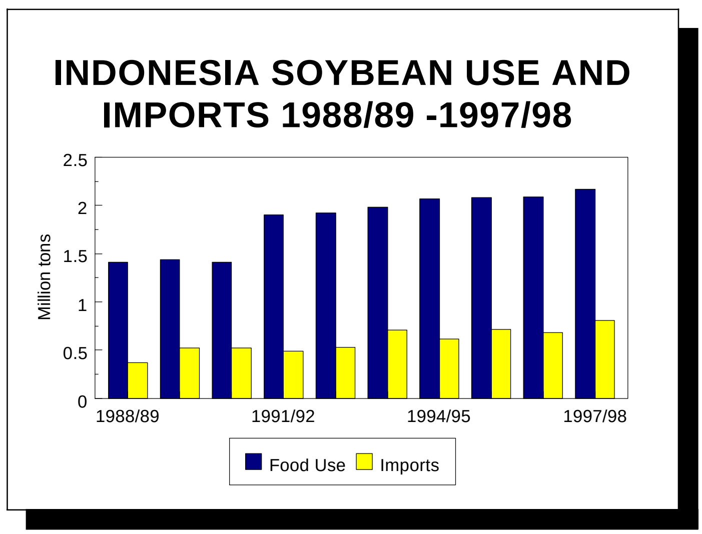
Special Report

INDONESIA: THE END OF STATE TRADING
SOYBEAN IMPORTS IN TRANSITION

OVERVIEW

In the two years between 1995 and 1997, U.S. soybeans exports to Indonesia increased 13 percent on a volume basis while export value increased 281 percent to $253.3 million in CY 1997. Since the economic crisis in Indonesia began soybean consumption has been on the rise due to shifts by consumers to this less expensive source of protein. Local production is not keeping up with the increased demand due to weather constraints and high returns from other crops. Developments in the Indonesian soybean market resulting from the elimination of the state monopoly known by its Indonesian acronym Bulog are very crucial for U.S. soybean exports and market share. Early indications show a plethora of imports due to huge margins between local and world prices which have attracted a lot of speculators. The rate of imports is expected to slow when prices equalize and at that time the few financially sound private traders will consolidate their positions as the main distributors of soybeans. Soybean consumption in Indonesia is expected to continue on an increasing trend in part due to the economic and financial crisis and the drop in incomes prompting shifts in consumption patterns.



Indonesia's total consumption of soybeans has increased from 1.7 million metric tons (mmt) in 1988/89 to almost 2.3 mmt in 1997/98, up more than 35 percent. Food use in the same period increased from 1.4 mmt to 2.2 million, a 57 percent increase. Feed consumption accounted for 10-12 percent of total soybean use until 1995/96 when the only soybean crushing plant closed and food consumption became the only use of soybeans. Since then Indonesia's soybean meal demand has been satisfied exclusively by imports. Local soybean production provides an average of 65 percent of the total consumption while the rest is imported mostly from the United States. Imports of soybeans and other agricultural commodities were monopolized until the later part of 1998 by Bulog. The United States has been the exclusive supplier in the last few years.

Soybeans are used to manufacture tofu and tempe (a fermented product made of whole soybeans, sold in chunks). Both products are usually eaten fried. Consumption is concentrated on the island of Java which reportedly accounts for about 90 percent of all food use. Java also accounts for almost 70 percent of Indonesian soybean production. Tempe and tofu have been a traditional and very important source of protein for a significant segment of the population.

After years of rapid growth and political stability, Indonesia slipped into a deep economic and financial crisis in the second half of 1997, followed by a political crisis in May of 1998. The economic crisis hit Indonesia at the same time the country was experiencing its worst drought in 50 years. The results of the double calamity were devastating for the food and agricultural situation in Indonesia. Food prices soared, the exchange rate spiraled out of control and the rupiah depreciated from 2,599/$ in July of 1997 to 13,850 in July of 1998. The international community including the International Monetary Fund (IMF) and The World Bank, and individual countries responded with several loan packages as well as with donations.

Monthly Exchange Rate 1996 - 1998, Official Data
Rupiah Per U.S. Dollar

Dates	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
1996	2305	2342	2346	2346	2345	2345	2360	2355	2340	2337	2358	2385
1997	2387	2403	2418	2443	2458	2450	2528	2935	3350	3700	3740	5700
1998	10250	8800	8660	7970	11250	14750	13850	11050	10850	7550	7300	7516

Data Sources: January 1996 to July 1998 Central Statistics Agency (BPS). August 1998 to December 1998 Bisnis Indonesia Daily. *: Data for Dec 10, 1998.

As usual, the loans provided by the IMF are subject to certain conditionalities or reform packages. Part of the reform package that Indonesia agreed to is the removal of Bulog as a state monopoly and distributor for all commodities except rice. With the exception of rice, which according to the government is the staple for food security, imports of the other agricultural commodities under Bulog’s control (namely sugar, wheat, garlic and soybeans) have been deregulated, and duties have been eliminated. In response to the drought and economic crisis, duties on most other agricultural commodities were reduced to 5 percent. Imports of soybeans are not only free of import duties but can be imported by any private entity.

THE SOYBEAN IMPORT MARKET

The primary users of soybeans are the manufacturers of tempe and tofu. These are very small enterprises, each one using an average of about 70 kg (154 lbs) of soybeans per month. Reportedly there are 160,000 manufacturers of which 85-90 percent are located on the island of Java. The majority of the 160,000 manufacturers are organized geographically into local cooperatives known by their Indonesian acronym KOPTI (i.e. the KOPTI of South Jakarta). The local coops are part of the National Association of Tempe and Tofu Manufacturers known as INKOPTI.

When Bulog reigned as the sole importer of soybeans, a part of the imports was sold directly to the members of the KOPTIs at a fixed price (set by Bulog) and the rest was sold to local traders at higher “market” prices. The soybean traders then were free to sell to anyone, members of

KOPTIs or not. Under this scheme Bulog usually sold 60 percent of the total imports at fixed prices and the rest at "market" prices. Prior to the economic crisis the prices set by Bulog were generally somewhat above the import price thus adding support to local grower prices and covering some of Bulog's overhead.

What will happen to soybean imports now that Bulog's role has been eliminated? The answer to this timely question will become clearer when Bulog is done disposing of its existing soybean stocks. However, the recent increase in import activities for soybeans suggests a future of lively competition. In addition, the most important factor in answering this question is how soon the Indonesian banking system regains its normal ability to support trade financing.

For the last 10 years imports of soybeans on average have increased by 9.4 percent annually, while the food use of soybeans has increased on average for the same period by 4.5 percent. With a very good GDP growth rate before the crisis and with a population growing at almost 2 percent per year Indonesia's demand for soybeans is destined to follow an upward trend. Since local production is expected to remain flat the import share of total consumption is expected to also increase.

Per capita income has dropped from a high of slightly more than $1,100 in 1996 to a current level of less than half that (about $500, but fluctuates with the value of the rupiah). Despite the forecasted 16 percent contraction of the economy, CY 1998 imports of soybeans are expected to have reached if not surpassed the 1997 volume. Imports remained stable despite the crisis, due to increased consumption of tofu and tempe as a larger sector of the population (the middle class) increased tempe and tofu consumption, switching their source of protein from higher priced poultry, than the segment of the population that ceased consuming because no longer can afford tempe and tofu.

THE OUTLOOK FOR SOYBEAN IMPORTS

Any area expansion for soybean production in Indonesia is constrained by the tropical climatological conditions, thus limiting the possibility of a supply response to local demand and movements in world prices. The overall outlook for soybean imports for the next three to five years is very optimistic. Preliminary data shows that imports during MY1997/98 hit a record level of over 800,000 tons. Demand for soybeans is expected to continue in an upward trend, especially food quality soybeans from the United States that are always preferred by the tempe manufacturers.

Storage capacity currently at the ports and points of distribution is plentiful and at very low prices. Most of the large KOPTIs in the vicinity of Jakarta have 40-60,000 tons of soybean storage capacity. Reportedly, five KOPTIs in the Jakarta area are in the process of forming a private company in order to combine their financial resources to import soybeans using the GSM program.

Currently there is hyperactivity in the import market for soybeans. Bulog stocks at mid-December were estimated at around 180,000 tons and its selling price was Rp. 2,600/kg (about

$370 per ton), which is significantly higher than the landed cost of imported soybeans. As a result many newcomers have been attracted by the profit margin and are trying to import soybeans. Reports from local traders indicate that between mid-October and mid-December 210,000 tons of soybean imports were contracted. This hyperactivity is expected to cease when local prices are driven down by competition to more closely reflect import costs. At that point, expected within the next six months, imports will return to a more regular schedule based on local demand. The infrastructure for imports of soybeans exists even without Bulog and imports will continue smoothly regulated by market forces as long as the financial environment returns to "normal."

Currently, most of the banks require 100 percent cash collateral deposited with the bank in order to issue a Letter of Credit (LC), while a few banks require between 70-80 percent cash deposit from their best clients. This is true even for importers that are using the GSM-102 program. The Indonesian traders surveyed by the Office of Agricultural Affairs in Jakarta indicated that the most serious problem right now is not the 100 percent cash collateral which they considered it the second most serious problem, but the extreme volatility of the exchange rate. Given the fact that soybeans from the United States take around six weeks to arrive at the port in Indonesia the uncertainty of the exchange rate makes even the most financially sound traders reluctant to commit to large shipments. Traders insist that a very unfavorable but stable exchange rate is better than the extreme volatility that was experienced in the summer and early fall of 1998. Over the period of November 10 to December 10 the exchange rate has been seen to somewhat stabilize between 7-8,000 Rp/$.

The average shipment size currently is 30,000 tons. Even the large private traders of soybeans that do have the financial ability to import large shipments and enjoy economies of scale in shipping costs prefer to limit shipments to 25-30,000 tons. This preference is due to fears of looting of the warehouses, riots and the overall political uncertainty. When political and financial stability returns to Indonesia, the soybean import market will not only function very efficiently without the presence of Bulog but demand might also benefit since prices will be regulated only by supply and demand.

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