

Foreign-owned plantations (Penanaman Modal Asing or "PMA" firms) also were subject to domestic allocation requirements that reduced profits, especially procurement of RBD olein for 'market operations'. And a portion of production of these private, foreign-owned plantations had to be sold through KPB-Medan. However, private, national (PMDN) plantations were not subject to domestic allocation requirements and were not required to market CPO through KPB-Medan.

Beginning about 1987, CPO supplied to KPB-Medan was marketed by a cartel of firms. These firms were involved mainly in trading, but some also had interests in processing.

Because certain members of the cartel received palm oil allocations from KPB-Medan at fixed prices, these firms were well-placed to profit when world prices increased. The cartel members also acted as brokers for palm oil exported through KPB-Medan.

Policy-induced benefits increasingly were concentrated among these few private firms acting as brokers for the export of palm oil supplied through KPB-Medan or who received allocations for "market operations." Because of the closed nature of the marketing system, many details are not known with certainty. It is also complicated because the relationships among the major firms apparently shifted over time. However, a clear pattern emerged: trade restrictions aimed at price stabilization actually created opportunities for a few private firms to buy raw materials at low prices and to sell these commodities at higher prices in domestic and world markets.

Fragmented palm oil prices

The complex of trade restrictions that had evolved by the late 1980s created four separate prices for CPO in Indonesia. One was the price of CPO that was exported directly by PMA and PMDN plantations. Another was the price of CPO imported by domestic processors for export under provisions of the 6 May 1986 decrees that allowed duty rebates on inputs used to manufacture exports. These first two prices followed the world market.

The third price was that of CPO produced by state plantation companies and exported through KPB-Medan and the cartel. In principle, the price

state plantation companies received from KPB-Medan for exports also should have followed world market prices. However, complaints from the state plantation companies that they did not receive a fair price for their CPO exports appeared in the press.¹² The *Far Eastern Economic Review* (24 August 1989, p. 64) reported that these marketing arrangements reduced prices received by state plantation companies by US\$15–20/tonne. The fourth price was that of CPO allocated to the domestic market to protect domestic processors, which had been set at Rp 425/kg since January 1986. Although the official price for domestic CPO allocations was increased to Rp 500/kg in February 1988, it still was below the parity price (the heavy dotted line in *Figure 6*). The CPO price for domestic allocations was raised again from Rp 500/kg to Rp 550/kg in January 1989. Then the world price of CPO fell below the official price for domestic allocations in mid-1989 and continued to fall until late 1990. For that period, producers received some protection from low world prices for the portion of their CPO marketed for domestic allocations. But while the allocation price exceeded the world price, many processors simply refused to accept their allocations. The Department of Trade finally faced up to this in July 1990, and reduced the allocation price from Rp 550/kg to Rp 475/kg. But world prices already were rising, so this move was reversed by the end of the year.

Further marketing complications came from the allocations of RBD olein for 'market operations'. By 1988, CPO allocations to protect domestic processors had declined and 'market operations' accounted for about two-thirds of domestic palm oil allocations. The pricing mechanism for RBD olein procurement for market operations established a producer price based on a delivery price for Jakarta less charges for value added tax, costs of transport from Belawan to Jakarta, and a 'distribution charge'. The allowance of Rp25/kg for transport from Belawan to Jakarta was reasonable. However, there is no good reason for palm oil producers to bear the burden of the cooking oil distributor's 'distribution charge' of Rp40/kg. Furthermore, although the delivery price was to be based on records of the Department of Trade, some sources asserted that the delivery price was specified by the

¹²Kompas, 11 Jan 1988, p. 2, and 14 Jan 1988, p. 12; Jakarta Post, 12 Jan 1988.

cooking oil company and that it averaged about Rp35/kg below the Jakarta market price in 1988. This indicates that the pricing arrangement reduced producers prices by Rp75/kg and thereby subsidized the distributor. This represented a direct transfer of income from estates (and associated smallholders) to some of the wealthiest business groups in Indonesia.

The state plantation companies and PMA firms would rather have sold CPO at the Rp500/kg set for domestic allocations than be required to refine it and supply it for market operations under these terms. Authority for market operations was not established by decree. Some suppliers circumvented the regulations to a degree by failing to provide the full amount of their quota. However, complete refusal to supply any palm oil would, they believed, be penalized through other regulations; for example, by denial of export permits for CPO. Thus, the existence of other trade regulations which were set by decree provided the indirect leverage for enforcement of market operations which had no basis in a decree.

TOWARDS EXPORT DEREGULATION, 1987-1991

By the late 1980s, there was emerging recognition by officials that administrative allocation and pricing of palm oil had not served consumers' interests. The 24 December 1987 Package (PAKDES) swept away most vestiges of consumer price stabilization policy for cooking oil by deregulating exports of RBD olein. Exports of stearin, a byproduct of RBD olein manufacture, were also deregulated. Deregulation of RBD olein and stearin was a positive step because it provided a legitimate outlet for exports of processed products.

Since RBD olein could now be exported freely, the link between domestic prices and world prices for RBD olein was stronger than ever and any effort to reduce domestic prices would be offset by increased exports. Many private, national (PMDN) oil palm plantations are 'integrated', meaning they have refineries as well as mills. Thus, after PAKDES, they also were free to export RBD olein. PMDNs without refineries or whose CPO output exceeds their refinery capacity were free to sell CPO on the domestic market. Moreover, the deregulation

of RBD olein exports in PAKDES eliminated any possibility that market operations could affect consumer prices. Indeed, there were no apparent restrictions to export of RBD olein made from palm oil intended for market operations.

However, no raw materials or semi-processed inputs to cooking oil manufacture were affected by the 24th December Package. The central policy issues for producers – administrative allocation and pricing in the domestic market, regulation of exports of CPO, and "market operations" for RBD olein – were unaffected by PAKDES. Export controls still applied to CPO, RBD olein, palm kernel oil (PKO), and palm kernels. Exporters still had to apply to the Department of Trade to receive a permit for each export shipment. Since the policy changes in PAKDES meant that a firm could export if it had refining capacity, profits were limited only by a firm's ability to influence Government agencies that allocate supplies and fix prices.

Although the November 1988 policy package (PAKNOP) reduced NTBs to imports of edible oils and oilseeds, consumers still paid more for cooking oil than they would under free trade because of import tariffs and lack of competition in the cooking oil industry. In May 1989, the cooking oil industry was added to the 'negative list', closing it to new investment, which only served to strengthen processors' power to influence domestic prices.

Partial steps toward deregulation, 1990

Starting in 1990, export permits for CPO, RBD olein, and PKO were issued for a year at a time rather than the cumbersome shipment-by-shipment approvals required previously. This positive step came as a result of lobbying by palm oil producers concerned about mounting stocks, but it did not go far enough in freeing firms to actively promote exports of Indonesia's expanding palm oil production. By this time, some officials of the Department of Agriculture privately acknowledged that the export restrictions intended to supply raw materials to domestic processors and to stabilize consumer prices were obsolete. An authoritative newspaper (Kompas 9 June 1990, p. 2) published statements by the Minister of Agriculture which suggested discussions were underway to deregulate palm oil. In part, this disclosure may have resulted from a proposal that

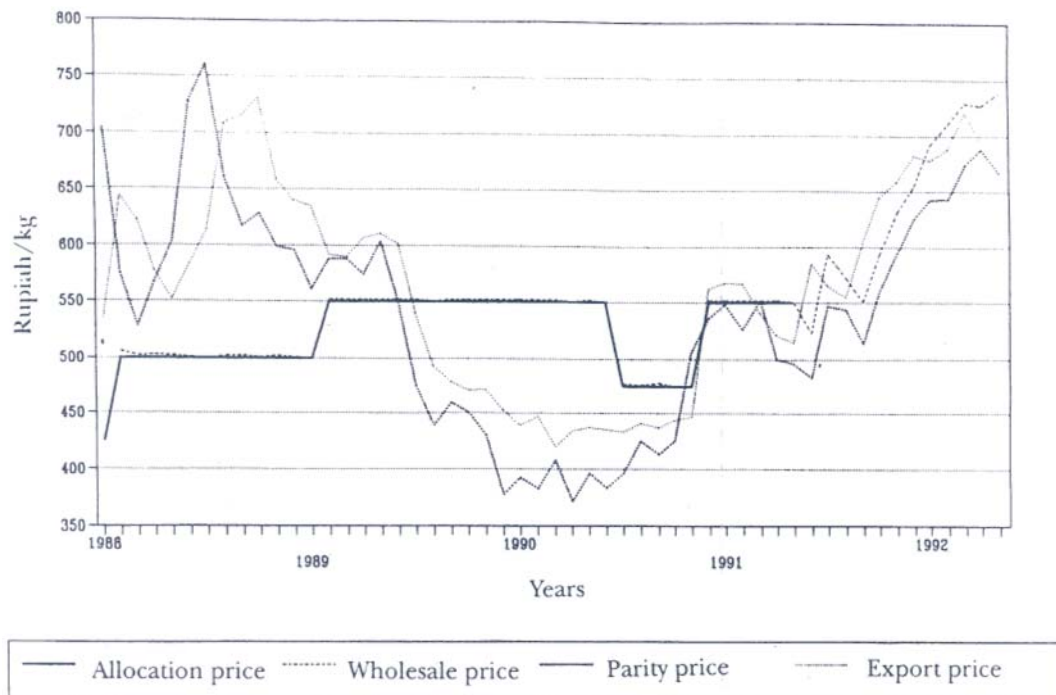


Figure 6. CPO prices, 1988–1992, by month in current Rupiah.

the Minister solicited from producers in May 1990 which recommended that all quantitative restrictions on exports be abolished in favor of export taxes, including provisions for taxes to stabilize consumer prices. The biggest advantage to producers of substituting an occasional tax for the existing array of trade restrictions would come from the shift to free trade when world prices are moderate or low, which is most of the time.

More reports of government plans to deregulate trading of palm oil (and copra) surfaced in the press in October (Jakarta Post 15 October 1990). (On 10 October, the Coordinating Minister for the Economy, Finance, and Development Supervision had written a letter to other ministers with economics portfolios supporting a shift to tariffs from non-tariff trade restrictions on these commodities.)

Palm oil trade deregulation, June 1991

Quantitative restrictions on international trade in CPO (as well as on copra and CCO) were

eliminated in the policy package of 3 June 1991 (PAKJUN). Domestic allocation of CPO also was abolished in that policy package. Substantial tariffs remained in place on imports, however. PAKJUN included an import duty of 10 percent plus a 30 percent surcharge for CPO and refined palm oil. Olein and stearin imports faced a duty of 10 percent, but no surcharge.

With PAKJUN, private firms were free to export CPO as they wished. Questions remained, however, regarding marketing arrangements for government-owned plantation companies (the PTPs).

The foremost among these was whether the PTP's exports would continue to be carried out under long-term contract through KPB-Medan. There were conflicting interpretations in the press when PAKJUN was issued, and the debate continued into 1992.

The focus of this debate was whether private firms (including, presumably, the marketing cartel) would have access to palm oil produced by PTPs.¹³ Some private interests argued that 'open tenders

¹³See *Jakarta Post* 10 June 1991 and *Far Eastern Economic Review*, 13 June 1991 (p. 74). Also see USDA, 1992.

would better serve to balance the relationship between FOB and domestic prices' rather than the 'current month plus five' pricing basis for long-term export contracts (USDA 1992, p. 6). In fact, although a large share of exports by PTPs was under long-term contract, KPB-Medan also had instituted a palm oil auction after PAKJUN.

Figure 6 shows that, indeed, the export price for CPO from Belawan (the light dotted line labelled "Export price") did not coincide perfectly with the export parity price, before or after PAKJUN. The lags apparent in the actual export price relative to the parity price reflect, at least in part, forward contracting. But it also is clear that the prices are linked, in contrast to the officially-determined allocation price. Moreover, the practical force of policy is demonstrated by the fact that the official price for domestic allocations of CPO and the domestic wholesale price were virtually identical until May 1993. (These are, respectively, the solid and dashed lines in Figure 6).

After PAKJUN, the domestic wholesale price, the price of exports, and the export parity price moved together¹⁴. In Figure 6, the lack of congruence in these prices after PAKJUN reflects imperfections in the data on prices and marketing margins as well as imperfections in the markets. But Figure 6 makes clear that whatever market imperfections persisted after PAKJUN, they were insignificant compared to the policy distortions resulting from prior CPO trade restrictions.

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¹⁴Domestic prices rose with world prices through the rest of 1991 and into 1992 (Figure 6). In March, government responded to concern about coincidence of prospects for rising cooking oil prices and the Idul Fitri holiday = a period of peak domestic demand - by halting the CPO auctions. Since domestic wholesale prices continued their climb while export prices fell, this move in fact may have added to the tight situation in the domestic market.