its partners in the Association of Southeast Asian Nations (ASEAN). However, there is a very clear case for Indonesia to liberalize raw sugar imports in order to foster the competitiveness of downstream food processors (e.g., sugar-containing juices). Likewise, the United States could liberalize imports of confectionery and other products with a high sugar content.

Restrictions on beef, poultry, and alcoholic beverages will be key issues for US agriculture in US-Indonesia FTA talks. Since September 2000 Indonesia has banned imports of chicken parts that do not meet halal certification regulations and further restricts imports through

23. The Bulog import monopoly was broken in 1998. Currently Bulog's role includes maintaining farm-gate prices, distributing rice for the poor, and engaging in countertrade. Bulog is also allowed to trade strategic commodities for profit if the government mandates it.

24. The Indonesian government also intervenes in sugar production, as it owns a quarter of sugar plantations and most of the milling sector.

25. Many countries argue that US rice subsidy programs violate WTO commitments. Uruguay has threatened to bring a case in the WTO Dispute Settlement Body.

requirements of letters of recommendation.[26] Indonesia has also banned US beef imports following the discovery of bovine spongiform encephalopathy (BSE) in US cattle. The US Trade Representative (USTR 2006b) contends that Indonesia's restrictions on US beef and poultry have cost US exporters $60 million annually in forgone exports. More worrying, Indonesian sanitary and phytosanitary (SPS) measures that ban meat imports do not recognize the principle of regionalization enunciated in the World Trade Organization (WTO) Agreement. Hence an isolated BSE case in a remote area of the United States can trigger a full ban on all imports of beef from the United States into Indonesia. US exports of apples, grapes, and pears also face SPS-related obstacles. The United States has repeatedly requested a review of SPS regulations, but progress has been slow.

Import-licensing schemes for alcoholic beverages establish quantitative restrictions determined by consensus between government agencies and the Indonesian Association of Hotels and Restaurants. Purchases are preferentially allocated to domestic companies and state-owned enterprises.[27] The United States recognizes the right of other countries to legislate on public safety, morals, and religious beliefs, but it has challenged policies that discriminate against foreign suppliers. Ensuring free access for corn and soybeans could be another US objective, as Indonesia only allows imports through designated importers and has drafted legislation to curtail soybean import surges.[28]

Export restrictions including export taxes are typically covered during US FTA negotiations. Of particular US interest will be Indonesian export restrictions that aim to create a competitive advantage in upstream products. These taxes deliberately depress prices received by domestic producers and limit the country's capacity to export primary products. On certain occasions, export restrictions on palm nuts and palm oil have been applied to stabilize the domestic price of cooking oil purchased by consumers. However, export restrictions mainly reflect the lobbying interests of domestic refiners of palm oil and the sharp tariff escalation that prevails in important markets for refined palm oil, such as that of Pakistan. In the WTO, developed countries have challenged the export restrictions that developing countries place

26. Letters of import recommendation specify the period of import, quantity, and distribution area approved by the Directorate General of Livestock of Indonesia.

27. The United States would likely request nondiscriminatory application of public moral bans on the commercialization of alcoholic beverages: To the extent that Indonesian firms engage in domestic production of alcoholic beverages, the United States would likely request similar access for US products (e.g., beer).

28. The law has not been enacted; moreover, Indonesian importers have a marked preference for US soybeans. Based on home and world price differentials, David Orden and Marcelle Thomas (2004) estimate single-digit nominal protection rates for Indonesian imports of soybeans and corn as of 2003.

on primary commodities.[29] Currently Indonesia applies export restrictions on palm nuts and kernels, crude palm oil, wood, plywood, and rattan, and these would probably be addressed in FTA negotiations.[30] Indonesia's participation in international producer cartels for natural rubber and oil, though contrary to the spirit of an FTA, are not likely to become the subject of negotiations, given the sensitive political overtones, particularly for OPEC.

While US NTBs take many forms, antidumping (AD) measures are a preferred instrument. AD duties could become quite damaging to Indonesian exports of agricultural, fishery, and forestry products. The United States currently applies AD duties to imports of preserved mushrooms from Indonesia and other countries. Other US antidumping measures are not directly targeted at Indonesian exporters, but they have already limited products that Indonesia typically exports, such as frozen shrimp, frozen fish fillets, and canned pineapple.[31] However, the United States has not constrained its use of AD measures in previous FTAs, and this topic is not likely to be addressed in the US-Indonesia FTA.

US health, SPS, and technical standards are typically not established with protectionist intent, but they can nonetheless act as trade barriers for Indonesia due to its nascent infrastructure for standardization and quality control. US Customs and Border Protection automatically detains Indonesian cocoa beans because of their high frequency of pest contamination; according to the World Bank (2004), this practice imposes additional costs of $200 per ton, roughly 16 percent of the unit import price of Indonesian cocoa beans in 2005. Surprisingly, Indonesia has yet to take appropriate measures to ensure cocoa shipments that meet US standards. According to Hadi Soesastro (2004), some fishery products and spices also face SPS hurdles when entering the US market. The solution lies in improving Indonesian export capacity—possibly with US technical assistance—so that agricultural products meet the standards of the US market.

Recommendations

If both the United States and Indonesia are to realize the full benefits of an FTA, they must reform the regulatory frameworks that govern the use of

29. The European Union has challenged Argentine and Pakistani regulations restricting the exports of hides and skins (DS 155 and DS 107).

30. Export licenses and taxes on wood, plywood, and rattan are credited with encouraging domestic export cartels but probably did not curtail illegal log exports. Export restrictions also apply to manioc, live bovine animals, crocodile leather, and fertilizer; these are less relevant to the United States.

31. The US Southern Shrimp Alliance has accused Indonesian exporters of selling dumped cultivated shrimp (Soesastro 2004).

natural resources outside of FTA negotiations. Tariffs and other protectionist measures should be reduced on both sides, and Indonesia would benefit from improving the production standards of its agricultural products to meet the standards of the United States. In this way, FTA negotiations can impel reform as they increase trade.

Energy and Mining

Restoring the long-term horizon for foreign oil, gas, and mining companies will require serious effort by the Indonesian government outside of an FTA framework. Indonesia needs to draft an acceptable mining law and clarify the regulatory framework for energy production. The principal contributions of a US-Indonesia FTA for hard-rock mining and energy will be threefold: to nudge domestic legislative and regulatory processes toward reform, to establish an arbitration mechanism for future disputes arising after the FTA is ratified, and to open new opportunities for investment (see chapter 6). Additionally, a US-Indonesia FTA should eliminate US tariffs on minerals and metal products and Indonesian tariffs on lubricating oil, mining equipment, and machinery.[32] Indonesia should also eliminate its remaining export restrictions on minerals and metals.

Agriculture, Forestry, and Fisheries

The immediate value of the US-Indonesia FTA depends on the span of phaseout schedules. We believe that the vast majority of tariffs on agricultural products could and should be liberalized within six years. Excluding raw and refined sugar may be a political necessity, but a US-Indonesia FTA should nonetheless liberalize sugar confectionery to some extent through preferential TRQs. Similarly, rice should be liberalized to a carefully calibrated degree, with US rice producers receiving access to the Indonesian market through a permanent and expanding preferential duty-free TRQ. In addition, a US-Indonesia FTA should include commitments to address rice and sugar issues in the context of the WTO.

The United States will request TRQs for Indonesian exports of cocoa powders and preparations, including chocolate, and preparations based on coffee containing sugar. While these TRQs are typically treated as sugar or dairy items, they should be large enough to provide a substantial incentive to boost Indonesian exports with higher value added. Tobacco will be

32. While US tariffs on these products are often low, a few items still face stiff tariff barriers. In addition, tariff escalation limits US imports of products based on minerals and metals, while capital goods used in mineral exploration and exploitation sometimes face high Indonesian tariffs. These barriers are examined more fully in chapter 3.

another sensitive product. The United States should provide meaningful initial preferential access for Indonesian exporters, and Indonesia should reciprocate by phasing-out tariffs following a similar schedule as US TRQs.

Indonesia should phase out tariffs on alcoholic beverages and vegetable oils and fats over 12 years. Following the US-Australia FTA, the United States should eliminate tariffs on forestry and fishery products immediately. As the only exception, the United States should phase out tariffs on processed tuna and skipjacks within less than 8 years. Indonesia should reciprocate and eliminate its own export restrictions.[33] Indonesia should also work toward eliminating SPS restrictions on US beef and poultry as quickly as possible and review hurdles affecting US export of fruits. For its part, the United States should extend to Indonesia targeted technical assistance to upgrade its domestic SPS regulatory framework. The framework in the CAFTA-DR pact can provide the model.

33. Indonesian tariff barriers on the paper industry are discussed in chapter 3.