# Indonesia Cotton Situation after Deregulation Efforts

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**Background**

Indonesia, the world's fifth most populous Country, is situated in the equatorial regions of Southeast Asia. A Country rich in cultural and ethnic diversity, Indonesia encomposses over 13,500 separate Islands, covering a land mass roughly three times the size of Texas.

Indonesia's main economic engines include petroleum, mining, manufacturing, and agriculture. Spurred by abundont natural resources, a stable Political environment, and a literate and energetic, workforce, Indonesia's economy is growing rapidly. Economic growth during 1988 and 1989 registered 5.7 percent, respectively.

Approximately three - fourths of the population of Indonesia live in rural settings, with more than half employed in agriculture. Major urban centers are concentrated on the Islands of Jawa and Sumatra. With population growth averaging 2 percent peranum (current population is estimated at 190 million) a major challenge to the Indonesia Goverment is meeting the employment neess of estimated 2 million workforce entrants per year. Estimates indicate that the economy must grow at a minimum of 4 - 5 percent per annum in order to meet the Countries employment needs. Estimates of per capita income 1989 range from US $ 500 - 550 per year.

Petroleum has long dominated the Indonesia economy. In 1987, oil provied approximately 60 percent or goverment revenue and accounted for about half of Indonesia's export earnings. However, declining world oil prices in the mid - 1980's resulted in a drop in Indonesia's economic prosperity as reflected by growth rates that plummeted to the 2 - 3 percent range during the period 1985 - 1987. Declining personal income and decreased budget outlays motivated the Indonesian Goverment to undertake structural changes to re-shape and diversify the economy. Special emphasis was given to promotion of the non oil sectors.

Recent years a series of deregulation measure were implemented to improve Indonesia's business climate and attract foreign invesment. Reforms were undertaken in the banking, transportation, and trade sectors.

Liberalization efforts included slashing red tape associated with setting up and expanding business operations easing regulations applied to importation of production inputs, allowing increased foreign ownership of domestic corporations, and liberalization governing the issuance of common stock by jointly owned foreign/domestic ventures. In addition the Goverment's gradual devaluation of the currensy maintained investor confidence in the Indonesian currency and kept exports Competitive.

Deregulation efforts proved highly successful and resulted in an economy that is now stronger and more diversitified. From 1987 to 1989, approvals by the Indonesian Goverment for foreign invesment projects jumped 200 percent to US $ 4,5 billion. Meanwhile, economic growth in 1989 rebounded to 6.5 percent and is expected to continus expanding in 1990. Growth in manufacturing and service sectors are particularly strong as the level of domestic and foreign invesment accelerated. Indonesia's manufacturing sector is evolving as the country's main engine of economic growth and principal source of non - agricultural employment for entry level workers. By 1987, non - oil exports overtook petroleum as the leading export category. Exports from this sector grew 16 percent to US $ 14,2 billion in 1989 and accounted for more than half of Indonesia's overall trade. In addition, the bulk of Indonesia's current foreign envesment is targeted towards manufacturing. Growth areas in Indonesia's manufactruring sector include furniture, processed wood, electrical products, chemicals and textiles and garments.

**Textile Sector**

Modern textiles production in Indonesia began 1962 with the establishment of the first modern cotton spinning and weaving operations. Subsequent years saw a rapid expansion of the industry spurred by low labor costs.

Government deregulation efforts, and an influx of foreign capital and technical expertise. Today, Indonesia has the largest fiber and textile production capacity among the ASEAN nations.

Exports are the main force behind the spectacular growth seen in Indonesia's textile industry in the latter 1980's. Textiles are now the first largest export eaner for Indonesia, training only petroleum and forestry products.

Indonesia's export earnings from texstiles in 1989 are estimated at us $2.0 billion, almost a 17 - fold increase from 1981. Domestic demand, spurred by Indonesia's burgeoning population and growing income, also has catributed to recent growth.

Indonesia's textile industry is broken into four main sectors : garments, woven fabrics, yarn, and man-made fabrics (MMF). In term of export value, garment exports are the most important category, accounting for approximately 55 percent (± us $ 770 million) of total export sales in 1988. Fabric yarn and MMF exports accounted for 30 percent (us $ 417 million) 8 percent (us $ 106 million), and 1 percent (us $ 17 million), respectively.

The bulk of Indonesia's textile exports are covered under the multifiber Arrangement (MFA), which sets limits on the growth of textile trade between participating nations. Quota markets accounted for about 96 percent of Indonesia's clothing exports (80 percent of non-clothing textile shipments) in 1988. Major export destinations include the united state, Singapore, Hongkong, the European community and other Asian markets.

Indonesia's textile exporters are regulated internally by an export quota system. Componies are allocated a share of Indonesia's overal MFA Quota based on the exporter's historical export performance. Distribution of export licenses are under the control of Indonesia's Deparment of Trade.

The united states is long standing co - signotary with Indonesia under the MFA and is Indonesia's single most important market, accounting for 33 percent of total export value in 1988. Garments made up the bulk (± 84 percent) of the us $ 468 million of textile shipments to the united states in 1988. Under terms of the MFA the united states allows Indonesia 6 percent growth per annum in most textile import catagories.

Multifiber Arrangement (MFA) limitations on Indonesia's Textile exports to the united states proved to be a point of contention between the two countries in early 1990. In March, Indonesia's FA quota limit for denim trousers exports to the united states was exceeded. This triggered an automatic import embargo mechanism by the united states, effective until the start of the new marketing year (june 1990). Other textile categories were also approaching quota limits due to strong growth in Indonesia's textile shipments to the united states.

Reaction by the Indonesia Textile Industry was swift and accusatory. The United States was said to be impeding the growth of Indonesia's textile sector and some in the industry called for abolition of Indonesia's MFA trade negotiators managed to clarify the situation, allow greater flexibility in some export categories, and defuse tensions.

**SPINNING SECTOR.**

Indonesia's emergence as a major textile exporter is due in large part to its success in filling a highly competitive niche in the world market.
Labor costs are among the lowest in the world (approximately 22 cents per hour) contributing to only 15 to 20 percent of total production costs. Textile Industries in Japan, Taiwan, South Korea, Pakistan, China and even India all have higher production cost ratios.

Nowhere Indonesia's strength as an emerging textile producer more evident than in its spinning sector, which grew 62 percent to 3.5 million spindles between 1985 and 1989. Currently, there are around 100 spinning mills in operation within the country. By 1995, it is estimated that the number of Indonesia's spindles will expand to 6 million.

Indonesia's large pool of affordable labor gives it a comparative advantage in labor intensive manufacturing processes. Indeed, most Indonesian mills specialize in the less autoamted spinning technologies such as ring spinning (appraximately 90 percent of all spindles are of the ring variety). The principal products include pure cotton yarn ( carded or combed), cotton yarn blended with synthetic fiber (mostly polyester of cotton blends), and synthetic yarn (including rayon and nylon). Yarn counts range from 6's to the 70's, however, the bulk of production is in the medium count range (20's - 40's). A few of the larger integrated mills have installed modern, capital intensive open - end rotor spindle systems, principally for denim yarn production. Mills Specializing in yarn targeted for export generally employ state of the art equipment.

Conversely, yarn produced for domestic purposes is largely spun on older equipment purchased second hand from other textile producing Countries in ASIA. Used spinning equipment can reportedly be obtained for 40 percent of the cost comparable new machinery. Sources claim that between 20 and 30 percent of the spinning mills currently operating in Indonesia would be considered absolete by world standards. Average mill size in Indonesia is also on the lower end of the industry spectrum at approximately 30,000 spindles. The optimal scale for spinning mills in Indonesia is said to be a minimum of 50,000 spindles. Indonesia's spinning sector is broken into two sub-sector, public and private. Most Government controlled spinning mills, were estsblished in the late 1950's and early 1960's to stabilize the then fledgling textile industry. The mid - 1960's saw deregulation of raw cotton imports and substantial inflow of private sector invesment. Public sector mills were quickly surpassed by private mills in term of yarn out put.

Today, public sector mills utilize only about 10 percent of Indonesia's raw cotton imports. Government mills are typically the older spinning operations, producing mainly 100 percent cotton yarn for domestic purposes. Due to technological (limitations, i.e; their inability to" blowclean" raw cotton prior to spinning) most cotton used by Governmet mills is of the higher quality varieties. Government mills consume approximately 150,000 bales of raw cotton annually.

Nowdays, private sector mills dominate the Indonesia spinning sector. Private mills produce a wide variety of yarns; however, cotton/polyester blends are most important. Large scale firms employ the latest spinning equipment and some are fully integrated from spinning to garment assembly.

Several private sector mills are joint ventures between Indonesian investors and management service while the foreign textile interest provides technological expertise and machinery.

While garment exports dominate Indonesia's Textile exports in terms of value, polyester/cotton blended fabrics is the basic export item for Indonesia's spinners and weavers. Due to the unpredictability of chages in fashions, about 75 percent of Indonesia fabric exports are unfinished "greycloth".

Final dying and printing is left to downstream users. Plain colour fabric is also exported upon special request order.

The Government of Indonesia has taken a strong progrowth stance approving virtually all applications for spinning sector expansion and in some cases even guarateeing investments. In addition, deregualtion of the stock markets in Indonesia has allowed textile firms to raise needed funds for plant expasion. Domestic invesment is roportedly at an all time high.

Foreign invesment also is expanding rapidly. Analysts point to a major shift of spindlage from East Asia (Japan, South Korea, Hongkong and Taiwan) to Sotheast Asia (Indonesia, The Philippines and Thailand) this invesment is reflected both in terms of financial transfer and capital equipment. Due to the favorabe invesment climate and labor cost savings, industry experts predict that as much as a fifth of the current spinning capacity of East Asia could be transferred to Southeast Asia by 1993. Total foreign invesment in The Indonesia Textile sector during the-5 year plan starting in 1988 is expected to reachh us $ 26 million.

## COTTON CONSUMPTION

Cotton consumption has closely mirrored the rapid expansion of the Indonesian textile industry. Growth registered about 10 percent per year throughout the early 1980's. However, many analysts contend that usage was restrained by regulatory impediments.

Deregulation efforts in 1986 allowed virtually unrestricted imports of row cotton such that cotton imports now face only a nominal import duty (about 10 percent). Row cotton usage surged 26 percent in 1988/1989, breaking the one million - bale hurdle. Preliminary data for 1989/1990 indicate Indonesian mills consumed approximately 1.25 million bales, up 13 percent from the previous marketing year. The consumption for 1990/1991 calls for 12 percent growth to 1.4 million bales. The consumption out look for 1992/1993 calls for 1.8 million bales. Since the bulk of Indonesia's yarn is coarse to medium count, more than half (55 percent) of the cotton used in Indonesia falls into short staple, "B index" category.

As Spindle capacity grows in Pakistan and China, the competition Indonesian mills face in low count yarns has stiffened. This has motivated spinners to increase production of high count yarns needed in up scale products. Demand is reportedly growing for long, and extra long staple cotton.

Cotton is a minor crop in Indonesia plagued with persistent pests and diseases. In this respect, Indonesia's attempts at cotton selt sufficiency is similar to that of its neighboring country Thailand.
Total production in recen years has been steady at about 15,000 bales. Therefore, virtually all of Indonesia's commercial raw cotton needs are met by imports. Cotton purchased from major world producers contingent upon price and quality considerations. The principal sources in recen years include the united states, Pakistan, China, Australia and Brazil.

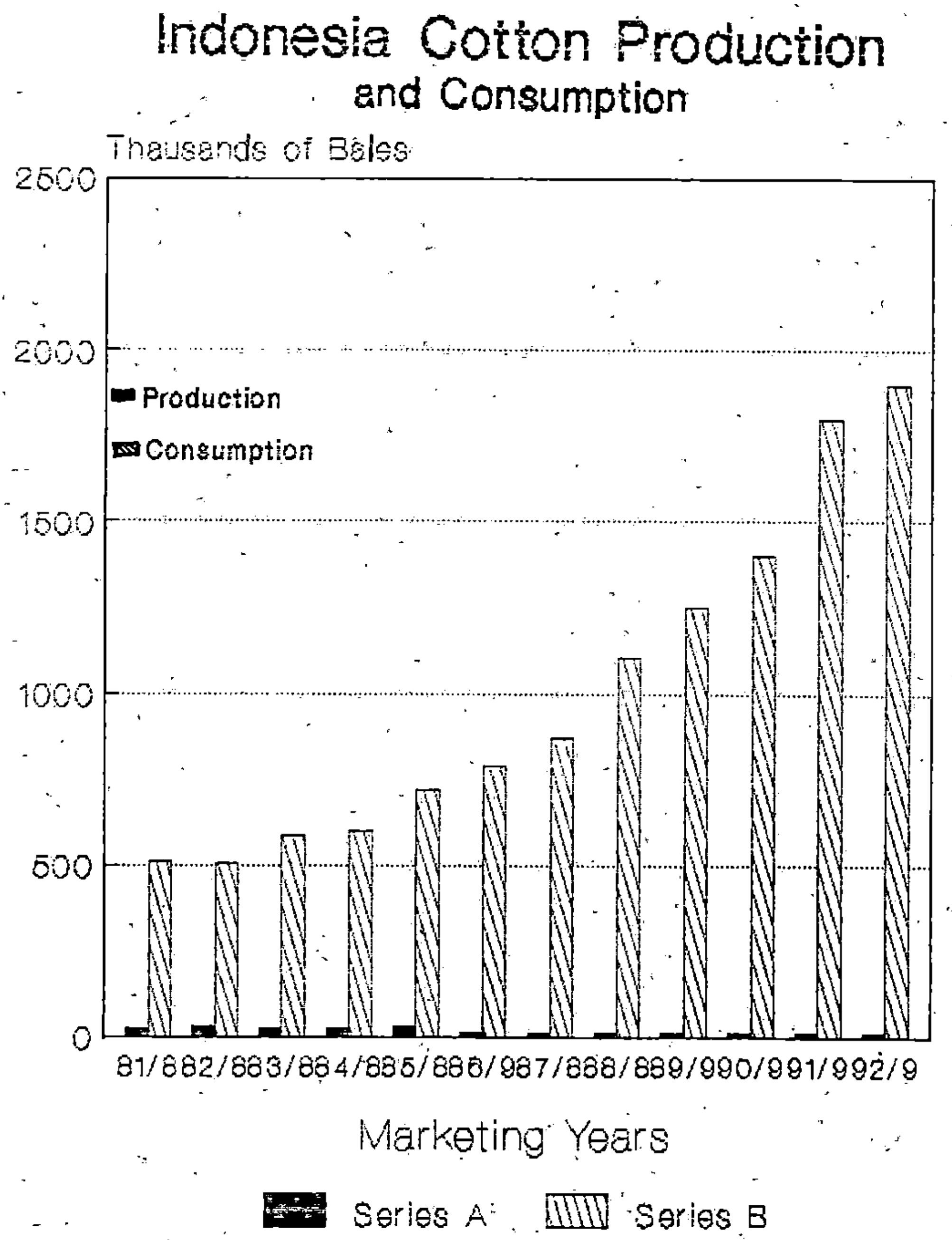
## OUTLOOK

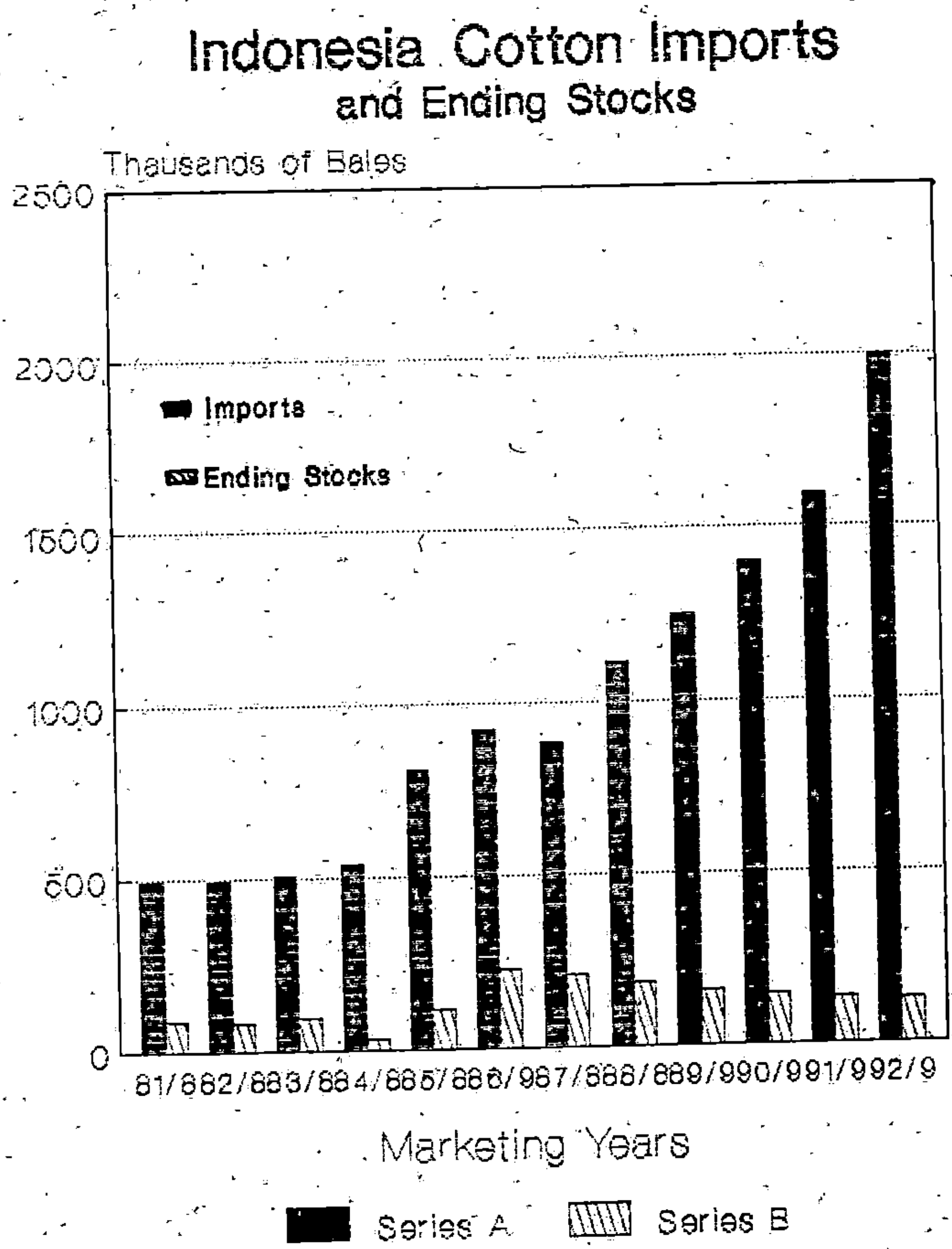
Currently, Indonesia boasts one of the fastest growing industrial sectors in the free world. Textiles have played a major role in this growth reflecting on going Government efforts to deregulate the economy and a wealth of private sector entrepreneurial skill.

Even with current MFA limitations on the growth of textile exports, the outlook for the Indonesian textile industry is optimistic. Indeed, its most important asset higly affordable labor should keep Indonesia extremcly competitive in the world market for the foreseeable future.

Industry sources contend that the textile sector will grow at an estimated 15 percent annual rate over the next few years, adding some half of a million spindles per year. Reflecting this growth, cotton consumption is expected to remain strong. Spinners are optimistic that consumption could reach 2.0 million bales 1992/1993, a 42 percent increase from 1990/1991.
Meanwhile, cotton imports especially from

theUnited States is expected to retain its leading position in Indonesia despite structural changes appearing on the horizon. Some sources contend that as the economy matures and income rise, Indonesia's comparative advantage in low count yarns coulderode. Already, a towards the production of higher quality fabrics is emerging among some of the larger Indonesia mills.




Indonesia Cotton Imports
and Ending Stocks
Thousands of Bales
2500
2000
1500
1000
500
0
Imports
Ending Stocks
81/862/883/884/885/886/887/888/889/890/891/892/9
Marketing Years
Series A
Series B

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