COMPETITIVENESS OF INDONESIAN CRUDE PALM OIL
AND THE EFFECT OF EXPORT TAX ON ITS
PERFORMANCE IN THE WORLD MARKET

THESIS

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DECLARATION

I do hereby declare that the thesis entitled “Competitiveness of Indonesian Crude Palm Oil and the Effect of Export Tax on its Performance in the World Market” is my original work produced through the guidance of my academic advisors and that to the best of my knowledge it has not been presented for the award of any degree in any University. All of the incorporated material originated from other published as well unpublished papers and are stated clearly in the text as well as in the references.

Bogor, August 2008

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ABSTRACT

Alphonse Joseph Obado. 2008. Competitiveness of Indonesian Crude Palm Oil and the Effect of Export Tax on its Performance in the World Market (Yusman Syaukat, Chairman and Hermanto Siregar, Member of Advisory Committee)

The objectives of this research include: (1) to find out the export competitiveness of the Indonesian CPO in the world market; (2) to assess the impacts of CPO export tax on Indonesian CPO industry. In addition it will assess the effect of exchange rate on Indonesian CPO industry; and (3) to propose strategies that can improve the competitiveness of Indonesian CPO in the world market.

Indonesia was found to be most competitive in the CPO export market than any other country, especially in India and China but it faces strong competition from Malaysia. Both Indonesia and Malaysia have comparative advantage of exporting CPO to China and India. Export tax was negatively related to mature area of oil palm plantation, production, export, and domestic price of CPO and positively related to CPO consumption and stock. The export tax policy benefitted the domestic consumers of CPO. Clearly, the export tax policy reduces competitiveness of the Indonesian palm oil industry and also hurts producers of CPO. The foreign exchange rate effect was discovered to be positively related to domestic CPO price, export and consumption but negatively related to production and stock. Alternative strategies to be utilized include: (1) improvement in the promotion, negotiation and enhancement of bilateral relationships between Indonesia and China to improve infrastructure; (2) Indonesia must cooperate and work closely with Malaysia to enable Indonesia to learn from Malaysia how to efficiently produce CPO; (3) development of palm oil projects that can be integrated with other industrial production programs through the revitalization of plantation systems, rejuvenation and rehabilitation of existing farm product; and (4) creation of a conducive atmosphere for investment, permit ownership of plantations by individuals, reducing import cost on farm machines and implements, provide incentives on imports of agricultural machines to improve the competitiveness of Indonesian CPO in the world market. It is recommended that export tax formulation with well considered and sound justifications is needed and from the study, 11.13 percent export tax on CPO was recommended.

Key words: Performance, Competitiveness, Comparative Advantage, Export Tax, Crude Palm Oil
EXECUTIVE SUMMARY

Agricultural products have a very important role to perform in the development of the Indonesian national economy. These commodities and specifically crude palm oil, has contributed immensely in the Gross Domestic Product of Indonesia, led to growth in production and areal development, created forms of employment for more than 3.5 million people, increased international and national trade, improved living standards for the local people, and improved financial status of the local people. Crude palm oil is considered a strategic commodity in the Indonesian economy as a source of raw material for the most commonly used cooking oil consumed in Indonesia and export earnings through foreign exchange inflows.

The crude palm oil industry in Indonesia has evolved from government sponsorship and market interventions to a private sector initiative in response to international price signals and market growth. Export growth can be decomposed into three factors: world demand factor, product and market effects and competitiveness effects. The world demand factor reflects growth in exports that can be attributed to rising international demand, i.e. the stronger global import demand, the stronger the country’s export growth. Considering the importance of CPO, Indonesia has launched policies to optimize the development of the industry, such as supply stabilization. The most important policies have been on export tax, first implemented in August 1994 to stabilize and secure the domestic supply and price.

This study has three main objectives that include the following; (1) to find out the export competitiveness of the Indonesian CPO in the world market; (2) to assess the impacts of CPO export tax on Indonesian CPO industry; in addition it will assess the effect of exchange rate on Indonesian CPO industry; and (3) to propose strategies that can improve the competitiveness of Indonesian CPO in the world market.

The research found out that India and China are the most important markets for Indonesian CPO. Considering the strength of CPO export into the India CPO market, Indonesia has dominated the market over the years. It was discovered during the study that Indonesia is highly competitive in the India CPO export market than any other country with competitiveness index value of greater than one. With respect to the China CPO export market, Indonesia is still competitive as its market share continued to increase.

It has been observed that Indonesia has registered a higher value of competitiveness index than Malaysia for the period that the study was carried out. This can be an indicator that Indonesia has an advantage on national endowments than Malaysia, cheaper labor input in CPO industry and increased intensive use of cheaper materials and inputs in the CPO industry that makes production cheaper than Malaysia. Malaysia on the other hand has recorded a higher Revealed Comparative Advantage Index (RCAI) over the years than Indonesia because Malaysian CPO production industry is more efficient than that of Indonesia. In comparing Indonesia with other CPO exporting countries to the two strong markets for its CPO especially China and India, the study revealed that Indonesia
is competitive in these two markets but the country faces strong competition from Malaysia in the export of CPO to these export markets.

Factors contributing to the competitiveness of Indonesian Crude Palm oil include the demand condition of Indonesian CPO that has been on the rise internationally due to steady rise in population, new farming technologies that are used by Indonesian palm oil producers, the diversification of crude palm oil production and the escalating price of CPO in the world market.

Producers, mainly smallholders, have suffered a great deal due to the export tax policy. As the domestic price of CPO is depressed by this policy, the farm gate price of the farmers’ produce declines substantially. The export tax policy reduces the competitiveness of the Indonesian palm oil industry and also hurts producers of CPO (some of them small-holder farmers) due to the lower price of CPO relative to the world market price. The export tax policy benefitted the domestic consumers of CPO as it controls domestic price CPO.

Alternative strategies that can be utilized to improve the competitiveness of Indonesian CPO in the world market include: (1) improvement in the promotion, negotiation and enhancement of bilateral relationships between Indonesia and China and India to contribute towards the improvement of the infrastructure of the CPO industry in Indonesia; (2) Indonesia must cooperate and work closely with Malaysia to learn from Malaysia how to efficiently produce CPO; (3) development of an integrated palm oil sector with other industrial production programs through the revitalization of plantation systems, rejuvenation and rehabilitation of existing farm products; and (4) creation of a conducive atmosphere for investment in the agricultural sector by guaranteeing security, permit ownership of plantations by individuals, reducing import cost on farm machines and implements that are used in palm oil industry, provide incentives on imports of agricultural machines and reduce export tax by deregulating export tax and retribution that are not an incentive to or that negatively affect the competitiveness of CPO from Indonesia in the world market.

The following recommendations should be considered to improve the competitiveness of Indonesian CPO in the world market: (1) there should be an increase in investment in research and development in the palm oil sector resulting in improved human resources and technology that would result in improved production by the farmers; (2) the government policy on imports should promote investment in the agricultural sector by guaranteeing security, reducing import cost on farm machines and implements that are used in palm oil industry and provide incentives on imports of agricultural machines; (3) the Indonesian CPO industry should widen its market for the produced CPO; (4) the Indonesian government in conjunction with investors in the CPO sector must invest in the infrastructure to make them compete effectively; and (5) the export tax formulation with some more meaningful justifications is needed. The benefits gained due to price increase or currency depreciation should be distributed among producers, consumers and the government after considering secondary rights (equity argument). The results of this study show that the recommended export tax rate should be about 11.13 percent. This would protect local consumers while at the same time earning revenue for the government.
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