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SM/85/20
Correction 2

CONTAINS CONFIDENTIAL INFORMATION

February 12, 1985

To: Members of the Executive Board

From: The Secretary

Subject: Indonesia - Staff Report for the 1984 Article IV Consultation

The following correction has been made in SM/85/20 (1/18/85):

Page 25, 1st full para., lines 9-11: for "the large tariff differential... Indonesia exports." read "the tariff differential... procedures in Japan.)"

para. 2, last two lines: Carried over to page 26.

Corrected pages are attached.

Att: (2)

Other Distribution:
Department Heads

arrangements include a condition of "additionality"--i.e., counter-purchases by the third party have to be in addition to "regular" imports from Indonesia. If that condition is not observed, the liability for fulfilling the counterpurchase requirement reverts to the original importer. 1/

On the subject of protection abroad faced by Indonesia's non-oil exports, the authorities indicated that textile and plywood exports had been particularly hard hit. The United States had recently notified Indonesia of an additional list of textiles that would be subject to import restrictions and this action, which the Indonesian authorities believed to be at odds with the Multifiber Agreement, was expected to have a quantitatively significant impact on Indonesia's textile exports. The authorities also explained that Indonesia's plywood exports to Japan were adversely affected by the tariff differential between imports of softwood and hardwood plywood. In 1984, tariff rates for hardwood plywood, the type exported by Indonesia, were 19.3 percent and 20 percent--the higher rate for products under 6 mm. in thickness, which accounts for somewhat more than half of imports--whereas the tariff rate on softwood plywood was 15 percent. (The 19.3 percent rate was reduced to 18.5 percent in early 1985 and is expected to be reduced further to 17 percent in April 1985, following completion of legal procedures in Japan.) In addition, tariff quotas (i.e., quotas for which low tariffs applied) for plywood in Europe were quite small. Moreover, there were a number of proposals currently under consideration in Europe which, if put into effect, would have a detrimental impact on a range of Indonesia's exports.

d. Foreign investment policy

During the discussions, the authorities stressed that encouraging private investment, both domestic and foreign, remains one of the Government's top economic priorities and is key to meeting the development goals of Repelita IV. Recent steps to reform the tax system and simplify and reduce regulations affecting business were aimed at stimulating investment and economic efficiency. Industrial growth has been accorded increased emphasis in the new development plan, and direct investment is to be encouraged. Foreign capital is especially welcomed in industries that contribute to the expansion of exports and also in those which require large amounts of capital investment and high technology. In the past year, the Investment Coordinating Board (BKPM) has stepped up its efforts to inform foreign investors of specific project opportunities, while the number of Minister-led investment missions abroad was increased. Also, foreign investment procedures have recently been simplified by BKPM which is in the process of setting up one-stop offices in regional centers to assist new ventures locating outside the

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1/ At the time of the discussions, there had been no cases where such a problem had risen. Moreover, there have been no cases in which penalties had been assesed because the terms of any countertrade agreements had not been fulfilled.

Jakarta area. Further, business travelers from 28 countries can now obtain visas upon arrival at ports of entry.

The authorities stressed that while the reform of the tax system may have created temporary uncertainty on the part of some investors, the new laws provide enhanced incentives: although tax holidays of 3-5 years had been eliminated, these had been replaced by what should be a more attractive incentive--lower tax rates. For the typical investment, it was observed that tax obligations will be lower or unchanged under the new law. The lower rates are applicable uniformly for the life of the project, and apply to all areas, not just to those selected by the Government for promotion as in the past. Further, the new laws have been designed to reduce irregularities in administration which can be particularly troublesome to investors. While implementation of foreign investment projects fell somewhat in 1984 and investment applications declined (though this was affected by a bunching of approvals at the end of 1983 so as to qualify for the tax holiday as well as the beneficial treatment of the new law), the authorities believe this to be temporary and associated with less buoyant economic conditions. 1/ For the long run, they stressed the strong attractions of Indonesia to foreign investors. These included a large domestic market of 160 million people, a vast store of untapped mineral and agricultural resources, a willing labor force, a strategic location, political stability, a free foreign exchange system, and an established record of prudent economic management.

IV. Medium-Term Prospects

1. The Five-Year Development Plan

The Fourth Plan (Repelita IV) covers the period 1984/85 through 1988/89. In recognition of the less favorable external environment and the additional constraint imposed by the substantial increase in external debt and debt service in recent years, the Plan envisages a lower average annual growth rate (5 percent) than the Second and Third Plans (7.5 percent and 6.5 percent, respectively). Industrial growth is to become increasingly important to Indonesia's development. Industrial output is expected to grow at an average annual rate of 9.5 percent and to become increasingly externally oriented; manufactured exports are to increase by over 21 percent per annum and contribute to raising the growth of non-oil/LNG exports to 15 percent per year. With a more conservative outlook for oil production and oil prices, the mining sector is expected to grow at an average annual rate of only 2.5 percent, and oil and LNG exports, by just 6 percent. Non-oil/LNG imports

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1/ The petroleum sector is governed separately from general foreign investment. It should be noted that expenditures by foreign petroleum companies for exploration, development, and production amounted to about $4 billion in the 1982-84 period. A similar level of such spending in 1985 is expected by companies.