

CRS Report for Congress

Received through the CRS Web

Indonesia-U.S. Economic Relations

nae redacted
Specialist in International Trade and Finance
Foreign Affairs, Defense, and Trade Division

Summary

Indonesia's economy continues to struggle against the lasting effects of the 1997-1998 Asian financial crisis and the political instability that resulted. Indonesia was one of the hardest hit economies in Asia; real GDP fell by 13.2 % in 1998. Indonesian-U.S. commercial ties were sharply diminished as well, caused in part by declining Indonesia living standards and a loss of foreign investor confidence in Indonesia (due largely to political instability). The Indonesian economy has improved over the past few years, however, recent activities of terrorist elements in Indonesia and the rise of separatist movements threaten to undermine further an already fragile economy. This report will be updated as events warrant.

Indonesia is a unique country in that it consists of an archipelago of over 17,000 islands (about 6,000 of which are inhabited). With over 231 million people, Indonesia has the world's 4th largest population; it is also the world's most populated Muslim nation (about 86% of the population are Muslims). Indonesia is a major petroleum producer and is the only Asian member of the Organization of Petroleum Exporting Countries (OPEC), the international cartel that seeks to affect world oil prices.¹ The U.S. State Department characterizes Indonesia as "the cornerstone of regional security in Southeast Asia and a key trading partner."² U.S. officials continue to encourage the Indonesian government to implement policies that help induce healthy economic growth, lower unemployment, and improve living standards as a means to promote democracy and political stability, combat the rise of terrorist and separatist groups, and enhance bilateral commercial ties with the United States.

The 1997 Asian Financial Crisis and Fall of the Suharto Regime

Indonesia, like many East Asian economies, suffered a severe economic shock when the "Asian Financial Crisis" struck the country in mid-1997. Prior to this period, Indonesia had enjoyed relatively healthy economic growth: from 1980-1989, real GDP

¹ Indonesia is a relatively minor supplier of U.S. petroleum imports, but it lies along major shipping lanes for U.S. oil imports.

² U.S. Department of State, International Information Programs web site: [<http://usinfo.state.gov>].

growth averaged 5.5%, and from 1990 to 1996, it averaged 8.0% (one of the highest GDP growth rates in the world). According to the World Bank, the proportion of people living below poverty declined from 60% in 1970 to an estimated 11% by mid-1997.³

The 1997 economic crisis (which began in Thailand and quickly spread to Indonesia and several other East Asian economies),⁴ resulted in a sharp depreciation of Indonesia's currency (the rupiah),⁵ large-scale capital flight, high inflation, widespread corporate bankruptcies (caused in part by large short-term debt of many companies and corrupt business practices), and a near collapse of the banking system.⁶ In 1998, real GDP plunged by 13.2%; exports and imports fell by 8.6% and 34.5%, respectively, and living standards (per capita GDP on a purchasing power parity basis) dropped by nearly 13% (see **Table 1**). Finally, the poverty rate doubled between mid-August 1997 (pre-crisis) and late 1998/early 1999.⁷

Political unrest followed the economic crisis, eventually leading to the resignation in May 1998 of President Suharto (or Soeharto) who had ruled the country since 1967. The collapse of the Suharto regime helped usher in a new era of democratic political reforms in Indonesia, although the transition to democracy has not been easy and political instability remains a problem. Indonesia's near economic meltdown forced it to turn to international lending institutions, such as the International Monetary Fund, the World Bank, the Asian Development Bank, and foreign governments for billions of dollars in loans, debt rescheduling, and economic aid.

Recent Economic Conditions

Indonesia has been somewhat successful in bringing the economy back to at least pre-crisis levels, but several problems remain. On the positive side, real GDP from 2000-2003 grew at a relatively healthy pace, averaging 4.0% (although it was half the average level of real GDP growth during the early 1990s). In addition, Indonesia's living standards (measured according to per capita GDP in purchasing power parity) finally reached and exceeded pre-crisis levels in 2002 (\$3,320 in 2002 versus \$3,201 in 1997). Living standards improved by 12.7% in 2003. Finally, Indonesian exports (in dollar terms) in 2003 were 6.6% higher than 1997 levels. On the negative side, Indonesian imports in 2003 were 21.1% lower than pre-crisis levels, reflecting the effects of the sharp devaluation of the rupiah. In addition, the stock of foreign direct investment (FDI) in Indonesia dropped each year from 1997-2002. While the stock of FDI is estimated to

³ World Bank, *World Bank and Indonesia: Country Brief*, December 2002.

⁴ For additional information on the Asian Financial crisis, see CRS Report 98-434, *The Asian (Global?) Financial Crisis, the IMF, and Japan: Economic Issues*, by (name redacted) (September 3, 1998); and CRS Report RL30517, *Asian Financial Crisis and Recovery: Implications for U.S. Interests*, by Richard Cronin (April 6, 2000).

⁵ In 1998 alone, the rupiah depreciated by 244% against the dollar (as compared to 1997 levels).

⁶ Indonesia's economy was further weakened by a severe drought and falling oil prices.

⁷ The World Bank, *Indonesia - Poverty Reduction in Indonesia : Constructing a New Strategy*, 2001, p. iv.

have risen slightly in 2003, it is \$14.8 billion (or 20.3%) lower than what it was in 1997.⁸ Finally, the rate of unemployment in Indonesia has steadily risen over the past few years, from 6.1% in 2000 to 8.7% in 2003.

Table 1. Selected Economic Indicators for Indonesia's Economy: 1997-2003

| | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003* |
|--|-------|--------|-------|-------|--------|-------|-------|
| Average Exchange Rate (Indonesian rupiah per \$U.S.) | 2,909 | 10,014 | 7,855 | 8,422 | 10,261 | 9,312 | 8,571 |
| Real GDP Growth (%) | 4.5 | -13.2 | 0.8 | 4.9 | 3.5 | 3.6 | 4.1 |
| GDP (\$billions) | 216 | 95 | 141 | 152 | 145 | 178 | 215 |
| GDP (\$billions, PPP basis)* | 645 | 571 | 599 | 640 | 678 | 711 | 749 |
| Per Capita GDP (\$PPP basis)* | 3,201 | 2,796 | 2,899 | 3,056 | 3,200 | 3,320 | 3,740 |
| Exports (\$billions) | 53.4 | 48.8 | 48.7 | 62.1 | 56.3 | 57.2 | 59.8 |
| Imports (\$billions) | 41.7 | 27.3 | 24.0 | 33.5 | 31.0 | 31.3 | 32.9 |
| FDI stock (\$billions) | 68.8 | 68.5 | 65.2 | 60.6 | 57.4 | 53.9 | 54.8 |
| Public Debt as a % of GDP | 72.5 | 55.2 | 76.9 | 102.4 | 90.1 | 78.1 | 70.7 |
| Consumer inflation | 6.7 | 56.5 | 20.5 | 3.7 | 11.5 | 11.9 | 6.6 |
| Unemployment Rate (%) | 4.6 | 5.5 | 6.4 | 6.1 | 8.1 | 8.3 | 8.7 |

Source: Economist Intelligence Unit and government of Indonesia. Data for 2003 are estimates.

*PPP data are measurements of foreign data in national currencies converted into U.S. dollars based on a comparable level of purchasing power these data would have in the United States.

The short-term economic prospects for Indonesia are relatively positive. For example, *Global Insight*, an international forecasting firm, predicts that Indonesia's real GDP will rise by 4.6% in 2004 and 5.0% in 2005.⁹ However, Indonesia faces a number of challenges that threaten to undermine long-term growth prospects. These include widespread government corruption and a weak legal system,¹⁰ large public debt, extensive government control of key economic sectors (such as oil and gas), a high level of corporate non-performing loans, a weak banking system, uncertainties surrounding the central government's efforts to decentralize fiscal and political authority to local governments, and failure by the government to provide adequate protection of intellectual property rights (IPR). In addition, the existence and activities of several separatist

⁸ In many developing nations, the level of FDI can have a major impact on GDP growth.

⁹ Global Insight, *Indonesia: Interim Forecast Analysis*, February 2004.

¹⁰ According to Transparency International's 2003 *Global Corruption Report*, Indonesia is one of the most corrupt countries in the world (ranking 96 out of 102 countries surveyed in 2002).

movements and terrorist groups in Indonesia constitute major threats to political and economic stability.¹¹ In October 2002, terrorists with reported links to Al Qaeda bombed a club in Bali frequented by western tourists, killing over 200 people (including seven Americans) and wounding hundreds more.¹² In August 2003, terrorists bombed a U.S.-run hotel in Jakarta, killing 12 people and wounding 150. The bombings have had a chilling effect on Indonesia's tourism industry and raised major concerns over the safety of foreign tourists and businesspeople in Indonesia. Ethnic, religious, and separatist violence in the country has displaced 1.3 million Indonesians.¹³

Overview of Indonesian Trade and Investment Relations

According to the World Trade Organization, Indonesia was the world's 28th largest exporter and the 39th largest importer in 2002. Indonesian trade data indicate that Japan was its largest trading partner in 2002, followed by the United States, Singapore, South Korea, and China (see **Table 2**). The United States was Indonesia's second largest export market and its third largest source of imports. Major Indonesian exports included petroleum and petroleum products, natural gas, and clothing and accessories. Its major imports were petroleum and petroleum products, organic chemicals, and general industrial machinery.¹⁴ According to Indonesian investment statistics (which record approved investment, as opposed to actual investment), the top five foreign investors in Indonesia are the United Kingdom, Japan, Singapore, China, and Malaysia. Major sectors for FDI in Indonesia include chemicals, pharmaceuticals, paper; metal goods, transportation, and real estate.¹⁵

Table 2. Indonesia's Major Trading Partner's: 2002
(\$billions)

| Trading Partner | Total Trade | Exports | Imports | Trade Balance |
|-----------------|-------------|---------|---------|---------------|
| Japan | 16.4 | 12.0 | 4.4 | 7.6 |
| United States | 10.2 | 7.6 | 2.6 | 5.0 |
| Singapore | 9.4 | 5.3 | 4.1 | 1.2 |
| South Korea | 5.7 | 4.1 | 1.6 | 2.5 |
| China | 5.3 | 2.9 | 2.4 | 0.5 |

Source: United Nations Conference on Trade and Development

¹¹ For additional information on terrorist and separatist groups in Indonesia, see CRS Report RL31672, *Terrorism in Southeast Asia*, by Mark Manyin, Richard Cronin, Larry Niksch and Bruce Vaun; and CRS Report RS20572, *Indonesian Separatist Movement in Aceh*, by Larry Niksch.

¹² See CRS Terrorism Briefing Book entry *North and Southeast Asia (Excluding China)*.

¹³ U.S. Agency for International Development, *Indonesia: Country Overview*.

¹⁴ United Nations Statistics Division, Commodity Trade Statistics Database.

¹⁵ Indonesia Investment Coordinating Board.

U.S.-Indonesia Commercial Relations

U.S. data indicate that Indonesia is not a large U.S. trading partner. In 2003, U.S. exports to, and imports, from Indonesia were \$2.5 billion and \$9.5 billion, respectively, making Indonesia the 37th largest U.S. export market and its 26th largest source of imports. As indicated in **Table 3** and **figure 1**, U.S. exports to Indonesia declined sharply in 1998 and 1999 and have been relatively flat since. Overall, U.S. exports to Indonesia in 2003 were 44.4% lower than 1997 levels. U.S. imports from Indonesia grew slightly from 1997-2000, but have been relatively flat since. U.S. imports from Indonesia in 2003 were only 3.6% higher than 1997 levels. The top three U.S. exports to Indonesia in 2003 were soybeans, textile fibers, and animal feed, while the top U.S. imports from Indonesia were clothing and apparel, telecommunications equipment (mainly audio and video equipment), and crude rubber. According to U.S. investment data (which lists the value of U.S. FDI on a historical cost basis, i.e., the cumulative book value of investment), U.S. FDI in Indonesia stood at \$7.5 billion at year-end 2002, down by \$700 million from 2001 and by \$1.4 billion from its peak in (\$8.9 billion) in 2000. Currently, 77% of U.S. FDI in Indonesia is in the mining sector (mainly oil and gas).¹⁶

Because Indonesia is a developing country and meets other criteria set in U.S. law, \$1.3 billion worth of its exports entered the United States duty-free under the Generalized System of Preferences (GSP). In an effort to boost U.S.-Indonesian commercial relations, promote political stability in Indonesia, and combat terrorism, the Bush Administration on September 19, 2001 announced that the United States would add 11 products imported from Indonesia (valued at about \$100 million) that would be eligible for GSP treatment and pledged that the United States would provide up to \$400 million in financial aid and loan guarantees under U.S. trade programs operated by the Overseas Private Investment Corporation (OPIC), the Export-Import Bank (Eximbank), and the Trade and Development Agency (TDA), largely targeted at Indonesia's oil and gas sector.

Indonesia has gradually reformed its trade regime over the past 10 years, reducing its average un-weighted tariff from 20.0% in 1994 to 7.3% in 2003. In 1999, Indonesia agreed to eliminate various discriminatory trade policies on auto trade after it lost a case in the WTO dispute brought mainly by the United States and European Union. Indonesia's enforcement of U.S. IPR has been a major issue of concern for U.S. firms. According to the International Intellectual Property Alliance (IIPA), piracy levels in Indonesia are "among the highest in the world," rivaling those of China and Vietnam. IIPA estimates that IPR piracy in Indonesia cost U.S. firms \$260 million in lost trade in 2002.¹⁷

¹⁶ U.S. Bureau of Economic Analysis, *Foreign Direct Investment Position in the United States on a Historical-Cost Basis*, 2002.

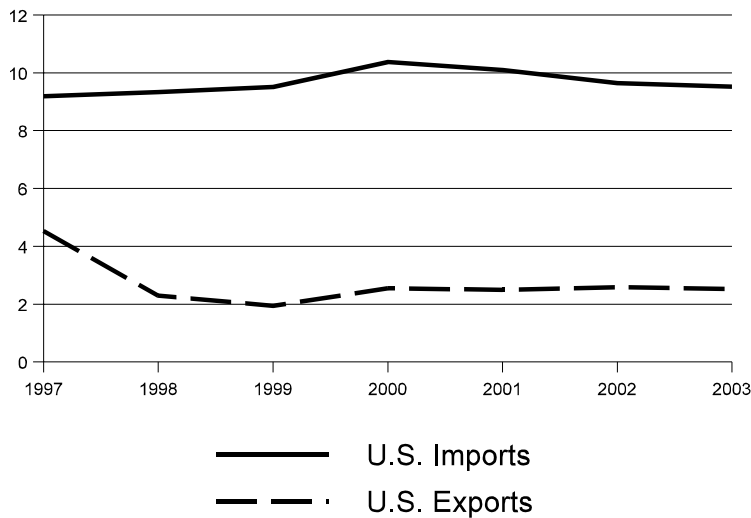
¹⁷ IIPA, *2004 Special 301 Report: Indonesia*.

Table 3. U.S. Trade With Indonesia: Selected Years
(\$millions)

| | 1997 | 1999 | 2001 | 2003 | 1997-2003 % Change |
|--|---------------|---------------|---------------|---------------|-----------------------|
| Total U.S. Exports to Indonesia | 4,532 | 1,939 | 2,499 | 2,520 | -44.4 |
| Major U.S. Exports to Indonesia | | | | | |
| Oil seeds and oleaginous fruits (mainly soybeans) | 255 | 202 | 245 | 326 | 27.8 |
| Textile fibers (other than wool) | 252 | 117 | 220 | 275 | 9.1 |
| Animal feed (excluding unmilled cereals) | 98 | 32 | 219 | 198 | 102.0 |
| Total U.S. Imports from Indonesia | 9,190 | 9,514 | 10,105 | 9,520 | 3.6 |
| Major U.S. Imports from Indonesia | | | | | |
| Apparel and clothing | 1,736 | 1,816 | 2,356 | 2,236 | 28.8 |
| Telecommunications and sound and reproducing apparatus and equipment | 1,004 | 1,022 | 1,147 | 892 | -11.2 |
| Crude rubber | 735 | 376 | 331 | 597 | -18.8 |
| U.S. Trade Balance | -4,659 | -7,575 | -7,065 | -7,000 | — |

Source: U.S. International Trade Commission Dataweb.

Figure 1. U.S. Trade With Indonesia: 1997-2003
(\$ Billion)



Source: U.S. International Trade Commission DataWeb.

EveryCRSReport.com

The Congressional Research Service (CRS) is a federal legislative branch agency, housed inside the Library of Congress, charged with providing the United States Congress non-partisan advice on issues that may come before Congress.

EveryCRSReport.com republishes CRS reports that are available to all Congressional staff. The reports are not classified, and Members of Congress routinely make individual reports available to the public.

Prior to our republication, we redacted names, phone numbers and email addresses of analysts who produced the reports. We also added this page to the report. We have not intentionally made any other changes to any report published on EveryCRSReport.com.

CRS reports, as a work of the United States government, are not subject to copyright protection in the United States. Any CRS report may be reproduced and distributed in its entirety without permission from CRS. However, as a CRS report may include copyrighted images or material from a third party, you may need to obtain permission of the copyright holder if you wish to copy or otherwise use copyrighted material.

Information in a CRS report should not be relied upon for purposes other than public understanding of information that has been provided by CRS to members of Congress in connection with CRS' institutional role.

EveryCRSReport.com is not a government website and is not affiliated with CRS. We do not claim copyright on any CRS report we have republished.