AGRICULTURE AND GOVERNMENTS IN AN INTERDEPENDENT WORLD

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INTRODUCTION**

The story of developing countries instituting economic policies which tax farmers and reduce the growth of agricultural production is familiar and well documented (for example, Johnson, 1973; Schultz, 1978; Bale and Lutz, 1981; World Bank, 1982,1983,1986; Anderson and Hayami, 1986). Furthermore, cross-country evidence from these studies suggests that policies change from discrimination against agriculture to protection in favour of agriculture as incomes grow. The main exceptions among developing countries are a small number with rapidly growing economies that have become net agricultural product importers, such as South Korea, Mexico, Nigeria, Taiwan (China) and Yemen (Anderson and Hayami, 1986). However, this generalization of developing country discrimination against agriculture also does not apply well to Indonesia. Consequently, it is the purpose of this paper to review the nature of Indonesia’s agricultural policies and explore some of the driving forces behind current protection.

Indonesia is somewhat unique because the attention it now gives to agriculture and the rural sector is greater than that which would be expected of a country with the relatively low income per caput of US$500. Having said that, it is also true that this statement masks more than the usual variety in agricultural policies, reflecting both the many centres of influence in Indonesian agricultural policy and the diversity of the country’s agriculture. For example, there are so many different commodity policies, some kept rather obscure, that it takes a major effort on the part of a decision maker in an information-poor country simply to be aware of what exists. It would be much simpler if we were concerned only with the single most important crop, rice, the production of which more clearly enjoys protection. This conclusion is also made more difficult because the country’s economic policies are now in a period of rather considerable change. But these
are in a direction which makes more clear the desire to protect and support agriculture.

Although concern for farmers is often expressed, it is understood that this conclusion should not be taken too literally as indicative of an explicit, consistent policy. In any country as large and varied as Indonesia, there is rarely a 'government' position on the nature of agricultural policies. The consensus which is so essential in arriving at a decision or policy in Indonesia often obscures wide differences in underlying support. This is especially relevant under the leadership of President Soeharto, the 'New Order' period since 1966, where there is a history of policies being chosen successfully to balance many different interests. The resulting policy mix is diverse and gives the casual impression of inconsistency.

Despite the policy variety and our interpretive cautions, what can be said is that Indonesia taxes its farmers much less consistently than do most other developing countries with Indonesia's income level per caput. When farmers are taxed, the reasons are more commonly due to the protection of processors (often argued on the basis of pursuing industrialization or increased value-added), opportunistic behaviour of traders, processors, co-operatives, or state-run agencies who happen to enjoy some monopoly over the procurement and/or selling of the agricultural commodity, or due to attempts to exploit perceived monopoly power in world markets. It has become uncommon for farmers to be taxed in order to favour consumers.

The paper begins with a brief review of the recent history of the Indonesian economy and its economic policies which affect agriculture, followed by a commodity-by-commodity policy description, and closes with some discussion of the political economy of the policy choice and some hypotheses of how the existing mix of policies came to be adopted.

BACKGROUND TO THE INDONESIAN ECONOMY

Indonesia is the fifth most populated country in the world, a population of 170 million growing at just over 2 per cent per year. With a GDP per caput of US$500, it is at the lower end of the World Bank category of 'middle income' countries (World Bank, 1987). Compared to the ASEAN countries, Indonesian GDP per caput is similar to that of the Philippines, two-thirds that of Thailand, and a quarter that of Malaysia. Compared to the country’s situation in the early 1960s with inflation in excess of 1000 per cent, many markets not functioning, and falling real income per caput, today’s income level represents considerable progress. With appropriate macroeconomic management and the early 1970s increase in oil prices, Indonesia grew in real terms in excess of 8 per cent per annum during the 1970s. This fell to 5 per cent per annum in the 1978–82 period, and to 3.5–4 per cent per year from 1982–87 as the country adjusted to the worldwide early-1980s recession and the more recent fall in oil prices.

Understandably, agriculture is the backbone of the economy. It provides employment for more than half the labour force, accounts for one-quarter of GDP and two-fifths of the value of non-oil exports. This contribution to GDP has been stable recently, at a similar level to other countries at Indonesia’s level of
development, but the share of exports has been falling since the mid-1980s due to the recent rapid growth in manufacturing exports. Agricultural GDP has grown at 4 per cent per annum over the last decade, exceeding that attained by most other East Asian countries and surpassing significantly the growth achieved by the other major oil producers.

This growth is dominated by rice, which accounts for 30 per cent of agricultural GDP and more than 40 per cent of land use and employment. Rice production has grown dramatically over the period of the New Order, from some 10 million tons as an annual average in the 1960s to 27 million tons in 1986–87. The result of this growth is that Indonesia is now self-sufficient in rice, an important change from its position as one of the world’s largest rice importers in the late 1970s. While production of other food crops such as corn, soybeans, and cassava has also increased, their growth has been slower. Other agricultural subsectors than rice have also grown rapidly—tree crops, livestock and fisheries all have grown by more than 4 per cent per annum over the last decade.

This agricultural growth has contributed in a major way to employment and income growth in rural areas. The share of the labour force employed in agriculture has fallen from 71 per cent in 1965 to 58 per cent in 1984, but the sector is still important for absorbing the growing workforce. It is also becoming well-integrated with urban labour markets, especially on densely-populated Java, by the seasonal movement of labour between farm and urban jobs and by extensive off-farm employment within farm families.

AGRICULTURAL POLICY ISSUES AND INSTRUMENTS

The wide range of policies applied in the agricultural sector collectively reveal much attention to familiar themes: self-sufficiency, support for producers (growing), and support for consumers (low and declining). In terms of policy instrumentation, there is: (a) considerable public sector involvement, especially in marketing; (b) a particular openness to using monopolies or monopsonies, public and private, in foreign and some domestic trade, processing and input supply; (c) a great deal of regulation of imports and exports; and (d) an exaggerated perception of Indonesia’s world market power with an eagerness to exploit it. One striking aspect of this list of goals and instruments is that it is not at all unique to agriculture—it could be used to describe the situation in most industries in Indonesia.

Self-sufficiency is a clear national goal for many commodities, motivating the rather considerable push toward import substitution in the industrial sector since at least 1980. In agriculture this is the pre-eminent objective of rice policy. It is also important for other food crops and sugar, but in no other crop is it given the priority which it is accorded in the case of rice. The recent decision to accept rice price increases of at least 30 per cent in 1988 after the unusual 1987 dry-season drought rather than allow rice imports underlines this importance of rice self-sufficiency. The two most important tools used to meet this goal are non-tariff import barriers such as import monopolies vested in a public agency (usually the national rice logistics agency, BULOG) and a significant subsidy to lower the price of fertilizer.
As in most countries, many Indonesian agricultural policies are promoted with the desire to achieve stability. But the vagueness with which this term is used makes its role less clear. There is no doubt that macroeconomic stability has been a first priority from the beginning of the New Order, to prevent high inflation, individual prices increasing by 100 per cent or more, and the chaos found when markets cease to function in supplying goods (see below). The more narrow definition, stability of rice prices, is also important, evident in the mandate and functions of BULOG and especially in its earlier years (Timmer, 1975). Furthermore, the concern for stable rice prices was dominated by consumer interests until the late 1970s to early 1980s, at which time price stability for farmers became the dominant objective. More recently, it appears that the goal has become less important, or that it is most critical only to food items as important as rice and for very large price changes, in excess of, say, 30 per cent. Many other farm commodities, particularly the important tree crops, have experienced wide price swings without policy intervention (sometimes exacerbated by policy) or apparent great concern. And in the case of rice, the recent decision noted above, to allow a large price increase in 1988 rather than permit imports, illustrates the lower priority of price stability. The mechanism by which BULOG undertakes its stabilization activities for rice is to operate a floor and ceiling price scheme, using a buffer stock to stabilize prices when budget circumstances permit, or imports when allowed.

Producer support is not universal across agricultural commodities but appears to be increasing. It is achieved on the output price side by restrictive import arrangements, usually import licensing with a sole importer, BULOG. At present, over 300 agriculture items (CCCN numbers) have some form of non-tariff barrier (NTB), and this number has not fallen noticeably in the recent series of trade deregulation reforms. This affects primarily those agricultural commodities which are on an import basis. The other major form of producer support is the large fertilizer subsidy, whereby farmers now pay between 40 and 80 per cent of the border price depending upon the nutrient. In addition, 50 per cent of the cost of pesticides is subsidized, there are a number of credit programmes for different commodities (although an unsubsidized credit programme is growing rapidly and showing most success), and irrigation water has been provided by a series of public investments (many financed by foreign aid projects) at no cost to the farmer. There are no machinery subsidies for farmers; in fact, due to a high level of industrial protection via NTBs, farmers receive negative protection on machinery. Tree crop producers are supported by various tree replanting and rehabilitation programmes which provide extension services and some subsidized credit, a number of which are financed by foreign aid (notably World Bank) projects. Finally, the government supports producers through its research and extension services, which made their greatest contribution in testing, adapting and distributing IRRI rice varieties. Work on other food crops and livestock production has been proceeding, but these activities have been seriously constrained in recent years by large oil-price-induced budget cuts.

The commodities where farm producers are being taxed (or negatively protected), receiving prices lower than world market levels, are the export basis crops, notably palm oil, copra/coconuts, and most spices such as pepper, nutmeg/mace, and cinnamon. Also, clove and sugar producers have been taxed, clove
producers due to trade policy and direct taxes and those sugar producers on irrigated land who have been required to grow sugar. (Even though their price has been above (and is now about twice) the world price. It is more profitable to follow a rice-based cropping system.)

Consumer support as a food policy goal has fallen considerably in importance and continues to do so. As mentioned above, this was not the case with rice policy in the 1960s and 1970s, when consumer interests were dominant, and prices were kept low and stable to consumers’ benefit. It would appear that the substantial economic growth of the 1970s to early 1980s has lowered the priority of helping consumers by keeping food prices low. The most important commodity whose price has been controlled to help consumers is cooking oil. This has taxed copra and palm oil producers, but, as it turns out, it did not help cooking oil consumers either. And recent deregulations have allowed the unrestricted export of refined cooking oil, thereby equating domestic cooking oil prices with world levels.

Public sector marketing has been very important in Indonesia, but to this point it has been concentrated largely in one agency, the national food logistics agency, or BULOG. Its primary responsibility is the procurement of rice in order to: (a) provide a rice allowance to the Armed Forces and the civil service; and (b) stabilize the price of rice for consumers and producers. This is accomplished by regional procurement throughout the country, the setting of floor and ceiling price, monopoly control over imports, and physical distribution to the aforementioned ‘budget groups’. Its role has evolved considerably over the years as its expertise has grown, as the main objective changed from maintaining a ceiling price for the benefit of consumers to defending a floor price for producers, and as Indonesia has changed from a major rice importer to being self-sufficient. But BULOG also controls the marketing of corn, soybeans, wheat, and sugar. In the case of corn, this has been done through buying as needed at a floor price, and guaranteeing delivery to important users. In soybeans and wheat, the situation is complicated by contractual agreements with processors, but BULOG’s role is essentially undertaken through (monopoly) import controls, not direct buying. In the case of sugar, BULOG is the sole buyer of domestic sugar and the sole importer, and it allocates sugar to the domestic trade with a quota mechanism. Given the erratic record of public sector marketing in other countries, it is worth noting Timmer’s observation:

Nearby all price interventions have been attempted through use of the market rather than displacement of it, and this no doubt accounts for much of the success in defending the desired price levels. As a consequence, the private food marketing sector has had a relatively large role, and the structure, conduct and performance of this sector is a crucial factor in the design and implementation of price policy in Indonesia. (Timmer, 1987, p.23)

These BULOG roles as buyer of domestic supplies and sole importer apply to commodities which are on an import basis. In the case of export commodities, there is no actual public sector marketing agency. But the activity is not free of government policy in the spice subsector, where certain private interests, often an association representing the commodity group, are licensed by the government to be the sole exporter. These roles of BULOG and licensed exporters give some indication of the use of sole importers and exporters in parts of Indonesian
agriculture. Other examples of sole importers can be found and there are cases where sole processors are licensed.

This use of private or semi-private trade monopolies performs a useful function in allowing certain groups (BULOG or the armed forces, for example) access to off-budget financing (Woo, 1987). In effect, monopolies are used to capture ‘tax’ revenues from consumers (or producers in the case of export monopolies) without the administrative difficulties of government tax collection. The revenues are then allocated to various public bodies without the laborious budgetary process. Another group which is important from time to time as a sole buyer or seller in agriculture, is the co-operatives. This is another off-budget transfer, and local village co-operatives are often the designated recipient. For example, fertilizer distribution at the village level, clove marketing, the provision of certain sugar inputs and milk pick-up from dairy farms must be undertaken by village co-operatives. In terms of farmers, these measures are mixed. The export ‘taxes’ are at the expense of farmers. The price-increasing effect of sole importer restrictions tends to help farmers while the arbitrage profits accrue to the sole importer. Co-operative charges and taxes reduce net farm prices, but the co-operative income accrues to members in the rural area.

Some of the flavour of trade regulation in agriculture should be evident from the foregoing. NTBs on imports protect numerous farm products, such as soybeans, sugar, until recently, rice, milk, most meats, and fruits and vegetables. Import restrictions, however, are the main source for many basic and engineering industrial inputs. Consequently, they raise farm costs whenever manufactured inputs are required (fertilizer excepted). But as the country turns its policy (and performance) increasingly toward exports, the opportunity to capitalize on import restrictions is unlikely to grow. Already a great many export restrictions have been introduced, such as the export licensing restrictions for spices. The international and farm pricing depends upon the strategy of the sole exporter, and little is known about the extent to which these sole exporters have been unsuccessful. The experience with forest products, logs, plywood and rattan, are not encouraging. The result to the farmer is not likely to be positive in any case; if the exporters are successful, net farm prices and quantities will have to suffer, and any export profits are not likely to be received by the farmers.

There are some worrisome signs for farmers on the trade policy front. In the enthusiasm to industrialize, there is a strong demand for increasing value-added, especially these days among export commodities. Because a large number of agricultural exports are less substantially processed, there is a growing inclination to ban the export of such raw or less processed materials in the interests of forcing further processing, higher value-added, and a greater value of exports. For example, this argument is being raised for rubber, a successful raw material export. This is just another infant industry argument, and the success of the downstream industry on the world market will depend upon its competitiveness. That may or may not come; what is clear is that even if the downstream processing industry will be successful in the interim period, raw materials producers – that is, farmers – will be hurt.

Mention must be made of the strong desire in the New Order (post-1966) period for sound macroeconomic policy and stability in Indonesia, stemming from the memory of the mid-1960s difficulties. In fact, the primary dimension
of the oft-mentioned goal of stability in agricultural policies would appear to be macroeconomic—a desire to avoid 600+ per cent per annum inflation, enormous budget deficits and the kind of economic chaos manifested by physical shortages and the prices of important commodities like rice increasing by two to four times. The lessons of this period were well learned. Since that time, Indonesia has enjoyed unusually well-managed macroeconomic policy (including exchange rate, monetary and fiscal policy) and this has become a hallmark of the Soeharto-New Order period. This has been considerably to the advantage of agriculture. As a result, and unlike the situation in a number of other countries at this level of development, agriculture is not taxed by an over-valued exchange rate or burdened by high inflation, there is little reliance on policies which require budgetary subsidies (except for the very large fertilizer subsidy) and no necessity (or desire) to use the agriculture sector as a source of tax revenues.

COMMODITY BY COMMODITY POLICY REVIEW

This review highlights the policies applicable to each commodity, with special attention to whether farmers of the commodity in question are being taxed or protected. We begin with the food crops, followed by tree crops, other export crops, sugar, other import-basis commercial crops, and livestock products.

Rice

With a BULOG import monopoly restricting imports, the domestic price has exceeded the world price from 1981 to 1987. This has been reversed only recently with the sharp increase in world rice prices, but this is not likely to indicate a permanent reversal to the period of the 1970s when domestic prices were systematically below the world prices. At the present, the BULOG import monopoly is effectively an import ban. Farmers benefit from the floor price which BULOG defends, although open market operations may be pressured when BULOG’s decreed procurement prices are too low. Farmers benefit considerably from the fertilizer subsidy; they also enjoy a 55 per cent subsidy on pesticides and government-funded research and extension services. Irrigation systems are widely provided with separate funding, and farmers are not charged for water usage. There is a widely-used, general, unsubsidized credit programme available as well as some subsidized programmes specifically for rice farmers. Farm labour is unregulated and no foreign ownership of land is allowed. Rice milling is largely private and competitive, although mills have been squeezed from time to time by BULOG open market operations. Most farm machinery and equipment is protected by non-tariff and tariff import barriers. On balance, since 1981 rice farmers appear to have enjoyed positive effective protection, in contrast to lower and negative protection previously.

Corn

BULOG controls the import of corn and defends a floor price, but this has seldom been operative in East Java, a major production area. High storage costs usually
have meant Indonesian exports in some months and imports in others within the crop year, with the feature that corn prices have been almost as variable as Thai (world market) corn prices (Timmer, 1987). In 1988, the BULOG import restriction has been lifted on an informal basis. Corn producers otherwise benefit from the same programmes as for rice: the fertilizer subsidy, pesticide, some research/extension, provision of irrigation water, and some subsidized credit. The net effect is a modest level of protection for producers, mostly through the fertilizer subsidy.

**Soybeans**

As above, BULOG controls the import of soybeans and soybean meal. Because production is considerably less than demand, imports are important. These controls have led to domestic prices considerably and consistently above import prices. This has encouraged soybean producers at the expense of the soybean meal users (livestock feed mills) and soybean food consumers. In addition, soybean producers have access to the same fertilizer and pesticide subsidies, irrigation water and selected subsidized credit programmes. Domestic processing of beans into meal has been started recently, but so far the result for livestock feed mills appears to be modest increases in the cost of meal. The net effect has been a substantial level of protection for domestic producers.

**Peanuts**

As for the other food crops, BULOG import controls have raised domestic prices. The other input subsidies also apply as above for fertilizer, pesticides, water and credit. The net effect is that farmers are protected by this policy package.

**Cassava**

This crop is not a major export, but has been shipped to Europe since the 1960s where it is mixed with soybean meal to make a livestock feed competitive with corn but without the feed grains variable levy. Accordingly, Indonesia enjoys an EC quota which has rarely been fully utilized in recent years. No government support such as a floor price has been implemented. Domestic prices have followed export prices, and the only protection for cassava growers has been the aforementioned input subsidies. The net effect is a modest level of protection.

**Rubber**

In this commodity, Indonesia is export-competitive and the second largest producer, next to Malaysia. As for the other tree crops, production is dominated by the Outer Islands, not Java as in the food crops, an important income distribution effect. World prices dominate with few government programmes or regulations. Rubber qualifies for the input subsidies already mentioned for food crops, but among smallholders there is little use of the subsidized inputs such as fertilizer. The major government policy affecting these growers are the large tree crop planting and rehabilitation programmes to help smallholders. This is
usually financed through foreign aid (for example, the World Bank) projects and features extension work among smallholders and some building of infrastructure and seedling dispersal, but the primary means of support is subsidized credit. Although this would appear to protect and help the smallholder, the programmes have been quite ineffective and have had little beneficial effect. Of greater concern are recent proposals for an export ban on raw rubber which will clearly lower domestic rubber prices and tax smallholders, the very producers who have been successful in exporting without subsidy on the world market. This is evidence of the growing conflict between a desire for industrialization and the health of the agricultural sector.

*Palm Oil*

Unlike coconuts, and rubber to a less extent, this is largely an estate crop with few smallholders involved. Like rubber, Indonesia is also export-competitive and in the past decade has embarked upon one of the largest tree planting programmes in the world. Very complex marketing rules have been instituted here to meet several objectives, including a ban on crude palm oil exports, restrictions on refined oil exports, three price regimes, and a system of domestic allocations. One objective has been the maintenance of low domestic cooking oil prices for consumers, and the other has been to assure favourable arrangements for oil processing firms. The reasons for processing plant protection are very familiar within the Indonesian industrial sector: to provide a stable supply of oil to the domestic market, to make better use of excess capacity, and to increase value-added. The effect has been to lower producer prices by some 30 per cent of the world market price over the 1979–85 period, lowering export earnings and investment accordingly. More recently, in December 1987, processed palm oil exports were deregulated, allowing export prices to prevail in the domestic market. Finally, there have been aid projects which subsidized a small number of producers with credit subsidies, some extension and some contribution to infrastructure of the estate. The net effect of these policies is clearly negative for oil palm producers. In the interest of helping consumers and processors, these farmers have been taxed, also reducing exports.

*Copra/Coconuts*

Indonesia is the second largest producer, most of which comes from smallholders on the Outer (non-Java) Islands. The policy framework affecting these producers is almost identical to that described for palm oil. To help consumers and protect copra processors, copra and cooking oil exports have been banned, lowering farm prices of copra. To compensate for insufficient replanting, government planting programmes have been tried unsuccessfully. In addition, there has been a tax on inter-island and export shipments of copra and crude coconut oil. The recent lifting of the export ban on refined oil will help raise farm prices, but as long as the copra ban remains, farm prices will be below world prices (currently 13 per cent lower). This taxing of copra farmers is historically due to a desire to protect consumers, but this argument ended with December 1987 deregulation. What remains is protection of the copra processing mills at smallholder farmer expense.
Coffee

This crop is predominantly for export and produced mostly by smallholders. The dominant constraint is the ICO quota, which has been managed in a highly restrictive and inflexible manner. The result has been lower-valued coffee exports, lower utilization of the ICO quota, and possibly fewer non-ICO exports. Although the result has hurt smallholders, the intent appears to have been to help them. The effects from research and extension and project-related subsidized credit have been marginal to negative. In addition, efforts to improve quality by banning the export of the lowest quality have backfired, reducing average coffee quality and reducing income to producers. The net effect on farmers from this policy framework is quite likely to be negative, but due more to the problems in finding acceptable means of allocating valuable quotas and counter-productive policies than a particular desire to tax farmers.

Tea

This subsector is affected by few government policies to protect or tax producing estates, although the estates are largely state-owned. Prices are export determined, under a well-functioning tea auction.

Cocoa

As in tea, prices are largely export-determined and there appear to be few government programmes to date. Production is split between estates and smallholders. Unlike the other tree crops, Indonesia has a very small share of the world market. This share is likely to increase, due to favourable costs of production, although major pest and disease problems will require careful management. This estate part of the cocoa subsector is aided by the fertilizer subsidy, and there are plans for multilateral project loans. The government imposes quality control restrictions, requiring inspections, but these appear to be largely redundant and ineffective. Therefore, on balance, producers are only protected by the input subsidies, and mostly the estates at that.

Pepper

This is an export crop but entry to the world market is restricted by licensed sole exporters, one for black (basically, for North American shipments) and for white pepper (European shipments). In the case of black, Indonesia has no world market power and restrictions on access are not stringent—the sole exporter must approve all exporters and export shipments, but approval on shipments is apparently obtained fairly easily. One exception appears to be exports to non-traditional markets in Asia, which are discouraged. In white pepper, Indonesia is an important exporter and the sole exporter not only approves export shipments, but makes all export arrangements, including determination of the price, the quantities and handling. Producers do benefit from usual farm input subsidies, but their prices have fallen under this marketing arrangement, and production is reportedly falling.
Nutmeg/Mace

This is another unique case, in that Indonesia accounts for 70-80 per cent of the world market, and has some 'arrangement' with the other supplier, Grenada. All sales are tightly controlled by a sole exporter, and any marketing by individual traders or producers is prohibited, to avoid the problem of inexperienced farmers negotiating prices which are 'too low'. This exporter appears to control carefully the quantities sold, without limits on purchases. There is mixed evidence that this sole exporter has kept down the farm price. What is clear is that the exporter requires tight inventory control, which has led to quality deterioration, and this may reduce supply. An unusual feature of marketing by this exporter is that it has negotiated to sell to a single buyer, not exactly what most monopoly managers would prefer. This arrangement may be simply renegotiated each year with competing bids by other buyers, or it may be a first-time contract which will soon be changed. The tightness with which this export arrangement operates suggests that effective farm prices will be kept low to reduce supply and allow the imposition of a privately collected optimal export tax. The distribution of the tax revenues is not yet clear, but it does not appear to include the farmers.

Cinnamon

The situation for cinnamon appears to be very similar to that described above for nutmeg, except that Indonesia has a smaller share of the world market. Exports are also undertaken solely by the licensed exporter and all sales must be approved by and done through the licensed exporter.

Sugar

This commodity is under BULOG control of domestic sugar purchases and imports. It has used this power to increase substantially domestic sugar prices relative to the world price. At present, domestic prices are about 100 per cent higher than world prices, and this margin is determined by BULOG. One of the goals of this policy is sugar self-sufficiency, although this has only been achieved in two years. Another important aspect of sugar policy is that farm production is largely directed (forced). Even at the high domestic sugar prices and with the fertilizer subsidy and a subsidized interest rate on credit, this use of irrigated land is less profitable than growing rice. The situation is less clear on upland or non-irrigated land. Quite apart from other complications of sugar policy, such as its effect on the goal of rice self-sufficiency and the effect of an implicit 100 per cent tariff, the coercive planting rules accompanied by current farm prices effectively taxes at least the farmers operating on irrigated land.

Cloves

This is another unique case, because Indonesia is the world's largest consumer, producer, and importer. There is a sole importer, domestic prices are kept high and world prices are usually low (although currently, prices are similar). The
policy has taxed the clove consumers, the cigarette producers, and has generally protected farmers by keeping farm clove prices high. But farm prices have been subject to great variability and are subject to a special tax by co-operatives. At low price periods, there are strong government efforts to support the producer price. On balance, clove farmers are protected by government policy, usually at cigarette producers’ expense.

Cotton

This industry is on an import basis and domestic production satisfies a small part of domestic demand. To increase demand for the low quality domestic cotton, there has been a domestic purchase requirement, forcing textile producers to spend some of their rents from importing cotton on the purchase of domestic cotton. However, this protection for cotton producers was opposed so strongly by the powerful textile producers that, coupled with the continued low quality of local cotton, the domestic purchase requirement was recently removed.

Poultry

There is an import restriction on poultry meat, but also a farm size limit of 5000 birds per farm and livestock feed prices which exceed border prices. Nevertheless, poultry prices are not much above world market levels, and as elsewhere, the substantial amount of technical change has kept the real price of chicken falling. Most of the technical change of the Indonesian livestock sector of the past decade has arisen in poultry (Saragih et al., 1988)

Dairy

Protection for this sector is motivated by a desire to improve protein consumption and increase local farmer incomes. Domestic production is encouraged, but by much less than processor prices indicate and in large part at the expense, not aid, of protein consumption. This sector is also regulated by a domestic purchase requirement for processors, whereby one unit of domestic milk must be purchased in order to be permitted to import 1.7 units of imported milk raw materials. In addition, there are several foreign aid projects which have contributed cows, credit, and extension services. Processor prices for milk are determined by government policy, but after all local taxes are paid, farm prices exceed world prices by only modest margins.

THE POLITICAL ECONOMY OF CHOOSING THESE POLICIES

Already, numerous references have been made to the goals, stated and actual, of agricultural policies, and to a variety of important considerations. In this section we attempt to summarize the goals and arguments or issues which have contributed to the choice of policies. Also, as part of this, we introduce more systematically some of the important political considerations.

As noted by Anderson and Hayami (1986) for East Asia and Timmer for
Indonesia, 'agricultural price policy tends to shift from a narrow objective of keeping urban wages low and consumers happy to broader objectives of providing price incentives well above world market levels in an effort to raise agricultural output and improve rural incomes relative to rapidly rising urban incomes' (Timmer, 1987, p. 4). This is clearly true for Indonesia, in moving from the Sukarno-era concern for maintaining political stability with low urban food prices, to a continued concern for consumer welfare via low urban rice prices in the early Soeharto years (mid-late 1960s) and a separate concern for economic stability. These concerns dominated rice policy in the early 1970s as rice was seen as an instrumental component of achieving these goals. In turn, the primacy of these consumer-orientated goals conflicted with and prevented increase in farm prices. But this transition has occurred at lower incomes per caput and with less dramatic growth in urban incomes than was observed in the East Asian countries studied by Anderson and Hayami.

With the oil-induced increase in budget revenues in the mid-1970s, the desire to raise farm prices and incomes increased and became feasible. One major motivation for increasing farm prices was the ascendancy of the goal of *rice self-sufficiency*. This was not a new goal, but its importance had increased with the import difficulties of 1973–74, and the budget could now finance it. Indeed, self-sufficiency has been widely considered desirable in all sectors of the domestic economy for some years. For example, this desire was a strong motivating factor behind the import substitution drive in the industrial sector in the early 1980s. Today, of course, this goal has become dominant in the case of rice.

The desire for *stability* is still an important factor influencing agricultural policy choice, but as argued earlier, the first concern appears to be for aggregate economic stability, relief from rapid inflation, non-functioning markets and a doubling or tripling of the prices of important commodities such as rice. Concern with price stability of other farm items, or even with moderately large price changes for rice, appears to have diminished.

One clear pattern which emerges from the commodity review of policies is the *dichotomy between import-and export-basis commodities*. Farm production of imported commodities is much more likely to be protected, whereas farm producers of exported commodities are very likely to be taxed. This pattern is consistent with a strong bias in favour of self-sufficiency, which has yet to be achieved in the case of the import commodities but has already been achieved in the case of the export commodities. This may also show evidence of a certain amount of opportunism in policy setting. First, exports represent a relatively easy source of tax revenue, public and private, to marketing boards and to the licensing government department, the Ministry of Trade. Second, protecting import-basis commodities is not costly in terms of the government budget (consumers finance the protection), whereas support to exported commodities would require the commitment of scarce budget resources. Such a pragmatic approach to policy making helps explain why rice was so heavily encouraged when the social or economic gains to expanding rice production appeared high, and it may explain the attraction of deregulating the economy at the present time when the importance of expanding non-oil exports in order to increase economic growth is clear.

But aside from the waning goal of consumer welfare, the important role of economic stability and the dominance of self-sufficiency, the *importance of the*
rural sector to the current Indonesian leadership, independently of other goals, is by now abundantly clear. At an early date, the agriculture sector was singled out for attention in the first development plan, Repelita I. There are many political reasons for this focus which are outlined below. But the dimensions of this rural focus or preference are made more clear when there are trade-offs which must be made between competing goals. Already it seems clear that the concern with the rural sector focuses on agriculture, but includes a desire to protect more than farmers, such as village co-operative members, sometimes rurally-based processors, or even certain licensed exporters.

Another important goal of recent priority, really since the dramatic oil price fall in 1986, is a desire to expand non-oil exports. This has already led to a significant change in cooking oil policy, by deregulating refined oil exports. Also, basic industrial materials, including farm inputs, are being gradually deregulated in successive deregulation packages. Mostly, this goal is consistent with farm interests, but it can conflict in the case of removing import restrictions, such as for selected BULOG food commodities. Already, corn and fishmeal have been informally deregulated, done at a time of favourable world prices and exchange rates.

The most significant conflict of objectives which can reduce protection of farmers is connected with the goal of industrialisation. This is particularly so for the exports crops, where the desire for higher value-added results in added protection for processors, usually at farmer expense. This is important in copra and palm oil where oil processing has a priority, it may be an important factor in the current sugar programme, where sugar mills are given a large weight, and it is certainly a matter of importance in the case of rubber where the desire for additional rubber processing may lead to an export ban on crumb rubber, lowering prices for smallholders. This may be a dominant factor in changes in agricultural policy in the next few years.

Finally, this discussion of the choice of policies would not be complete without some mention of the role of the leadership in Indonesia, particularly the role and politics of the President. To quote Woo extensively, first regarding the President’s role:

[The President is important] because of the unusual degree of decision-making concentrated in and the broad executive powers granted to, this one individual... [As] there are substantial differences in interests and ideology within the bureaucratic polity, Soeharto must be considered an independent force rather than merely the compromise byproduct of competition among the elite groups. One way of describing the economic policy-making process is: the different lobbies and advisory groups propose policy initiatives, and the President adopts those which are either compatible with his innate preferences, or vital to maintaining his positions as the overarching patron.(Woo, 1987)

Woo goes on to outline the reasons why Soeharto gives such a high priority to the rural sector in general and agriculture in particular.

It is the combination of three factors—concern about the traditional peasant base of the Communist Party of Indonesia, experience with secessionist movements (in the Outer Islands), and a personal commitment to rural development—which explains a great deal of the observed allocation of government expenditure in particular, and the conduct of economic management in general. The first and third concerns imply the
need to improve the absolute level of living standard in rural areas, while the second concern implies the need to improve (or bring to par) the relative living standard in the Outer Islands. Together, these three factors focus attention on development of the agricultural sector—rice in Java, and agricultural commodities in the Outer Islands. (p. 12)

These, of course, are not the only considerations of the President, as his concerns embrace most of the issues already raised above, as well as the task of mediating other elements of his government. But they show some of the rationale for his special interest in agriculture, which is so important in understanding existing agricultural policies and protection in Indonesia.

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DISCUSSION OPENING – CHRISTINA DAVID

The paper attempted to answer the question: Why, despite the fact that Indonesia is a relatively low-income country, does discrimination against agriculture in that country not seem to be as large as might be expected?

Most of the paper was devoted to describing the policy goals, the policy instruments and the direction of policy bias, commodity by commodity. Except for the rate of price subsidies for fertilizer and pesticides, no orders of magnitude of nominal protection on output price and effective protection rates were provided. Nominal protection rates appear to be zero or negative in general, except for a few cases such as soybeans and sugar. The positive price protection shown for rice during the late 1980s is due mainly to the collapse of the world rice price. From 1970 up to 1982, NPR for rice was actually slightly negative. In the case of sugar, the high NPR, as noted by the author, need not mean benefit to producers as indeed they were required to plant sugar on irrigated farms in order to supply raw materials to the government-owned sugar processing factories in the area.
The author pointed out that agriculture is not taxed by an overvalued exchange rate – this may be true for exchange rate distortion due to disequilibrium in the balance of payments. Hence Indonesia, unlike other oil exporting countries, did not suffer from the ‘Dutch Disease Syndrome’. However, overvaluation of the exchange rate due to the industrial protection system has not been considered. It is not clear therefore, whether the net effective protection rate for agriculture in Indonesia is significantly positive or negative even in the case of rice where input subsidies have been provided. Quantitative estimates of the degree of agricultural protection and the extent by which it differed from other LDCs or its changes over time would have been useful.

In the final section, the paper attempted to explain the country’s choice of policies in terms of: (a) the implied and/or stated objectives of policy – rice self-sufficiency, stability, expansion of non-oil exports, industrialization and so on; (b) The ease of implementation – protection of importable products, taxation of exportable ones; (c) The motivation of the President – concern about the traditional peasant base of the Communist Party of Indonesia, experience of secessionist movements in the Outer Islands, and a personal commitment to rural development.

There are other potentially more interesting explanations that could have been explored, as other papers in this Conference have suggested, for example distribution of political power and cost of collective action of potential gainers and losers of agricultural policies; rent seeking; and the neoclassical theory of the political market for agricultural protection. BULOG was viewed quite positively. But while this parastatal agency may have been successful in achieving price stability, the cost has not been evaluated relative to the benefit. Clearly, the high protection on sugar and soybeans can be interpreted as rent seeking by BULOG and other agencies. Rent seeking by processors thus explains trade restrictions on exportable raw materials. Subsidies on pesticide was also to some extent caused by rent seeking.

In terms of the neoclassical theory of agricultural protection, the relatively favourable policies in Indonesia occurred at a lower income per caput than typically observed among LDCs and may be explained by the country’s lower or declining comparative advantage in agriculture. In order to achieve food self-sufficiency under the condition of apparent land constraint, part of the windfall profits from the oil boom was used to subsidize agricultural inputs. Input subsidy was the preferred policy instrument because output price protection would have had negative effects on nutrition and on urban political stability in a low income country such as Indonesia.

While the generally favourable nature of Indonesia’s agricultural policy is often commended, it is still relevant to ask whether allocation of windfall profits from the oil boom should have been invested more towards instruments for increasing long-term productivity than short-term effects which price subsidies for fertilizers and pesticides have achieved.

The extremely small farm size in Java, and to a large extent in the Outer Islands, indicates land scarcity and thus declining comparative advantage in agriculture. While Indonesia has the lowest cultivated area per caput in the ASEAN, its total land supply per caput is 20 per cent higher than in Thailand and double that of the Philippines. Of course, a large part of the Outer Islands may
be an unfavourable agricultural area but why is it that opening up frontier land for
cultivation in Indonesia has not proceeded as fast as in Malaysia or Thailand
where agricultural growth rates were higher? Possible reasons are:

1) The historical land policy provided few incentives for opening up new
lands to cultivation. Private plantation agriculture is discouraged by
lease rental arrangements and hence plantation farming has been primar­
ily a public sector activity. Transmigration projects provided only 2
hectare per family.

2) The introduction of varieties of rice suited primarily to irrigated areas
raised the profitability of intensive rice farming relative to opening up
frontier land – thus public investment for rehabilitation of irrigation in
Java, subsidy on fertilizers and pesticides, rather than public investment
in market and social infrastructure in the Outer Islands, was pursued.

3) Rent-seeking promoted subsidies to pesticides and heavy protection of
sugar and its production in Java.

Thus there is a need to evaluate whether government policy could have raised
the private profitability of extending agriculture in the Outer Islands which might
imply a higher agricultural growth rate in the long run. Some examples of such
specific policies are: greater public investment in the Outer Islands; rice research
focus in the ‘unfavourable’ areas where vast potential areas could be tapped; and
reform of sugar production policies.