Report on Competition Policy in Indonesia

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I. Introduction

The purpose of this report is to review and discuss the economic goals and benefits of competition policy and describe how the benefits of competition may be achieved in the Indonesian economy. Benefits from competition include lower prices, increased output, quality and choice, incentives for innovation, and more efficient use of resources. This report also examines several industries in Indonesia and suggests a framework within which the competitiveness of these, and other, industries may be evaluated.

Section II of this report begins with a survey of the relevant economic and competition literature that discusses the goals of competition policy. Consumer welfare and efficiency are the most generally-accepted concerns of competition policy worldwide. This section includes a brief summary of the explicit and implied goals of competition policy in several countries. We also discuss competition policy in the context of broader governmental policies and its role in developing countries in particular.

Section III describes several types of anticompetitive behavior. The two most significant problems being collusion and abuse of dominance. We examine a few case studies to highlight the role of economic evidence and inference in evaluating competition in an industry. This section touches on some of the most important issues to keep in mind while doing a competitive analysis. These include the definition of a relevant product and geographic market, based on sound economic principles, and the identification and understanding of the sources and significance of barriers to entry.

Finally, in Section IV we discuss competition issues in Indonesia. We discuss several recent empirical studies dealing with the Indonesian economy and present a more detailed look at several industries in which competitive problems may exist or have existed. We attempt to point out relevant facts and questions that those who may perform more complete competitive analyses may wish to consider. We trace the evolution of these industries to their current competitive state and discuss the potential role of the KPPU (Komisi Pengawas Persaingan Usaha) in improving the performance of these industries and increasing the benefits that will accrue to consumers.

II. Economic Goals of Competition Policy

Economists and antitrust practitioners agree that competition in general benefits consumers and society. Policymakers in all parts of government need a clear understanding of the benefits of competition, what types of practices might help or hinder competition and how the policies they set might affect competition.
This knowledge will help policymakers better evaluate whether particular policies, whether in business law or trade, for example, create an overall benefit for a country’s citizens.

Both trade and competition policy have similar objectives. The preamble to the 1947 General Agreement on Tariffs and Trade describes them, “…raising standards of living, ensuring full employment and a large and steadily growing volume of real income and effective demand, developing the full use of the resources of the world and expanding the production and exchange of goods…” The benefits of more competitive markets generally include lower prices, increased output and consumer choice, as well as improved processes and less waste of resources. Consumers are better off. Society is better off with better, more efficient use of resources. Economics can provide some insight into the types of practices that limit competition, the benefits of removing barriers to competition, and the role competition policy plays in achieving these benefits.

We start with a discussion of the economic goals of competition policy, as generally accepted in the literature. There is widespread agreement among economists and antitrust practitioners that efficiency and consumer welfare are the primary concerns of competition policy. At times these goals conflict. The competitive process, however, is considered a means to both ends.

**Monopoly Theory as a Framework for Understanding Efficiency and Consumer Welfare**

Efficiency and consumer welfare are improved, generally speaking, with more, rather than less competition. This does not mean necessarily a greater, rather than a lesser number of firms competing. A market in which two firms compete, may be the result of competition, rather than a competitive problem. We will discuss this in more detail later in the report. But a useful tool for understanding the theoretical arguments about competition is to look at efficiency and consumer welfare in hypothetical markets with many firms and in markets with only one firm (a monopoly). By comparing the prices and output of a monopoly to a benchmark of prices and output in the economic model of perfect competition, we may better understand how the degree of competition affects the welfare of consumers and producers.

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2. For example, a merger may allow two manufacturers to better use their factories, lower the costs of production, and increase profits. The reduction in competition might result in slightly higher prices for consumers. Here consumers are worse off, but producers are better off and resources are used more efficiently. Alternatively, a merger may be blocked because it may raise current prices to consumers, but technology that each firm possesses individually would not then be shared to produce a new, desirable product or innovation. Consumers may be better off in the short run, but not the long run. These tradeoffs will be discussed further in the paper.
The logic is that competition provides various benefits to consumers such as lower prices, greater output, better services, more choice and increased innovation, compared to situations in which competitive forces are limited. The case of monopoly is one extreme in the continuum of possible market structures. Monopoly is defined as one seller (or a group of sellers acting as one) and characterized as having control over price. Perfect competition is the other extreme, defined as many sellers, none having control over market price. Oligopoly refers to a market structure with few sellers. It is important to keep in mind that perfect competition rarely exists in the real world and is used as a benchmark for discussion purposes, not as a realistic goal of competition policy.

**Monopoly and Perfect Competition Compared**

A monopolist (or a group of sellers acting like a single seller) can change the price at which his product will sell in the market by changing the quantity available for sale. This "power over price," the essence of the economic concept of monopoly, simply means that the amount of money people generally are willing to pay for a product tends to rise as the quantity of the product offered for sale falls. As the quantity available shrinks, the people who value the product highly will offer to pay more to get the relatively more scarce product. The seller who controls the supply of a product can therefore raise its price by restricting the amount supplied.

Because firms attempt to maximize profits, and the scarcity of goods tends to increase their price, a monopolist will reduce output and raise price until it reaches its profit-maximizing level. The monopolist, therefore charges a higher price and produces less output than in perfect competition. Figure 1 illustrates this point. $Q_c$ and $P_c$ refer to quantity and price in perfect competition; likewise $Q_m$ and $P_m$ refer to monopoly quantity and price. Here marginal cost is assumed constant.

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4 There is some debate in the literature about the relationship between market structure and innovation.

5 Because we’re examining welfare benefits due to competition, not market structure, we will not explicitly discuss oligopoly in this section.

6 Firms maximize profit by setting output at a level at which marginal revenue (MR), which is the change in revenue from selling an additional unit, is equal to marginal cost (MC). For a perfectly competitive firm, price equals marginal revenue, as the firm cannot affect price by selling additional units. For a monopolist, marginal revenue is less than price, because a monopolist must lower its price to sell additional units.
Consumer and Producer Surplus

Consumer and producer surplus are used in economics as a measure of the welfare of producers and consumers. Consumers are better off, or have higher welfare, if they pay lower prices for products and services than if they were in a situation where they would have to pay the most they felt comfortable paying. For example, a person might be willing to pay Rp 15,000 for a bottle of Coke on a hot day, but would prefer to pay Rp 3,000. Likewise, producers are better off the greater the price they receive for the sale of their product or service exceeds the minimum they would be willing to take.

The demand curve reflects the valuation that consumers place upon consuming additional units of a good. The difference between total willingness-to-pay (demand curve) and what consumers must actually pay (price, P) is defined as consumer surplus (CS). The supply curve represents the amount firms are willing to supply at any given price. Producer surplus (PS) is equal to the difference between what firms actually receive (price, P) and minimum price the firms are willing to receive. It is the area below price and above the supply curve. Total surplus is the sum of consumer and producer surplus. The greater the total surplus, the better off is society as a whole. Innovation that lowers the costs of production (or shifts the supply curve down) increases total surplus, for example.

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7 This section discusses the “static” and relatively quantifiable measures of consumer and producer welfare. Other considerations, such as product choice and quality, for example, affect consumer welfare both in the short run and the long run.

8 The short-run industry supply curve is the horizontal sum of individual firm supply curves. A firm’s supply curve is the portion of its marginal cost curve above average variable cost. A monopoly, however, does not have a supply curve that can be defined in...
Deadweight loss is the cost to society of a market not operating efficiently. It is the sum of the consumer surplus and producer surplus lost compared to the perfectly competitive level. (See Figure 1, triangle area labeled “DWL”). Because consumers are willing to pay more than the cost of producing the good, the market is operating inefficiently. In addition, monopolistic pricing will lead some consumers to buy something they value less. This increases the demand and production of these lesser-valued products. Society’s resources are misallocated – that is, they are not being used in their highest-valued uses. Some consumers will simply pay the higher prices. A country may be worse off because its resources are not being used most productively. It is important to note at this point that like competition policy, other policies, such as taxes, that affect production (price at which firms are willing to supply) and demand (prices consumers are willing to pay) will result in deadweight losses as well.

Efficiency

Discussion of deadweight loss leads directly into a discussion of efficiency. Efficiency refers to the use of resources, both today and in the future. Efficient production today means that people, machinery, raw (...continued) terms of price alone. Its choice of output depends on both marginal revenue and marginal cost.


10 Technically speaking, industries with high fixed costs, for example, may be operating efficiently, but price above marginal cost. One example is network industries, in which consumers may find it useful to standardize on one product. The competition to become the “standard” may result in one or two firms remaining. This is an efficient outcome.


12 Consumer surplus may be less, not only in total, but also relative to producer surplus, as consumers pay more for a good than in a perfectly competitive market. This is often described as a wealth transfer from consumers to producers. We will return to this topic while discussing the views of various economists and antitrust practitioners about the goals of competition policy.

13 See Carlton and Perloff, p. 105-107, supra note 8, for a discussion of deadweight loss from taxation.
materials and other inputs to production are used to produce the most output they can. Inputs are not wasted or used poorly. Efficiency today also means that the goods or services being produced are what consumers value most highly -- their choices are not distorted. Efficiency in the future comes from incentives for innovation that generate improvements in goods and services as well as production processes in the future. Increased production at lower cost, as well as innovation that provides new and improved products and services in the future, increases total surplus.

The relevance of efficiency considerations for competition policy is that inefficient use of resources, simply put, results in higher prices, lower output and waste of valuable resources. When firms compete with one another to identify consumer needs, produce what consumers want at the lowest prices possible and continually attempt to improve and innovate to gain sales, resources are used more productively and consumers get what they want. More productive use of existing resources, and consequently greater output, translates into greater wealth and economic growth for a country. Lower prices give consumers more disposable income for other purchases, investments or savings. Total surplus, or wealth of both consumers and producers, expands. Therefore, a competition policy that reduces barriers to competition will help to achieve these efficiency benefits for its society.

**Efficiency (or Maximization of Total Surplus) as a Primary Goal of Competition Policy**

With this background, we review the arguments made by economists and antitrust practitioners that efficiency should be the primary goal of competition policy. Policies that reduce distortions or other limits to competition generate efficiency and consumer benefits. Countries often must make explicit their competition policy priorities when developing merger review guidelines, for example. Businesses then know the relative importance of efficiency, consumer welfare or other policy goals and take these into consideration when making business decisions. In practice, a tension exists between maximizing consumer welfare in the short run and the long run, and whether focusing primarily on efficiency considerations will resolve the tension. Some debate how consumer welfare should be measured. Some

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14 Economists refer to these concepts as static and dynamic efficiency. Static efficiency describes the efficiency of producing current products with the current inputs and processes. Dynamic efficiency, also known as technical progress efficiency, describes efficiency in the future from process and product innovation.

15 Scherer, supra note 1, writes, “From vigorous competition flow, in turn, pricing that sends the right signals to market participants, fostering efficient resource allocation; pressure forcing suppliers to manage their operations tightly, that is, at minimum unit cost; and incentives to introduce superior new products and production processes, because only through innovation can a firm outrace its peers and realize supra-competitive profits.”
argue it should be simply a function of prices, others take a more broad view, including quality and technical improvements, for example.

As mentioned earlier, a merger might produce innovations and new products in the future, and therefore increase consumer welfare in the long run -- but it might result in higher prices and lower consumer welfare in the short run. Many economists believe that focusing on efficiency, even at some minimal loss to consumer welfare in the short run is preferable. The simple reason is that efficient use of resources (people, land, equipment, raw materials, etc) increases the total wealth of society, over some time frame. The following excerpts from the economics and antitrust literature relates the reasoning.

Many believe that in the United States, the Chicago School proponents, Aaron Director, Henry Simons, George Stigler, Robert Bork, Richard Posner, and others, were the first to attach an economic efficiency "spin" to the purpose of competition laws. Bork, in his review of the Congressional proceedings leading up to the passage of the Sherman Act of 1890, concluded "...the policy the courts intended to apply is the maximization of wealth or consumer want satisfaction. This requires courts to distinguish between agreements or activities that increase wealth through efficiency and those that decrease it through restriction of output."

Others point out that while economic efficiency has become a focus of competition policy, and that many of the goals of U.S. antitrust laws are consistent with efficiency, it was not the legislative intent of the U.S. Congress. Regardless of a particular country’s legislative intent, evaluating competition policies from the viewpoint of their possible effects on economic efficiency is useful.

The general acceptance of efficiency as a primary goal of competition policy is supported by many economists. For example, Dennis Carlton and Jeffrey Perloff in their widely-used industrial organization textbook state:

16 There has been some confusion in the literature about the use of the term “consumer welfare” to mean “total welfare.” The confusion lies in the fact that some authors equate the two because producers (the other half of total welfare, excluding consumers) are actually consumers too. Strictly speaking, the economics literature distinguishes between total and consumer welfare. (See Figure 2. Total surplus = CS + PS; consumer surplus = CS). In this report, we maintain that distinction.
18 Note: this discussion has been cited as confounding consumer and total welfare, but is included because of its importance in the debate.
“Most economists believe the antitrust laws should have the very simple goal of promoting efficiency. That is, they should prevent practices or amalgamations of firms that would harm society through the exercise of market power. Some analysts, however, argue that the actual objective of these laws is not efficiency, and that these laws were passed to help certain groups and harm others. For example, some argue that the antitrust laws are designed to help small firms that compete with large firms, whether or not efficiency is increased.20 The view that the guiding principle of the antitrust laws should be efficiency, rather than the taking of resources from one group and granting them to another has gained increasing acceptance among legal and academic scholars.”21

A joint World Bank and OECD report discusses the objectives of competition policy in terms of the efficient allocation of resources and thus industry performance and economic welfare that is affected by competition.

“Competition forces firms to become efficient and to offer a greater choice of products and services at lower prices. In a competitive market economy, price (and profit) signals tend to be free of distortions and create incentives for firms to re-deploy resources from lower- to higher-valued uses. Decentralized decision-making by firms promotes efficient allocation of society’s scarce resources, increases consumer welfare, and gives rise to dynamic efficiency in the firm of innovation, technological change, and progress in the economy as a whole.”22

Posner explains that the basis for efficiency, or wealth maximization, as a goal of competition policy is for “…the things that wealth makes possible – not only or mainly luxury goods, but leisure, comfort, modern medicine, and opportunities for self-expression and self-realization…”23

**Consumer Welfare as a Primary Goal of Competition Policy**

As evident in the preceding passage, economic efficiency increases wealth, including consumer wealth, through better use of resources. Some argue that consumer welfare maximization alone should be the primary goal of competition policy. They usually mean that firms should not be able to raise prices to consumers and in fact, should be attempting to lower them to remain competitive (i.e. sell their products). Consumers are also generally better off if the quality, availability and choice of products are improved. The consumer welfare focus may stem from the belief that consumers need to be protected from producers and that the wealth transfer from consumers to producers, which can be seen in the comparison of monopoly to perfect competition, is unjust. Many economists believe that the wealth transfer is a “neutral” economic

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21 Supra note 9.


event, that deciding who should “own” the surplus is not in the domain of economics. The following excerpts from the economics and antitrust literature point out some of the arguments.

Robert Lande argues that the main purpose of the antitrust laws is to prevent firms from acquiring and using market power to force consumers to pay more for their goods and services. He believes that the U.S. Congress was primarily concerned that corporations would use market power “unfairly” to extract wealth from consumers, and legislators were not thinking about economic efficiency. He believes that the U.S. Congress in effect gave consumers the property right (or entitlement) to purchase competitively priced goods. This argument clearly is based more on legal principles than economics.

F.M. Scherer, along with many other economists, point out the benefits of competition for both efficiency and consumer welfare, but recognize that various competition authorities have chosen, or been give the mandate, primarily to maximize consumer welfare.

“By logic of their mandate, competition policy enforcers…are (or should be) concerned with enhancing the welfare of consumers, not with maximizing producer profits….consumer welfare is higher when producers set prices competitively than when pricing is cooperative or collusive. This occurs because monopoly prices transfer purchasing power from consumers to producers, because monopoly pricing inefficiently distorts the allocation of resources, and because a high-price position may permit producers to become fat, wasteful, and unprogressive.”

Goals of Competition Policy in Perspective

Richard Posner quite correctly provides some caveats to the use of economics in deciding policy goals, such as those for competition policy.

“If income and wealth were distributed differently, the pattern of demands might also be different and efficiency would require a different deployment of our economic resources. Economics does not answer the question whether the existing distribution of income is good or bad, just or unjust although it can tell us a great deal about the costs of altering the existing distribution, as well as the distributive consequences of various policies; neither does it answer the ultimate question whether an efficient allocation of resources would be socially or ethically desirable. Nor can the economist tell us whether, assuming the existing distribution of income and wealth is just, consumer satisfaction should be the dominant value of society.”

Government, business policies that affect production, consumer choices

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25 Supra note 1. Though other economists argue that even a monopolist wants “more” profits, and would be equally driven to lower its costs as competitive firms.
26 Supra note 23.
The late Harvard professor Phillip Areeda provides further insight into the limits of both economics and competition policy to provide readily the benefits of competition. He explains that many industrialized countries rely on market forces to stimulate innovation, to minimize resource waste, and generally to satisfy consumer wants at minimum cost. But the competitive process occurs within, and is affected by, the general ground rules provided by the law of contracts, products liability, business associations and other government policies such as taxes, transfer payments and trade policy. Broadly speaking, governments affect the general level of economic activity (and thus producer and consumer incentives and ability to make or buy products) through monetary and fiscal policy.  

Ross Singleton in his article on competition policy in developing countries, argues that government is the single-most important source of monopoly distortions. In this article he also cites a World Bank publication that points to trade restrictions, regulatory entry and exit barriers, and price controls, among others, as significant impediments to competition. Once again, to better achieve the benefits of competition, the various government ministries, leaders, business people and public need to have a clear understanding of the benefits of competition and their role in promoting or impeding it. Competitors, all else equal, would rather not face the rigors of competition. We will discuss the various types of conduct firms engage in to avoid or limit competition in the next section. Addressing such conduct is, obviously, one of the most important roles for a competition authority.

**Size of welfare losses from monopoly and the cost of competition policy**

Some economists have argued that deadweight loss of monopoly is not large, and therefore have led some to conclude that the benefits competition policy are, necessarily, not large as well. Arnold Harberger, in a seminal paper on the topic, calculated that deadweight loss in the U.S. economy was less than 0.1 percent of gross national product (or “GNP”, the value of goods and services produced by a country’s firms in a year).

Many economists have since debated the findings, both conceptually and technically. Some argue that Harberger’s results underestimate the true deadweight loss as they ignore “non-price” dimensions of economic value, such as quality, and innovation over time. Also, Harberger examined U.S. industries, so inferences about deadweight loss in a developing or transition economy may be misleading. Richard

27 Supra note 11.
Posner argues that Harberger’s estimate does not capture the waste of resources on “rent-seeking” behavior (the use of resources to secure a monopoly), such as lobbying government for restrictive entry regulations or other expenditures to restrict or eliminate competitors. Posner estimates deadweight losses in some industries up to thirty percent of revenues. His work shows that a great part of these welfare losses may be due to government insulation of firms from competition.

Finally, even though deadweight loss estimates may be small in relation to GNP, they may represent a significant redistribution of wealth from consumers to producers and this may be an important policy consideration. Also, from a cost-benefit perspective, the “benefit” of less deadweight loss may be greater than the “cost” of competition law enforcement, so investment in competition policy may be worthwhile.

**Difficulty identifying inefficient behavior**

Carlton and Perloff point out that even if the goal of competition policy is efficiency, economists often have difficulty determining which practices will result in inefficient behavior. They present the example of a merger in which competition would be lessened and prices to consumers would rise. This would appear to be undesirable from an antitrust perspective. They then suppose that the merger produces a new, low-cost method of production or a new product that otherwise would not have been produced. This seems to be a benefit to society. So in evaluating possibly inefficient behavior, factors such as the magnitudes of the price increase and the efficiencies, the timing of response by rivals, and the likelihood and importance of merger-created innovations for future competition all should be weighed. In Section III we will examine more closely the various factors relevant for assessing the competitive effects of firm behavior.

**Competition Policy Goals Chosen by Various Countries**

Efficiency and consumer welfare maximization appear to be the most common goals of competition policy around the world. Other goals cited or implied in the laws of various countries include protection of small or medium-sized businesses (or discouragement of excessive concentration of economic power in the hands of a few market participants), removal of inefficient government regulation, and equality of access to markets. Some of these goals, superficially, may seem to be ways of encouraging competition (i.e. keep a large number of firms in an industry). Careful examination of these goals may reveal that they may keep more firms in an industry than is efficient. Distortions may keep a firm investing in paper-making machinery when society’s resources may be better used in e-commerce, for example. Merger regulations, as noted

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earlier, often provide good information about the relative importance of such goals, as the frequency of mergers and their potential significant impact forces countries to address and codify their decisionmaking principles.

**UNITED STATES**
The United States, as articulated by the U.S. Department of Justice and Federal Trade Commission in their *Merger Guidelines*, puts primary importance on the goal of maximizing consumer welfare, when efficiency and consumer welfare objectives conflict. In general, mergers are presumed to be motivated by legitimate business concerns and that they will result in better products and production methods, thereby enhancing efficiency. These mergers may increase competition both now and in the future. A small percentage of mergers each year in the U.S. give rise to concerns about possible anticompetitive behavior and consumer harm, both in the short and long term. The agencies are concerned about the increased ability to collude or unilaterally to raise prices and restrict output.

Efficiencies are considered as possible “offsets” to potentially anticompetitive mergers, for example, but “almost never justify a merger to monopoly or near-monopoly.”31 Other mergers may present minimal likely anticompetitive effects that may be offset by significant efficiencies, and thus allowed to proceed.32 The efficiencies to be considered in the balance of a competition-lessening merger, must be merger-specific (i.e., not achievable by other less restrictive means) and reasonably verifiable. While speculation is involved in assessing the potential future competitive harm of a merger as well as its potential efficiencies, the U.S. antitrust agencies place more emphasis on evaluating the likely competitive effects.

**CANADA**
Canada, on the other hand, seems clearly to favor an efficiency, or total welfare approach, when its goals for competition policy conflict. Margaret Sanderson, former Acting Director of Economics for the Bureau of Competition in Canada, writes that when reviewing merger transactions, Canadian competition legislation resolves the conflict in favor of the merger when the likely efficiency gains are greater than and offset the likely anticompetitive effects.

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32 One important question is whether the benefit of the efficiencies (e.g., lower costs) would be passed along to consumers in the form of lower prices. Merger efficiencies that benefit consumers are more compelling to the agencies that efficiencies that only benefit producers.
She explains that the need for an emphasis on efficiency is quite important in a small economy, like Canada. Concentration levels are high in many Canadian industries, yet firms may not be operating at minimum efficient scale. In addition, regulatory constraints and trade barriers may have led to higher costs of production. Sanderson explains that a result, efficiency gains are realizable, in certain industries, through greater specialization and by achieving potential economies in production, distribution, and marketing. She also points out that this is advantageous for Canadian firms trying to compete in an increasingly international market.

To be precise, Sanderson explains that in Canada, anticompetitive effects refers to deadweight loss to the Canadian economy as a whole, attributable to the diversion of resources to lower-valued uses. The total welfare approach has the effect of increasing the sum of producer and consumer surplus, but views transfers of wealth from consumers to producers as neutral. In contrast, a “price standard,” whereby the prices charged by the firm post-merger must not rise, views consumers as more deserving of a dollar than producers.  

MEXICO

Mexico also appears to give significant weight to the total welfare approach. A recent OECD review of competition law in Mexico states that “efficiency is the primary, and perhaps the sole, criterion for applying the competition law.”

In a 1998 APEC workshop the Mexican delegation reported that when dealing with mergers and acquisitions that may have anticompetitive aspect but would nevertheless lead to technological improvements, the Commission assigns top priority to identifying solutions that will eliminate their anticompetitive aspects but not affect the gains in competitiveness arising from them.

The delegation also pointed out that competition policy should work with other pro-market reforms so that efficiency gains and consumer welfare improvements are achieved effectively. Pro-market reforms in most transitional and developing countries seem to share common themes: pursuing competitive market

structures through the process of privatizing state enterprises, liberalizing trade and eliminating excessive regulation.

EUROPEAN UNION
The European Union espouses many goals, including efficiency, consumer welfare, the protection of small business and to some extent, the political goals of Community-wide integration. The EU appears to have mixed goals. EU competition policy provides protection for consumers through prohibitions against “abuse of dominance” by opposing excessive pricing, but also seem to protect small business, which may be at the expense of efficiency. For example, the EU law provides exemptions for restrictive horizontal agreements that may be efficiency enhancing, but not for dominant firms, however. This implies a goal of limiting the concentration of economic power, and the protection of competitors, even at the possible expense to consumer welfare and total welfare.

AUSTRALIA
Australia takes a primarily consumer welfare approach to competition policy. For example, the revised Merger Guidelines state that the analysis of efficiencies must be integrated within the framework of competition analysis, rather than being considered as a “trade-off” with competition effects. In a merger analysis, the magnitude, speed and probability of the various efficiencies flowing to consumers are important considerations. The relevant question is the effect or likely effect of the merger on firms’ abilities and incentives to compete in the relevant market and create benefits to consumers.

CHINESE TAIPEI
Asia provides us with additional examples of countries that put significant weight on total welfare or efficiency considerations, but have numerous exemptions and exceptions to this rule. Chinese Taipei merger policy must balance the proposed benefit to the economy as a whole with the possible disadvantages of lessened competition. Article 14 strictly prohibits certain types of concerted actions,

35 Speech: Competition Policy in Developing Countries: The Case of Mexico, by the Mexican delegation. www.apeccp.org.tw/doc/Workshop/1998/doc5.html
36 Kalypso Nicolaides and Raymond Vernon, “Competition Policy and Trade Policy in the European Union,” in Global Competition Policy, supra note 16.
37 See, Articles 85 and 86 (now 81 and 82) of the Treaty of Rome, and Council Regulation No. 4064/89 on the control of concentrations between undertakings.
38 Australian Competition and Consumer Commission, revised Merger Guidelines, June 1999, Section 5.17.
39 See Article 12 of the Fair Trade Law.
regardless of their potentially efficiency-enhancing effects, but may choose to approve them with prior authorization.

JAPAN

Japan is interesting in its long-held aversion to the idea of competition. In Japan, political, social and economic goals other than competition have occupied relatively more important positions over time. According to Douglas Rosenthal and Professor Mitsuo Matsushita, “…the idea of competition generally, and of economic competition in particular, has often connoted something dangerous and unstable – in Japan the work is often preceded by the adjective “excessive.” …Vigorous competition has long been missing and is missing still from many aspects of Japanese economic life. Japanese culture has not traditionally embraced the idea of competition as expressed by Adam Smith.” They note, however, that free market reforms are more accepted in Japan now than years ago and that Japan is now enforcing its antitrust laws more vigorously. They believe that consumer sovereignty is gaining more acceptance and as well as the need to improve production and distribution. For example, the number of exempted cartels has been reduced from 1,079 in 1965 to 248 in 1991. The authors state that it is “widely recognized that such cartels tended to be inefficient and to raise prices artificially.”

The authors identify eight goals of economic competition, these being economic efficiency, fairness of business practices, equality of market access, absence of inefficient government regulation, discouragement of excessive concentration of economic power in the hands of a few market participants, restriction of collaboration among competitors that facilitates collusion, promotion of consumer sovereignty by encouraging manufacturers to give consumers the products and services they want, and to lower the costs of production and to pass them on to consumers. The authors also point out that increased efficiency has sometimes been met with trade sanctions by their trading partners’ countries -- countries whose consumers benefit from the increased production efficiencies in Japan. They point out that though many countries have similar goals for competition policy, differing degrees of implementation, enforcement, and across-sector harmonization of policies to achieve these goals may render competition policy ineffective.

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41 Douglas Rosenthal and Mitsuo Matsushita, “Competition in Japan and the West,” in Global Competition Policy, supra note 16.
While the goals of competition policy in Japan have been debated, it nevertheless has experienced economic stagnation and has seen its consumers pay higher prices than many other places in the world. K.C. Fung reports in a recent paper examining deregulation in Japan, that there is a large price gap between Japan and other industrialized countries. He acknowledges that many point to implicit and explicit trade barriers and other rigidities that have kept imports low and prices in Japan high. He find that prices in Japan were on average 41% higher than in the U.S. in 1989 and 37% higher in 1991. Prices for products associated with Japanese firms were about the same in Japan and in the United States.

III. Elements of Competition Policy

Clear and Simple Goals

Competition policy should have clear and simple goals. This reduces uncertainty in the business environment and aids enforcement. Many business dealings are quite complex and people outside a business may not understand its product, much less the subtleties of its arrangements with suppliers, distributors and customers. Therefore, in the absence of evidence of anticompetitive behavior, businesses generally should be allowed to carry on their activities without government regulation or intervention. The core task of a competition authority is to distinguish between procompetitive and anticompetitive behavior. This is often not an easy task.

Many competition commissions around the world investigate many types of business behavior, ranging from arrangements between farmers and traders to refusals to license intellectual property in high-tech products. It would be useful to begin a more concrete discussion of firm behavior and the role of competition policy by focusing on the two main concerns of competition policy around the world, collusion among competitors (cartel behavior) and abuse of dominance (monopolization or attempted monopolization through unfair means).

Examples of Anticompetitive Behavior

Collusion among competitors

The most blatant, anticompetitive form of collusion among competitors is price fixing. Price fixing by competitors is harmful to consumer welfare. Competitors agree to set price at a level higher than if they were competing against each other for customers’ business. Sometimes firms set an exact price,

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sometimes they set a “floor”, which is a price level below which the cartel member will not sell, even though it would be profitable to sell below that price. Consumers are unambiguously worse off because they must pay higher prices than if there were competition. Producers are better off because they are receiving higher profits, but efficiency is not improved. The firms are “acting” like a monopolist, but not producing with lower costs or greater efficiency. They are simply engaged in a conspiracy to get more money.

Price fixing is not simply setting a price unilaterally. For example, a canned fruit processor may announce a set price it will pay for peaches during a particular harvest. This may save the processor from negotiating prices with dozens of farmers, for example. Farmers may decide to sell at that price or sell to someone else. In this case, the processor is competing with other processors for the harvest, so the price offered should be competitive, subject to other factors, such as location of its factory and shipping costs. The possibility of another processor offering to pay more to get the harvest is a real factor the first processor must consider while determining the price it would offer. If, however, all the processors decide together to set a price lower than what they would each pay competing against each other, then the processors are colluding. They are acting like a monopsonist. The farmers are worse off because competition is restricted.

It may be the case that only one canned fruit processor is within practical shipping range for the raw fruit. This may be due to perfectly legitimate factors, such as low demand for canned fruit, so that only one firm with scale economies can exist profitably. This would not be considered an anticompetitive situation even though there is only a single buyer. It is a natural market outcome. A farmer may choose to sell to the processor at terms the processor sets, or use his land for other more profitable uses.

Because there is usually little or no reason to fix prices with competitors, this practice is usually deemed “per se” illegal. Investigation into possible efficiency justifications or other mitigating factors are not worth the resources of the competition authority. The admonition not to collude on price with competitors is also a simple rule that businesses can understand.

Sometimes consumers face the same price from all suppliers in a market. Is this evidence of price fixing? It is almost impossible to tell without further detailed analysis. A uniform price may result from vigorous

(...continued)

43 To be more precise, monopolization is parallel to single firm abuse of dominance.
44 A monopsonist is a single buyer. The analysis is essentially the same as that of a monopolist, or single seller, except monopolists may harm buyers and monopsonists may harm sellers. Both harm efficiency.
competition or price fixing. For example, airlines may exactly match each others’ fares on various routes because they’re competing, not colluding.

**Abuse of Dominance**

The second major type of anticompetitive behavior is called “abuse of dominance” in many parts of the world and “monopolization” or “attempted monopolization” in the United States. It is unfair behavior by a large firm to gain or to maintain its market power. In Japan, the United States and the European Union, for example, the mere possession of a monopoly or market dominance is not, by itself, *per se illegal*. The reason is that competition policy serves to promote competition, but competition will not be fostered if the result of success is punishment. As one noted American judge, Learned Hand, said years ago, no one would be interested in entering a race that punished the winner.

If a firm grows in size and drives its competitors from the market by superior skill and innovation -- offering better products and services at lower prices to consumers -- it makes more sense to reward rather than attack this behavior. If, on the other hand, a firm misuses the power it obtains to injure consumers, that effort can and ought to be deterred by competition policy. But even for firms with monopoly power, one must separate conduct that misuses that power from conduct that is procompetitive (such as supplying better products and services).

So what are examples of abuse of dominance? In this section, we will focus on exclusionary practices. One example is when a dominant firm attempts to exclude or to limit entry into the dominant firm’s market. One recent case involved a branded drug manufacturer acquiring exclusive licenses from suppliers of a particular drug’s active pharmaceutical ingredient (“API”). This would prevent other generic drug manufacturers from entering and competing with the first firm. U.S. Federal Trade Commission deemed there was no legitimate business justification for this foreclosure of the market – that the firm’s actions were aimed at maintaining monopoly profits. Consumers were worse off with higher prices for a longer period of time, as entry was prevented.

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45 In antitrust laws, term that implies that certain types of business agreements, such as price fixing, are considered inherently anti-competitive and injurious to the public without any need to determine if the agreement has actually injured market competition.

A dominant firm may also attempt to deny market access to a competitor by penalizing or refusing to supply distributors who might do business with the competitor. If the costs of duplicating the distribution system are high enough, this behavior would prevent entry and help maintain the dominant firm’s monopoly profits. In this situation, there likely is no procompetitive business justification – just avoiding competition. On the other hand, some manufacturers have built or developed a distribution network. The fact that an entrant would have to incur similar costs to enter (build a distribution network) does not make a refusal by integrated distributors to carry the entrant’s products anticompetitive. Firms generally should be able to decide with whom they conduct business. Generally speaking, the incumbent who invested in the distribution network should not have to provide access to a competitor. An entrant is not entitled to a “free ride.” Such a requirement might discourage this type of investment in the future.

Analysis of Anticompetitive Behavior and Mergers

The brief discussions above show some of the factors necessary to consider to properly and fairly evaluate the behavior of firms. Some economists and antitrust practitioners focus on examinations of and inferences from market structure (number and size of firms and market share). While a useful first “filtering” step in a competitive analysis, market share or structure alone are by no means dispositive of anticompetitive behavior. In some cases, economists focus more narrowly on a firm’s, or group of firms’, behavior and ignore market structure almost completely. We will now discuss some of the most relevant factors in more detail.

Relevant market

Often the first step in evaluating the possible anticompetitive effects of firms’ behavior is to estimate their market shares within a properly-defined relevant product and geographic market. Market share cutoffs may be useful in determining whether there is a presumption of market dominance. For example, firms with small market shares are unlikely to have, much less abuse, dominance and numerous small firms in an industry are less likely to collude successfully as fewer firms.

Although the exact method of defining relevant markets is somewhat arbitrary, it is important to evaluate the demand and supply substitution alternatives before computing market share. For example, the U.S. Merger Guidelines’ market definition test is designed to determine whether a hypothetical monopolist of a market segment could profitably increase prices by a small amount without inducing demand-side substitution by

47 In the case of a natural monopoly, such as local telephone service, the government may dictate access to the lines and switches to entrants in order to foster competition that otherwise would not develop.
consumers or supply-side substitution by other firms. If either of these responses would defeat a small but significant non-transitory price increase, then the market segment is too narrowly defined.

For example, one may be tempted to say that Indonesia defines a relevant geographic market for the sale of chemical fertilizer, for example. Who are the competitors and what are their market shares? Suppose only one firm in Indonesia produces chemical fertilizer for sale in Indonesia. Does this firm have a monopoly? There are two dimensions by which competition from outside the proposed relevant geographic market of Indonesia may constrain the “monopolist.” First, there may be sufficient capacity among foreign producers to import chemical fertilizer into Indonesia in the event the “monopolist” producer attempted to increase price. Second, there may be sufficient domestically-produced alternatives to chemical fertilizer such as organic fertilizer to prevent a firm with a large share of sales in Indonesia from having market power. If foreign producers may readily shift sufficient supply of chemical fertilizer to Indonesia to defeat a price increase by the domestic “monopolist” then in this case, we would conclude that the relevant geographic market is larger than Indonesia – perhaps Southeast Asia or perhaps the world. If sales of organic fertilizer constrain the prices of chemical fertilizer, then the relevant product market may be “chemical and organic fertilizers.” Market shares would be calculated based on the sales and/or capacity of both domestic and foreign producers of organic and chemical fertilizers.48

**Barriers to entry**

The view that reducing barriers to entry is a good method of gaining the benefits of competition is well accepted. Scherer states, “By striving to maintain a diversity of competitors and keeping entry barriers from being raised unnecessarily, antitrust is at least pointing in the right direction.”49 Economist Ross Singleton notes that absent government-created barriers to entry, large firms in concentrated markets must respond efficiently to changing market conditions or “go the way of the dinosaur.”50 The threat of entry by innovative newcomers forces incumbents to pursue product and process innovation. Obviously Singleton’s comments must be taken in the context of an absence of other anticompetitive behavior or distortionary non-governmental barriers to entry.

Barriers to entry are relevant for competition policy in two primary ways. One is to evaluate the likelihood, timeliness and sufficiency of entry by firms to defeat price increases by incumbent or merging firms. This

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48 A more complete discussion of defining relevant markets and calculating market shares is beyond the scope of this report.
49 F.M. Scherer: Efficiency and Progress, in Monopoly & Competition Policy, supra note 21.
50 Supra note 33.
may be part of a merger analysis, for example. The other is to evaluate whether barriers to entry were erected unfairly to deter competition or are a “natural” feature of a particular market.

Firms usually incur costs to enter a market. Entry may be by a new firm, by a firm producing the same product in a different country, or by a firm producing unrelated products but owning a shipping line, for example. The costs for each of these firms to enter the same “new” market vary. For example, the costs for a new firm entering canned fruit processing may include buying a factory and machinery, hiring workers, advertising, paying for permits and contracting with distributors to carry its product. Entry by a foreign firm may simply entail shipping the product to retailers in the prospective market or may entail selling and monitoring franchises in the new market area. In another industry, entry may simply be the cost of telephone service, through which someone may provide counseling services. These are simply “normal” costs of entry.

In evaluating the potential competitive effects of a merger, for example, and as part of defining the relevant market, the commission must examine potential entry. If the costs of entering are low, or even if they are high, but easily recoupable, firms may enter a market quickly. This entry may be sufficient and timely enough to defeat any potential price increases by the merged firm, so the merger is approved. An example of this may be glass lighting fixtures. These are easily designed and manufactured. They are light, so shipping costs, as a percentage of total value is fairly low (i.e. shipping great distances is not prohibitive). Finally, lighting fixture distributors typically are independent and carry a wide variety of styles. Two domestic manufacturers may wish to merger. Evidence shows significant imports from neighboring countries at competitive prices. Domestic manufacturers of other glass products could easily begin producing lighting fixtures. Supply can increase almost overnight. This merger would likely have no anticompetitive effects. On the other hand, even with low barriers, firms may not enter. This may be due to the small size of the domestic market, for example. Alternatively, the cost to enter on a small scale may be low, but the cost to enter on a scale to be competitive with an incumbent firm with scale economies may be quite high.

Some say that costs that must be incurred by entrants that were not incurred by incumbents are indicators of anticompetitive barriers to entry. This is too broad a statement. For example, firms entering the personal computer market today may incur lower costs than incumbent firms years ago. Tariffs or quotas that incumbent firms overcame may be gone today. Or firms in related markets may incur only incremental costs to enter a new market that an incumbent entered as a new firm.
Anticompetitive barriers to entry (or barriers created by firms to limit competition) must be analyzed carefully on a case-by-case basis. One example may be foreclosure through long-term contracts with suppliers or customers in order to lock-out competitors, without legitimate business justifications (such as risk-sharing). Another example is tying the purchase of one product (say a web browser) to the sale of a monopolized product (PC operating systems) to prevent or limit entry into the first product market.

**Concentration**

Economists have long studied the relation of industry structure, conduct and performance and the debate continues about their connection. Viscusi, Vernon and Harrington relate, “...there is controversy at the present time among specialists in industrial organization concerning this structure-conduct-performance relationship. Some argue that there is neither good theoretical nor empirical evidence that supports the hypothesis that structure determines performance; others contend just the opposite. An increasingly influential viewpoint seems to be that differences among industries are so complex that simple generalizations (for example, fewer sellers lead to high profit rates) are invalid.”

As we’ve pointed out previously, a proper competitive analysis involves investigating and analyzing numerous factors. Simply looking at published industry SIC-code based concentration ratios to infer anticompetitiveness of markets would be misleading. These concentration ratios are not calculated within a relevant economic market. They do not include firms making products that are good substitutes in demand for the product in question. They may provide some information about the rate of entry and exit of firms over time, general information about the relative sizes of firms serving the domestic market and the reaction of industry participants to changes in other policies, such as trade barriers or deregulation. More discussion of the useful information provided by concentration ratios in general, and as they pertain to Indonesia in particular, will follow in Section IV.

**Examples of other Types of Anticompetitive Behavior**

**Allocation of Customers, Territories**

Generally speaking, competitors who agree not to compete with each other are engaged in anticompetitive behavior. We previously discussed price fixing. Related anticompetitive behavior includes allocating

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52 Ibid.
customers or territories. Firms may decide together to allocate particular geographic areas to particular competitors. They agree not to sell or otherwise compete for sales in each others' territories. This practice reduces consumer surplus as customers pay higher prices than if more than one firm was competing for his business. Similarly, competing firms may agree to allocate certain customers to certain firms. One form of this is bid rigging. For example, suppose four construction firms bid for large building projects throughout the year. Suppose that they agree to take turns winning the bids by agreeing which firm would win each bid. The consumer, in this case the building owner, is harmed by having to pay higher prices than if the four firms competed actively. Consumer surplus is reduced and efficiency is not improved.

When discussing vertical arrangements between a manufacturer and a distributor, agreements between these parties to designate exclusive sales territories or customers may be procompetitive and efficient. For example, say Coca-Cola gives its distributors exclusive territories. This means that the distributor is not competing in its territory with other Coke distributors. He reaps the benefits of his sales efforts. If there is exclusive dealing (carry only one product) as well, the distributor concentrates on competing with Pepsi or other soft drink distributors to get grocery and other stores to carry/sell more of his product. A classic reason for exclusive territories is to prevent free-riding. For example, a furniture dealer may build and beautifully decorate a showroom to help sell the furniture. A dealer setting up shop next door with a catalog and lower prices because he has not invested in the showroom may free ride on the first dealer’s efforts. The first dealer will have a disincentive to invest and advertise if someone else gets the benefits. Consumers were better off in the short run with lower prices and information gained at the showroom. In the long-run, without the showrooms, consumers may have less information and incur search costs.

**Resale Price Maintenance, Other Vertical Restrictions**

Resale price maintenance is the agreement by manufacturers and retailers on a price or a minimum price to resell products. Once again, fixing prices, this time in a vertical relationship, deprives downstream purchasers of the benefits of competition. Retail price maintenance may also be used as a way of facilitating and policing cartel behavior. A hypothetical example may be if video game manufacturers agreed to fix prices. If each manufacturer then successfully set prices with retailers, then any deviations from the agreed price in any stores would indicate cheating on the cartel agreement.

While vertical price restrictions are considered anticompetitive, other vertical agreements between manufacturers and retailer, such as exclusive territories, usually have valid business justifications. For example, a manufacturer may require retailers to carry a certain amount of product in inventory, offer a
service plan, or dress in uniforms. The key issue to keep in mind with vertical agreements is to consider if the restriction helps or hinders competition.

**Tying, Boycotts**

Tying, as discussed previously, involves conditioning the sale of one product on the sale of another in order to harm competition. If the consumer does not want the “tied” product or could purchased it at a lower price independently, then consumers are harmed. Generally speaking, if a firm does not have market power in the “tying” good, then it is unlikely consumers can be harmed. Let’s say that in order to buy a computer printer, a consumer also had to buy a box of computer paper from the same manufacturer. If the printer manufacturer has no market power in the printer market, the tying is unlikely to cause consumer harm, as consumers have other choices to turn to and defeat the tying scheme. Or they may buy the tied “package” if the total price is lower than the total price of the items purchased independently. This example of tying does not harm consumers.

A current case in the American judicial system relates to allegations that Visa tied the acceptance of its debit card to acceptance of its credit card. The allegation is that Visa wanted its debit cards (or check cards) to be accepted by merchants. Instead of allowing merchants to choose if they wanted to accept these cards, Visa allegedly told merchants that if they wanted to continue accepting Visa credit cards, they had to take Visa debit cards too. Plaintiffs argue that this gave Visa an unfair advantage over competing bank network debit cards.

Sometimes firms are concerned with the perceived reliability of their products and “tie” parts and service to the sale of the original equipment. Third-party service companies have complained that this foreclosed competitive opportunities to them, and caused the owners of such equipment to pay higher parts and service prices than with if the third parties could supply or serve the customers as well. Some economists argue that consumers understand that equipment will need service and parts over its life and include such considerations into their original purchase decision. If competition exists in the market for the original equipment, consumers will not be hurt by lack of subsequent competition to service the equipment, given consumers knew this at the time of the original purchase. The issue is how to evaluate reputational arguments to understand if the restrictions are legitimate or aimed to lessen competition.

53 Visa Check / Mastermoney Antitrust Litigation.
Boycotts may include exclusionary behavior by horizontal firms to deter entry, as discussed previously in the example in which manufacturers may refuse to supply a distributor who begins carrying a foreign firm's products, for example. The purpose is to restrain competition. Firms might also agree not to purchase inputs from a particular seller unless prices are reduced or other conditions met.

IV. Competition in Indonesia

Introduction

By March 2000 the Indonesian national business competition law will be implemented. The question that policy makers and Indonesians at large will be asking is whether there are competition problems in Indonesia, and if so, how extensive the problems are. If competition problems are found, and are extensive, then the next question will be about their sources. At this point, questions of methodology and tools of analysis become relevant and important. How do we identify a competition problem, and how do we measure the extent of the problem? Further, how do we relate these problems to their sources?

Competition policy, though widely discussed in the economic literature, is relatively new to Indonesia. Although Indonesians are aware of many situations and environments that deviate from what is commonly believed to be competitive, their understanding of competition issues may not coincide with the academic understanding. Indonesians have observed how conglomerates with strong political ties to policymakers have received monopoly franchises from government. In many cases these conglomerates exploited their power at the expense of the public or certain groups in the economy such as small businesses. As a result, a general perception has developed among the public, and to a great extent among policymakers, that anticompetitive behavior is linked to market concentration or conglomerates. Although there may be merits to these perceptions, many of them may not be in line with the academically-accepted understanding of competition problems. Competition is a complex issue that may sometimes defy common logic.

After the competition law was enacted in March of 1999, there have been expectations from the public that the law would correct what the public perceived to be anticompetitive conduct by various parties. Small business interests, for example, expect that this law will protect them from what they see as unfair practices by large enterprises. These types of conduct may seem to be unfair, but may not necessarily be violations of the competition law. Many also hope that the law will inhibit KKN (the Indonesian abbreviation for collusion, corruption, and nepotism). The law is not designed for such purposes, though it could reduce KKN indirectly to the extent that it reduces opportunities for rent-seeking that fuel KKN. In any case, it is crucial that the public be educated on what competition policy is, what constitutes anticompetitive conduct, and which anticompetitive practices can handled by the competition law.
Benefits of Competition for Indonesia

An Example from the Clove Industry

Competition in general is good and healthy for Indonesia. One superb example of how competition would have produced a better result for the Indonesian economy is given by the experience during 1991-98 with the clove monopoly under the BPPC (Badan Penyangga dan Pemasaran Cengkeh, or Clove Support and Marketing Board). Government intervention unfortunately distorted the competitive process and resulted in higher prices to consumers, lower prices to clove farmers and reduced supply of cloves and kretek cigarettes.

One of the primary objectives of the BPPC was to maintain a floor price for cloves at the farm level that was higher than in the past. However, in clove-growing areas throughout Indonesia, farmers reported declining prices under the BPPC. Official statistics also indicate that clove farmgate prices were, on average, lower during the BPPC era than either before or after. Moreover, the fall in prices in real terms was more rapid than during the previous decade.

Another objective of the clove trading system was empowerment of the village unit cooperatives (KUD, or Koperasi Unit Desa) along with the central cooperative organizations at the district (PUSKUD) and national (INKUD) levels. Under the BPPC system, although some cloves were sold to KUD at the official floor price, most were rejected due to either lack of KUD funds or spurious quality criteria, which depressed prices further. The KUD generally purchased less than 20% of cloves directly from farmers. The exclusion of most cloves from the official KUD purchase scheme forced farmers to make heavily-discounted sales to private traders favored by the KUD, who then unofficially sold the cloves to the KUD.

Even for the small proportion of cloves sold directly to the KUD, prices were lower, even if one includes in the price the Rp 1,000/kg that was collected from the farmers by the KUD under a forced savings scheme (SWKP), an amount that was refunded to farmers typically only after a delay of two years if at all. By all accounts, no cloves sold unofficially to traders (who then sold unofficially to the KUD) were eligible for reimbursement under the SWKP scheme. In addition, payments to farmers for cloves sold directly to the KUD were often delayed by several months.

Some Official Clove Price Data

Data from prime clove-growing areas on the island of Sulawesi reveal the impact of BPPC on clove prices. Data from North Sulawesi in Table 1 show that market prices (in nominally illegal sales to traders) for most cloves during the seven years of BPPC were on average half what they had been in the seven years prior to BPPC. In real terms this price decline was even more pronounced.

Similarly, in Central Sulawesi, farmers and others reported that clove prices on the open market were much lower under the BPPC than they had been before. Aggregate data for the period before the BPPC were not available for the province. However, Table 2 shows the low prices for the second through sixth years of the BPPC. Table 2 also shows that there was only a small improvement in prices in 1997—indeed that prices were lower in December than in September 1997, even though the rupiah price of dollars had already more than doubled relative to its value in June 1997. By February 1998, with BPPC formally ended, the clove price had doubled relative to its value in September 1997.

Low farmgate prices for cloves, a direct result of the BPPC system, discouraged farmers from caring for their clove trees. The end result was a decline in clove tree productivity and reductions in planting. It is likely that a third of standing clove trees are now dead, a third are severely debilitated and a third are in moderate to good condition. Provided the BPPC or some other similar mechanism is not reinstated, higher prices probably will be sufficient to persuade farmers to improve cultivation of existing trees and to plant new trees. Indeed, in 1999 it was reported that clove prices had reached as high as Rp 30,000 at the dealer level, up from Rp 8,000 to 10,000 previously. Increased supply in the future should eventually push prices down, in the absence of further disturbances to the market.

The declared social goals of the clove monopoly were not achieved primarily because the policy instrument itself was at fault: it is illogical to suppose that replacement of an oligopsony in which there was considerable competition (the kretak cigarette industry) with a monopsony (BPPC) will lead to better market performance.

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An Example from the Sheet Glass Industry

The Indonesian sheet glass industry provides an example of how deregulation resulted in increased competition, even in the face of high concentration. Until the mid-1980s the sheet glass industry in Indonesia was characterized by a protected monopoly. There was one producer supplying the domestic market (Asahimas Flat Glass, a joint venture between Asahi Flat Glass of Japan and a local partner, Rodamas group). Imports were greatly restricted by relatively high import tariffs and there were quantitative restrictions. New investment was also restricted.

In the mid-1980s the government began to deregulate the industry. First, the government opened up the industry to new investment. In the late 1980s the government eliminated quantitative restrictions on imports and gradually reduced tariffs to 25% by 1995 and to 5% by 1997. By the late 1980s three new companies entered the industry. The largest of these was owned the local partner of Asahimas glass (Rodamas group). Asahimas and Rodamas group merged their companies in 1991. Thus, the industry remained dominated by one company with market share well over 90%.

Muliaglass (a conglomerate with activities in the construction industry) commenced construction of its first sheet glass plant in 1989 and by December 1992 began commercial production. Within three years Muliaglass had captured about 30% of the domestic sheet glass market, mainly at the expense of Asahimas which saw its market share decline from over 90% in 1991 to 60% by 1995.

In anticipation of Mulia’s entry, Asahimas dropped prices in 1992. The smaller firms lobbied the Minister of Industry and in May 1992 the minister issued a letter (Surat No. 505.I/M/5/1992) requesting Asahimas to increase its prices back to pre-price war levels. However, with the entry of Mulia Glass the industry is characterized by periodic price wars, and prices, on average, have remained relatively low since its entry, despite the fact that the combined market share of the two firms was about 90% in 1995.

Market Concentration Issues

How do we start to look for possible anticompetitive behavior in the economy? The most common way is to examine the market concentration of an industry. This is consistent with the economic literature, since high concentration makes it easier for firms to collude and to exercise market power to their advantage. However, high concentration is neither necessary nor sufficient for anticompetitive conduct to occur. Although it cannot be denied that anticompetitive behavior occurs in many highly concentrated industries,
merely looking at market concentration is unlikely to provide a true picture of the level of competition in the industry. Measuring market concentration may be a useful first step in a competitive analysis.

The issue of high market concentration deserves further elaboration since the Indonesian law uses market structure as one of the bases for creating a presumption of anticompetitive conduct in an industry. In fact, public officials as well as private observers have often used market concentration as an indicator of the extent of competition problems. The level of market concentration in Indonesia is relatively high, particularly in some manufacturing sectors, and this fact can be used erroneously to conclude that such sectors are not competitive. It is, therefore, important to look deeper for the reasons behind the high concentration and how it relates to the degree of competition and ultimately the efficiency of the market. As discussed earlier, the proper definition of the relevant economic market is critical. It is within this well-defined product and geographic market that market shares and thus market concentration should be calculated.

**Recent, Relevant Empirical Studies**

Market concentration, measured as the combined market share of the four largest firms (CR4) or as the Herfindahl-Hirschman Index, is commonly used as a first step in analyzing industry competitiveness. A firm is said to have market power if it can affect the price it receives. Market power also implies the ability to profitably set price above marginal cost. There is an extensive body of research that tries to link market concentration to the level of economic profit. In many studies conducted in developed economies, the relationship has been found to be positive and statistically significant. That is to say, market power tends to exist in highly-concentrated industries. However, it cannot in any way be concluded that high concentration in an industry implies the existence of market power in that industry. The degree of market power a firm possesses may also be measured by the Lerner Index: the amount by which price exceeds marginal cost, as a percentage of marginal cost.

Moreover, the relationship between high concentration and market power appears to be less prevalent in developing economies. Kirkpatrick, Lee, and Nixon (1984) provide an extensive review of market

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57 Price would equal marginal cost in a perfectly competitive market, which would provide no excess profits. The exercise of market power will lead to enjoyment of excess profits. Marginal cost is defined as the additional cost incurred per additional unit of output produced. It can be very difficult to measure in practice.
concentration-performance studies that have been conducted in developing countries. Most of the studies tend to show that the relationship is not statistically significant. Shauki (1998) conducted a similar study using data from Indonesian manufacturing industry and obtained similar results. According to Kirkpatrick, Lee, and Nixson, market structure-performance analysis in developing countries can be inconclusive due to nature of the economy and the unreliability of the data. Moreover, the factors that generate market concentration in developing countries may be different from those in developed economies.

A recent paper by Bird (1999) further analyzes the available data on the relationship between industrial concentration and competition in the Indonesian manufacturing sector. Bird echoes other contributors to the literature in noting that concentration is neither necessary nor sufficient for monopolistic, high-cost outcomes. Concentration can occur because inefficient firms have been driven from the market and efficient firms have grown, for example.

On the other hand, there are cases in which industries with low levels of concentration have not been competitive. One example is the sugar processing sector in Indonesia: Java sugar mills currently have the exclusive sugar import rights, by decree of the Minister of Industry and Trade, which significantly inhibits competition and drives up prices, even though there are more than 70 sugar mills in Indonesia.

Table 3 presents some characteristics of highly-concentrated Indonesian manufacturing industries, based on the presentation by Bird. It ranks industries by their four-firm concentration ratio, and includes recent estimates of the effective rate of protection, as well as indications of significant entry barriers, in cases in

62 It must be acknowledged that the vast majority of these sugar mills have a common owner—the government of Indonesia. It must be acknowledged, however, that the vast majority of these sugar mills are subject to common ownership, as state enterprises.
63 The effective rate of protection is usually defined as the percentage increase in value added per unit of output due to tariffs (and possibly other trade interventions). It accounts for the impacts of policies on both the prices of outputs as well as inputs for various sectors. See, for example, James E. Anderson, “The Theory of Protection,” in David Greenaway and L.
which such barriers have existed. Also included are data on foreign and state ownership shares, the relative capital intensity of the industry and the importance of the industry, measured as its share of manufacturing value added.

Bird notes that the simple average four-firm concentration ratio in 102 manufacturing industries declined from 63.6 percent in 1975 to 53.5 percent in 1993. Industries that had four-firm concentration ratios between 75 and 100 percent were 39.2 percent of all manufacturing industries in 1975, but only 27.5 percent in 1993. Bird also adjusted the data for international trade. For the 67 industries for which such calculations were possible, the four-firm concentration ratio unadjusted for trade was 53.3 percent in 1993, whereas the adjusted four-firm concentration ratio was 41.1 percent. Thus, one can conclude that the Indonesian economy has been becoming less concentrated on average in recent decades, and that import competition adds a substantial source of competition for the domestic market.

Indeed, the actual quantity of imports does not have to be large, as long as there is a potential for it to be large, for import competition to impose a significant discipline on domestic prices. An open trade regime is the first step toward enhancement of competition within the domestic economy.

Hal Hill (1987) studied concentration in Indonesian manufacturing from 1975 to 1983, and noted that the combination of high import protection plus high domestic concentration lessened competition in many Indonesian industries. He also compared concentration patterns in Indonesia with those in Australia, which also had a small and relatively highly protected domestic market, and found that many highly concentrated industries in Indonesia were much less concentrated in Australia. He concluded that basic industry characteristics were not a major explanation of the high levels of concentration.

Although Bird was able to compare concentration ratios in only 14 of the 102 Indonesian manufacturing industries with those in other countries, he did find some correlation between industry concentration in Indonesia and in other countries, which tended to suggest that similar structural factors may be at work in the various countries.

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64 Weighted average calculations of the concentration ratio, in which the weight for each industry is based on its share of manufacturing output in each year, were 55.0 percent for 1975 and 44.0 percent for 1993.

What Explains High Concentration?

There are three primary explanations for high market concentration in Indonesia. We will consider each of these factors in some detail in this section, drawing upon examples from various sectors of the Indonesian economy, and will then examine them in more detailed profiles of several industries in which competition problems have been especially significant or persistent.

Economies of Scale

The first explanation is related to the nature of the production technology and the size of market. When production requires a large initial investment and costs are sunk (cannot be recovered after being incurred), then large-scale production will entail lower cost per unit, at least up to some point. If such economies of scale characterize the industry and the market size is small, then the market may only support a limited number of firms. Consistent with this observation, Bird notes that many of the concentrated industries in Indonesia are highly capital intensive, which is closely associated with economies of scale.

It must be reiterated that, if barriers to entry are low, then high market concentration may not bring with it market power. In fact, when barriers are very low then incumbent oligopolists may be disciplined to keep their costs continuously low in order to survive. On the other hand, when there are significant barriers to domestic entry and to importation of competing products, high market concentration will enable firms to increase price (exercise market power), although not necessarily by collusion.

An example of high concentration and low entry barriers is given by the Indonesian export-oriented industries. For a number of such industries—like processed food, electronics, and dry cell batteries—the concentration ratio of the four largest firms has reached as high as 90 percent. The high concentration is due to the fact that these industries have to compete internationally, and for that reason the scale of production needs to be high. But since they are competing in the global market they are forced to be competitive. At the same time, entry restrictions and import protection for these industries are relatively low. For instance in the canned fruit industry, entry barriers are low and the effective rate of protection is 21 percent. For this industry, and others like it, high concentration does not entail market power.

For other industries, such as tires and inner tubes, the effective rate of protection is quite high (for tires it was estimated recently to be at least 600 percent), indicating very little import competition. However, this again does not imply that domestic competition is distorted by anticompetitive behavior. For this type of industry, in which the product is somewhat differentiated, entry may be costly in the short run, but in the
long run there seem to be no significant barriers to entry. The fact that the four-firm concentration ratio has been consistently higher than 60 percent in the last thirty years indicates that large-scale entry into the industry has not been very attractive. At this point there seems to be no evidence of anticompetitive practices in the tire sector. Therefore, the price of domestic tires may be high by international standards, but domestically the industry seems to be competitive. Reducing import barriers is probably the best way to increase economic efficiency.

**Anticompetitive Conduct**

The second explanation for the high market concentration is that it is a result of anticompetitive behavior by firms in the industry. In their pursuit of higher profit, firms may engage in anticompetitive conduct to eliminate existing competitors or to inhibit entry by potential competitors. This conduct can be very effective in industries in which import competition is low due to high government protection. Such conduct will seek to lower unfairly the (actual or prospective) revenues or raise the (actual or prospective) costs of (actual or prospective) rival firms. In such industries an increase in the market concentration over time can be an indication of the existence of anticompetitive conduct.

**Government Intervention**

The third major cause of high market concentration is government intervention in the market. Government intervention in the Indonesian economy is very extensive, and is justified by the Constitution of 1945, which declares that the state will control economic activities that can affect the welfare of the general public. This has been interpreted liberally by government throughout Indonesian history, often for its own political interest. During the Old Order it was used as justification for nationalizing foreign-owned enterprises. During the New Order it was used to justify the mixed-economy idea of government intervention, in which government intervenes not only to promote macroeconomic stability but also for economic planning purposes. The latter rationale for government intervention has led to most of the government interventions that have distorted competition.

Government interventions that especially have distorted competition have taken several forms. First, government has restricted competition in certain industries by creating barriers to entry by domestic firms. Included are policies that set aside all or part of a market for small business, cooperatives, state enterprises, or other parties. Also included are explicit or tacit restrictions on domestic investment; even if a product is not explicitly on the negative list for investment, it may be difficult or costly to obtain approval from the BKPM (*Badan Kordinasi Penanaman Modal*, Capital Investment Coordinating Board) for new
projects. Second, government has protected domestic industries from foreign competition by creating tariff and non-tariff barriers to importation, as well as foreign investment restrictions. Third, taxes and price controls on various products have also limited competition. For example, in the clove cigarette sector, firms of different sizes must charge different minimum prices and pay different excise tax rates.

Some of these interventions may have an economic rationale—such as keeping prices stable, guaranteeing the continuation of supply, or promoting infant industries—but others have had much weaker rationales—such as the creation of a clove monopoly for the BPPC.

Discussion
Three sources of industrial concentration have been reviewed in this section—scale economies, private anticompetitive conduct, and government intervention. The first is presumably innocent in character, and suggests that concentration will tend to increase economic efficiency and benefit consumers. The second is generally not innocent in character, though in many cases anticompetitive conduct that is harmful to consumer may provide some efficiency benefits to the economy. Government intervention, in some cases, may have been driven by good intentions, and in other cases may have reflected more the preferential treatment of favored parties. The impact on competition and economic efficiency in both of these kinds of cases must be investigated thoroughly, but especially in the latter case there can be a presumption that the net effects on competition and efficiency are negative.

In the remainder of this paper, we take a deeper look at a variety of sectors of the Indonesian economy that present competition problems, due to private anticompetitive conduct and/or government intervention. The list of sectors examined is not meant to be exhaustive, but rather to be illustrative. We especially focus on sectors that have been studied previously or that clearly present competition policy dilemmas. The paper closes with two cautionary notes—one on popular misconceptions about competition, and one about the threat of the competition law being used for anticompetitive purposes through predatory pricing and other complaints. Concluding remarks are then offered.

66 The existence of this regulatory regime was one of the principal reasons why kretek cigarette prices at the consumer level did not fall following the ending of the clove monopoly.
Objectives of the Case Studies Presented

The following cases studies are by no means complete analyses of competition problems in the various sectors being examined. We have varying amounts of information on these cases, as will be seen. Our brief presentations of these case studies are intended to provoke thought and to provide preliminary answers to the following questions:

- How is the case grounded in the competition law? Which article or articles of the law apply?
  - In trying to obtain further information on some of these cases, particularly on issues related to anticompetitive conduct by market participants, our strategy was to begin to identify and talk with those potentially harmed by firm behavior or government policies about their perceptions of the problems in the markets. This would be a useful strategy in future research by the KPPU (Komisi Pengawas Persaingan Usaha, or Business Competition Oversight Commission).
  - Among the tasks of the KPPU specified in Article 35 of the competition law is the following: “memberikan saran dan pertimbangan terhadap kebijakan Pemerintah yang berkaitan dengan praktek monopoli dan/atau persaingan usaha tidak sehat” (“to give suggestions on and consideration to Government policies that are connected with the practice of monopoly and/or unfair business competition”). Thus, we will include cases in which governmental policies have distorted or limited competition, since there is a formal role for the KPPU in commenting on such cases.

- What kinds of questions need to be asked by investigators to conduct a competitive analysis in each case? Among the questions that can be asked are the following:
  - What is the relevant market in “horizontal” terms? In particular, for a given product, what are the substitutes in demand and supply? What are the own-price and cross-price elasticities of demand and supply in the short run and the long run?67
  - What is the relevant market in “vertical” terms? In particular, which stages of the production, processing, or distribution processes should be included within the market? One view is that a market should not be limited to any stage of these processes that cannot sustain independent firms. For example, if no firms could survive in the paper market unless they also were involved in the pulp sector, then it would be incorrect to limit the relevant market only to the paper sector.

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67 The own price elasticity of demand for a good, for example, is the percentage change in quantity demanded divided by the percentage change in the price of the good. The cross price elasticity of demand for the good is the percentage change in quantity demanded divided by the percentage change in the price of some other good. The higher is the cross elasticity of supply, all else equal, the stronger is the argument that the other good should be included in the relevant market.
What is the market structure at various levels of production, processing, and distribution? In particular, are market shares concentrated on either the supply side or the demand side? Have there been any substantial changes in market shares of the various firms?

What disciplines prices in the market? Actual or potential domestic entry? Import or export competition?

Is there any potentially anticompetitive conduct that can be observed? Could the conduct in question provide any potential efficiency gains?

Apart from data on elasticities or market concentration, what other kinds of data would be useful to obtain as part of a more thorough analysis?

Comparisons of prices between regions of Indonesia? Between local prices and export prices? Such comparisons could indicate that consumers are paying prices that are too high, or that sellers of primary commodities like raw coffee are getting prices that are too low.

Information on profit margins in production and distribution of products. The existence of high margins could be indicative of barriers to entry—which could include “natural” ones due to scale economies, government-imposed barriers to entry, or barriers to entry due to anticompetitive conduct of firms within the industry.

Business plans, industry analyses, forecasts, customer surveys. These may provide further evidence about the motivations for firm behavior, which firms industry participants consider close competitors, which products consumers consider close substitutes and how prices and quantity adjusted to mergers or other events in the past.

If government intervention is an important influence on the nature and extent of competition in an industry, what are the objectives of the policy or regulation? Are there other approaches that could achieve these objectives more efficiently?

Wheat Flour and Noodles
The evidence from both the wheat flour and noodle markets shows how both firm conduct and government intervention have limited competition. For a history of the industry, see Stephen L. Magiera, “The Role of Wheat in the Indonesian Food Sector,” Bulletin of Indonesian Economic Studies 17 (November 1981), 48-73.
**Government Intervention in Wheat Flour**

The wheat-flour industry in the past was organized in a very intricate way involving not only a monopolist but also government.\(^{69}\) Legally Bulog, the State Logistic Board, was responsible for supplying domestic needs for wheat flour, and held the monopoly for importing wheat grain. The purpose of this monopoly was not only to guarantee continuity of the supply of wheat flour but also to keep the price stable. However, Bulog did not have milling facilities, and the milling process was assigned to four firms—primarily to the PT Bogasari Flour Mills, owned by the Salim Group, which had an 81 percent market share of flour milling.

The milled wheat was then sold back to Bulog at a price that reflected the cost of wheat, the milling cost, and a milling fee. Bulog, however, did not have access to Bogasari’s internal cost information, which could have allowed Bogasari to sell the wheat flour back to Bulog at prices much higher than its cost. Bogasari was also a large, efficient producer. It could have priced its milled wheat flour as high as the next-most efficient producer, and extracted all the “rents” from its large efficient scale. Bogasari did not have the authority to distribute or market wheat flour independently in Indonesia. However, because it kept the milled wheat flour on its premises, it enjoyed some measure of control over shipments to buyers of wheat flour from Bulog. The implication of these factors was that the price of milled wheat flour was higher to Bulog, and thus to downstream producers, than if firms competed to mill the wheat flour.

Since 1997 the wheat-flour industry has been deregulated and liberalized. Entry restrictions into the market have been lifted to allow general importers to import wheat and flour directly. The tariff rate has been reduced to ten percent, and will drop to five percent in 2003. Nevertheless, it is unlikely that these changes will lead to significant competition for Bogasari, for several reasons:

- The importation of wheat has to be in bulk, so it can only be done by large importers. In this respect, Bogasari clearly has an advantage over potential domestic importers because of its large milling facilities and captive market for wheat flour for its own instant noodle production.
- Bogasari, being an established firm in the industry, and a distributor itself, exerts control over distribution channels through its a close-knit relationship with the distribution association. Thus, even if importation is free, potential foreign competitors can only create effective competition for Bogasari if they are allowed to enter into distribution, which in the past has been closed to foreign firms. Though the distribution sector is nominally open to foreigners following a sequence of reforms mandated by the International Monetary Fund (IMF) in 1998, the real extent of this openness remains to be tested.

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\(^{69}\) The four-firm concentration ratio for the wheat flour industry in 1995 was almost 100 percent, and the level of concentration had not changed since 1975.
• Bogasari has cost advantages over new entrants. For example, due to its assured market position and other advantages in the past, Salim was able to construct a deep-water port for the Bogasari factory. The advantages of a cost-reducing investment like this would probably not be achievable by new entrants in the future.

**Firm Conduct in the Noodle Sector**

The noodle industry is one of a number of the domestic-oriented industries that have shown a sharp jump in market concentration, which as noted above may be indicative of private anticompetitive conduct. In 1975 the noodle industry had a four-firm concentration ratio of 44 percent, but that increased to 75 percent by 1985 and to 96 percent by 1995.

Mass production of instant noodles was started in 1968 by PT Supermie Indonesia, which produced the Supermie brand. Instant noodles were accepted eagerly by the market, and Supermie soon became the dominant player in the industry. In the early 1970s, PT Sanmaru Food and PT Sarimi Asli entered the instant noodle market with Indomie and Sarimi brands, respectively.

PT Sarimi Asli was owned by the Salim Group, which through the PT Bogasari Flour Mills had a monopoly on the milling of flour, the main intermediate input for the instant noodle industry. In the mid-1980s, the Salim Group, through its affiliate PT Indofood, took over PT Sanmaru and later PT Supermie. Since then PT Indofood has become the largest manufacturer of instant noodles in Indonesia. PT Indofood later shifted the distribution of all of its products from independent distributors to Indomarco, a distribution firm owned by the Salim Group.

Before deregulation of wheat flour, Bogasari may have been earning excess profits on its milling of wheat flour in its resales to Bulog. All noodle producers purchasing wheat flour from Bulog, including the Salim Group, had to pay the same price. To the extent the Salim Group profited on the sales to Bulog, it therefore had achieved a lower net price of the key ingredient, wheat flour: the more wheat flour that Indofood used, the more wheat that could be profitably imported and processed by Bogasari. The Salim Group's cost advantage may have allowed it to sell more noodles by lowering price and gaining sales.

**Questions and Issues**

• What is the relevant downstream market in this case? Should it only include dry, instant noodles? Should wet noodles also be included? These are usually sold to restaurants, not directly to the public. What do consumers view as substitutes in demand?
• Separately, how has Bogasari affected downstream competition for other wheat products like cookies and bakery products, or even products made from other grains such as rice?

• In the past, food processors using wheat flour as an input complained of the quality of flour provided by Bogasari. Indeed, the flour produced by Bogasari varied by country of origin of the wheat, the type and quality of wheat used, and the quality of the milling process itself. In particular, given that the price at which Bogasari could sell flour was regulated, Bogasari may have had incentive to provide Salim Group subsidiaries downstream with the best available flour. There is a question whether the extent of competition in the industry is now sufficient for such alleged practices to have ended.

  – Discussions with smaller independent noodle producers would be useful, to learn their perceptions of whether any such problems of abuse of dominance remain within the flour-noodle sector. Abuse of dominance could be actionable under Article 19, Part a (market dominance) of the competition law, which would not allow a dominant firm to “deny or impede certain business actors from doing the same business activities in the relevant market” if this led to the practice of monopoly or unfair competition. These sorts of issues could also be relevant under Article 14 (vertical integration).

• Are imports a significant discipline on prices locally? Given that there are only a small number of flour mills, is there any evidence that the three smaller flour mills are colluding with Bogasari? Such collusion would be prohibited under Article 4, Part 1 (oligopoly), Article 5, Part 1 (price fixing), or Article 11 (cartels) of the competition law.

• Did noodle prices go down (at least relative to other prices) in September 1998, following deregulation of the wheat sector?

• Indofood, which is the largest producer of dry noodles in the world, chaired the International Noodle Association in 1999, and pushed the Association to require that all noodles sold in Indonesia have halal status, meaning they had been formally approved for consumption by Muslims. Were these efforts by Indofood intended to raise the costs of its competitors, especially those from other countries? Such efforts could constitute an abuse of dominance under Article 19, Part a. The free-market perspective is that consumers should decide whether they want to pay a price premium in order to buy noodles with halal status, by choosing among competing brands in the market.

70 The text of Article 19, Part a, in Indonesian is: “menolak dan/atau menghalangi pelaku usaha tertentu untuk melakukan kegiatan usaha yang sama pada pasar bersangkutan.”

71 See, for example, “World Noodle Producers Agree to ‘Halal’ Status,” Jakarta Post, February 13, 1999.
• Indofood executives in 1998 proposed to provide a “cross-subsidy” for noodles for the poor, and stated that they would invite the other 10 noodle producers to discuss the issue. Such price discrimination would tend to be beneficial in equity terms, and might or might not be efficient. However, the proposed discussions clearly would entail collusion, and would be problematic under the competition law.

• The ultimate question of whether Bogasari should be broken up, separated from Indofood, or regulated in some new way is extremely complex. There could be significant efficiency costs in any of these remedial approaches.

Pulp and Paper

In the pulp and paper industries, alleged anticompetitive conduct as well as government intervention have led to the accumulation and exercise of market power by a limited number of parties. The market concentration for industrial paper jumped from 37 percent to 90 percent between 1985 and 1995, whereas the concentration ratio for pulp, the main input to industrial paper, has consistently been above 90 percent.

Certain participants in the pulp and paper sector have benefited significantly from special favors from the government in the past. For example, the PT Kiani Kertas paper company received Rp 250 billion (US$108.70 million) in reforestation funds to build the PT Kiani Lestari pulp and paper factory, which opened in early 1997. This loan comprised about 20 percent of the total investment. It was to have an interest rate of 6.7 percent and a maturity of eight years, including a three-year grace period. Given these highly concessionary terms, it is clear that competition in the industry has been on a distorted basis.

The paper sector is heavily protected from foreign competition in the form of import tariffs; the effective rate of protection for paper products was 41 percent in 1995. Long-fiber pulp (used in manufacture of products like computer paper and newsprint) and used paper, which substitutes for it, are imported into Indonesia, as the pine trees that provide the material are scarce. Short-fiber pulp is not imported extensively, but exports of it have increased dramatically in recent years, so that the export market may affect domestic pulp prices.

74 For a welfare analysis of import barriers and the high level of concentration in the industry, see Faisal H. Basri, “Pulp and Paper Industry: Protection for Whom?” paper presented at conference, sponsored by Indonesian Economists Association, the World Bank, and the University of Indonesia, on “Building on Success: Maximizing the Gains from Deregulation,” 26-28 April 1995, Jakarta.
Questions and Issues: Industrial Paper

Accusations of anticompetitive conduct related to vertical integration (Article 14) in the industrial paper sector have arisen. For example, late in 1998 the Association of Indonesian Graphics Companies (PPGI) urged the national legislature to prohibit vertical integration in industry under the new competition law. The chairman of the Association stated:

“There should be a clause which strictly forbids the practice of dominating an industry from upstream to downstream, be it by a company or a business group.”

He claimed in particular that PT Indah Kiat of the Sinar Mas Group dominated the paper industry from upstream to downstream. PT Indah Kiat owns industrial forests and makes products ranging from wood pulp to notebooks, envelopes, computer paper, photocopy paper and other stationery products. He added that two Sinar Mas subsidiaries, PT Pindo Deli and PT Paper Onward Utama, dominated the tissue paper industry.

• The chairman of the Association asserted further that large integrated groups tended to drive out smaller competitors through predatory pricing (actionable under Article 20 of the competition law), and afterward could easily raise prices to exploit their monopoly power. Because vertical integration (Article 14) and other vertical controls can have efficiency benefits, though they may also have anticompetitive motivations, these accusations must be examined only with great care. A later section of this paper will consider further the question of predatory pricing accusations.

• It would be useful to interview smaller independent paper producers, to learn whether they have any evidence of predatory pricing or abuse of dominance more generally within the pulp-paper sector.

• The market structure data do not necessarily support the claim that PT Indah Kiat is dominant. Of the 81 companies producing industrial paper in 1999, as many as 13 were integrated with pulp production. Four other pulp producers are not integrated into paper production. PT Indah Kiat had 36.4 percent of short-fiber pulp production capacity, and 19.2 percent of paper production capacity, though admittedly there may be specific segments of the paper market in which its market share is higher. Closer examination of the data by market niche would be useful, as part of a broader effort to identify relevant markets within the sector.

76 The figures are calculated from Tables 2 and 8 of “Pulp and Paper Industry Saved by Exports,” Indonesian Commercial Newsletter, No. 277, PT Data Consult Inc., Jakarta, 12th October 1999, 9-20. Table 8 also indicates the particular paper products sold by various companies.
Finally, in order to understand competitive conditions in the short-fiber pulp and industrial paper sectors, it will be important to understand the nature of entry barriers into pulp production. For example, are new pulp factories required to have associated timber plantations, and if so how easy it is to acquire such plantations?

Questions and Issues: Newsprint

The newsprint market is a final area of concern within the pulp and paper sector. Through 1998, the Indonesian Pulp and Paper Association (APKI) negotiated with the Press Publishers’ Association (SPS) over the price of newsprint. However, under the terms of the January 1998 agreement with the IMF, joint price fixing by APKI was to be abolished.

There are currently five companies that produce newsprint within Indonesia. The largest, PT Aspex Paper, controls 72.3 percent of production capacity. According to one recent assessment, “As the largest supplier of newsprint to the domestic market, PT Aspex Paper has the power to dictate the market price of newsprint, especially when imported newsprint is more expensive than local products.” Thus, the market power of PT Aspex Paper could be problematic, under Article 17 (monopoly) of the competition law.

However, imports come into the country duty free; imports do discipline local prices, though transportation costs provide some natural protection to the local newsprint industry. Moreover, one of the newsprint companies is a new entrant, which was formed by the Jawa Pos Group to provide it with newsprint, so domestic entry appears to be possible as well.

Finally, it is quite possible that the past negotiation over newsprint prices was not harmful: a bilateral monopoly, in which a single seller bargains with a single buyer, is generally believed to lead to a more efficient outcome than would a monopoly facing many buyers or a monopsony facing many sellers. In the case of newsprint, there are large players on both sides of the market, but PT Aspex Paper commands a dominant market share. Thus, it could be useful to monitor this situation, to make sure that import competition does provide an effective discipline on the exercise of monopoly power.

79 This natural protection tends not to provide cost advantages, as it is offset by higher costs of the basic materials, used newspaper in particular, much of which is imported by Indonesia.
The cement sector worldwide inherently presents dilemmas for competition policy:

Because of the geographic dispersion of cement markets, the low aggregate price elasticity of demand for cement, the industry’s high entry and exit costs, the relative importance of transport costs, and the potential to achieve marked economies of scale, cement production may be viewed as having a ‘natural’ tendency to produce a geographically concentrated, oligopolistic industry.\(^80\)

At the national level in Indonesia, the four-firm concentration ratio decreased from 93.9 percent in 1975 to 83.0 percent in 1993. In 1998 the largest company in the sector had 28 percent of industry production capacity.\(^81\) However, the industry remains much more concentrated in some regional markets, in which only one or two competitors may be present.

In addition to the structural factors that have contributed to this outcome, government policy in Indonesia has played an important role in limiting competition in the cement industry. Cement producers in the past, with the support of the government, explicitly colluded to fix prices and divide the market among themselves. Thus, in consultation with the Asosiasi Semen Indonesia (ASI, Indonesia Cement Association), the government periodically issued local directive prices (HPS, or Harga Pedoman Setempat) for markets throughout the country, which were set based on estimated production cost plus transportation cost. Markets were also divided according to the geographical location of each manufacturer, and quantities to be sold by the manufacturers allowed into each region were specified by agreement between the government and the ASI.

Entry into the industry was restricted as well. In the past import licenses were only given to producer importers, though since 1995 import restrictions have been relaxed to allow general importers into the market. However, distributors are reluctant to carry imported cement because domestic producers have strong control over them, as discussed further below. Moreover, domestic entry was closely regulated. Because entry was so restricted, there was a tendency for existing producers to apply for business expansion licenses long before their investments were realized. One motivation for this behavior may have been to dissuade potential investors from entering the industry by giving the impression that there was already over-capacity in the market.


The argument put forward by regulators and the cement industry for the price-setting collusion was that it was important to sell cement to distant regions such as Irian Jaya (now Papua Province) at a “reasonable” price. To do so, it was decided that the producers would cross-subsidize their sales in remote areas by charging higher-than-competitive prices in other regions. To maintain such a system, entry barriers were necessary, particularly for the areas in which prices were above unit costs. Entry barriers at the overall national level were also necessary, given that export sales were limited.

- One of the unfortunate consequences of this system was that it discouraged more efficient market-based solutions to supply problems in remote areas. For example, with prices held down in a given area, the incentives to build new cement factories or find lower-cost import supplies for the area were limited.

In the cement industry, producers exercise vertical control over distributors. Manufacturers divide the market among distributors and appoint agents to ensure distribution to their respective markets. Although market areas of distributors are not regulated by government, in practice cement distributors have been reluctant to sell outside of their market areas for fear of jeopardizing their relationship with the manufacturer.

For the same reason distributors are reluctant to market products other than those of their primary supplier or to handle competitive imports of cement. As one piece of evidence on this problem in the past, in October 1995 cement imports were opened to general importers, because domestic prices were very high, but only a negligible amount of imports actually entered the country.

**Questions and Issues**

- The HPS and the cartelization of the market were outlawed by the recent agreements with the IMF.

The cement companies may have continued the price fixing and cartel traditions on their own, however, perhaps in subtle ways.

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82 In addition, cement manufacturers handle distribution for large contractors and readimix companies directly through their own distribution network, though this latter practice could be motivated at least in part by efficiency considerations.
83 For corroboration on several of these points, see, for example, Jacqueline L. Pomeroy, “Distribution Systems for Selected Commodities: A Summary of Survey Results from Several Provinces,” Trade Implementation And Policy (TIP) Project, U.S. Agency for International Development and Ministry of Industry and Trade, Republic of Indonesia, Jakarta, May 1997.
84 Market prices could and did diverge from the HPS, but there is evidence that the IMF-mandated ending of the HPS system in November 1997 led to lower prices in some areas.
In particular, given the relatively high transportation costs and previous price-fixing and market-division arrangements for cement, the concern is that regional cement markets may face monopolies or near monopolies. Article 1, Part 10, of the competition law (which defines the relevant market or pasar bersangkutan) appears to allow that the relevant market could be regional as opposed to national. In this case, the cement industry could present issues under Article 4, Part 1 (oligopoly). Similarly, the behavior of cement suppliers or the ASI could remain problematic in terms of Article 5, Part 1 (price fixing), or Article 11 (cartels) of the competition law.

- It would be useful to have data on cement producer market shares on a regional basis, particularly to see the extent to which current market shares differ from the past market allocations prior to the liberalization of the cement market in 1997 and 1998. Moreover, an indicator of the possible exercise of market power on a regional basis would be price differentials among regions in excess of those that could be accounted for by transportation costs or any quality differentials among the various brands of cement.

- Comparison of the domestic prices for cement in Indonesia with prices in other countries, both in money terms and relative to other prices, could indicate whether competition problems exist at the national level. A simple comparison along these lines would be between domestic and export prices for cement produced in Indonesia. A more difficult comparison would be between prices in other countries that could export cement to Indonesia, plus transportation costs, with domestic prices in Indonesia. In particular, given the problems that imported brands of cement may have experienced in the distribution system, the recently estimated effective rate of protection of -12 percent could be deceptive.

- Interviews with cement distributors in various regions could provide insight into the extent to which cement producers have foreclosed competition from other domestic or imported brands by pressuring independent distributors not to sell competing brands. Such foreclosure could be actionable under Article 19 (market dominance), especially Parts a or c, or Article 25 (dominant position), especially Part c. Interviews with any frustrated domestic or foreign cement suppliers that could be identified would also be useful. Candidates for such interviews could include suppliers that appear to be “natural” suppliers to a given region within Indonesia, based on their presence in nearby regions and on transportation cost considerations, but have not entered it to this point.

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85 The relative price comparison would be useful because of the relatively high transportation costs for cement, which could permit substantial differences in money costs across countries.
• To the extent that uneven regional development remains a concern, the government could look for other less distortive means to assist less developed regions, such as through direct grants for infrastructure development.

**Importation of Foreign Films**

The Subentra Group, following several mergers of film importation associations in the past, monopolizes the importation and distribution of Western films. The market domination also extends downstream to theaters, in which the Cinema 21 theaters under the Subentra Group enjoy a large market share, at least in the Jakarta area. The former Minister of Information, Muhammad Yunus, called for the film importation monopoly to be ended, but the status of the monopoly in both legal and practical terms is unclear at this point. Some have suggested that ending the importation monopoly may not be sufficient to restore the Indonesian film industry, and that film importation, distribution, and theaters should be separated. The importation monopoly is problematic under Article 17 (monopoly). The vertical integration of the industry also could be problematic under Article 14.

**Questions and Issues**

• What is the relevant market in this case? Should it include only movies from America and Europe, or also movies from Indonesia, India, China, and other countries? Should it include video cassette and disk sales and rentals, or even television, as well?

• How do movie theater ticket prices in Indonesia compare with those in other countries, in purchasing-power-adjusted terms? How do these other countries handle the importation of Western films?

Independent movie owners complain that they are often denied good movies by the distributors, and can only play movies two years after they are played at the Cinema 21 theaters. Many theater owners have given up, and either sold or rented their theaters to the 21 Group. Such rentals have paid fixed monthly rental fees.

A serious concern in this regard is whether the film importation monopoly permitted the Subentra Group to confiscate the property of independent theater owners at deep discount prices, by effectively threatening to withhold top films if the owners did not cooperate. A very complicated question for the KPPU or other

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86 Marselli Sumarno, "Film Importing Monopoly ‘Should be Scrapped’" *Jakarta Post*, August 9, 1998.
87 "Signs of Hope for Local Film Revival?,” *Jakarta Post*, September 13, 1998.
authorities would then be whether this process could be undone efficiently if the Subentra Group were forced to divest itself of these properties or through other remedies.

Rattan in Central Sulawesi
Partly in response to earlier national bans on the export of raw rattan (*rotan asalan*), and in particular in order to favor local rattan processors over those in other areas (primarily Java), the governments of a number of rattan-producing provinces (notably all four provinces of Sulawesi) imposed restrictions on inter-island trade in raw and semi-processed rattan. In some cases, these restrictions have been formally administered, while in others the government has effectively delegated their administration to local offices of Asmindo (Asosiasi Industri Permebelan dan Kerajinan Indonesia, Indonesian Furniture and Handicraft Association), such as under a 1991 decree of the Governor of Central Sulawesi. This decree forbids the shipment of *rotan asalan* out of the province. However, an exception existed for raw rattan that could not be processed locally due to its type or size: this could be shipped with permission of the local office of Asmindo. Only registered members of Asmindo were allowed to ship raw or semi-finished rattan out of the province.

Problems with acquisition of rattan from Sulawesi have within the past two years have led to complaints by furniture manufacturers in West Java that a “Mafia” had control of the Sulawesi rattan trade. To illustrate this point, one West Java manufacturer pointed out in April 1998 that forest-level prices for Sulawesi rattan were around Rp200/kg, while prices as high as Rp11,000/kg were being paid by buyers in Cirebon, West Java. The implication was that some traders were enjoying huge profits at the expense of both primary producers in Sulawesi and end users of raw material in Java furniture factories.

Field work in May 1998 revealed that Asmindo continued to regulate the shipments of raw and semi-processed rattan out of Central Sulawesi, and that the 1991 decree of the Governor had not been retracted. As will be shown below, the field work indicated further that trading margins in the sector were very large for Asmindo members in the provincial capital of Palu.

The delegation of market power to an industry association is questionable under the national business competition law, as it effectively authorizes the establishment of a cartel (actionable under Article 11).

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91 This work is summarized by Christopher P. A. Bennett, Stephen V. Marks, and Lukman Muslimin, “Policy Influences on Central Sulawesi Rattan Production and Distribution,” Trade Implementation And Policy (TIP) Project, U.S. Agency for
Moreover, the decree of the governor and the continued role of Asmindo are evidently in violation of the 15 January 1998 agreement with the IMF, as well as Presidential Instruction No. 2 of 1998 and the related decrees of the Minister of Home Affairs.

Such cartels may have some market power relative to buyers of their products in Java or even in export markets. Central Sulawesi produces about one-fourth of the large-diameter rattan produced in Indonesia. It is also conceivable that there could be collusion among Asmindo offices in different Sulawesi provinces, which together produce most of the large-diameter rattan in Indonesia. However, their real market power is relative to suppliers of rattan within the province: the only way such suppliers can legally get their rattan out of the province is to get it past Asmindo.

**Data on Profit Margins**

In the May 1998 field work, economists of the Trade Implementation and Policy (TIP) Project, along with staff of the Ministry of Industry and Trade, gathered information on trading profit margins in Central Sulawesi, from forest areas in the vicinity of Lore Lindu National Park to the provincial capital of Palu.

Table 4 shows the estimates of net trading profit margins at various levels of the market and for various rattan products. These estimates are based on rattan input and output prices and typical weight loss due to drying or processing, as well as estimated variable costs for each activity (not shown in the table).92

The profit margins are all calculated as percentages of the typical inter-island sale price received by Asmindo members in Palu for polished Batang rattan, the most common rattan product shipped from the province. The data may be summarized as follows:

- Gatherers in the forest who cut the wild rattan and remove it from the forest earn a net profit margin of 0 to 5 percent. The higher returns from alternative agricultural activities such as harvesting, maintenance, and cultivation of cocoa, coffee, and cloves draw labor away from rattan except in the most remote forest areas. The field work indicated that wages were higher for cocoa and clove cultivation work than for rattan gathering, and that the former is preferred anyway to the more dangerous and arduous work of rattan gathering.

92 The field work confirmed that harvesters sell their cane for prices as low as Rp200/kg and that buyers in Java pay prices as high as Rp11,000/kg (but only for *fitrit*, which is not commonly traded).

(...continued)
• Local traders who sort the rattan and transport it to Palu for sale to dryers and semi-processors receive margins of 5 to 10 percent.

• Standalone dryers in Palu receive margins about 10 to 12 percent. These penggorengan (frying) operations previously sold ready-for-export semi-processed rattan (classified as rotan asalan) but after the national export ban of 1986 and the 1991 decree of the governor that restricted inter-island shipments of rotan asalan, this small-scale industry went into decline. It survives primarily in remoter areas in which some penggorengan operations produce rattan ready to be smuggled.

• Semi-processors in Palu, who are members of Asmindo, receive net margins of 55 to 75 percent. There are at most 12 such members, but only about five are active in the market. Semi-processors in Palu purchase the wet rattan using a dry-weight price which they discount by about 50 percent, roughly the amount of water weight that will be lost by drying. There is also an additional loss of rattan for each semi-processed product, as shown in Table 4, due to the smoothing and in some cases reshaping of the rattan.

Domestic trade preferences that effectively authorize cartels, such as the one granted to Asmindo by the Governor of Central Sulawesi, would be expected to provide an opportunity for excessive rents and a partial explanation for the Sulawesi-Java rattan price spread. The evidence in Table 4 is strongly consistent with this hypothesis, as the estimated profit margins as percentages of the inter-island price are far larger for the Palu Asmindo members who are semi-processors of rattan than for any other group shown in the table. The only exception is for fitrit, a product for which there is a large amount of loss of material because the rattan is radically reshaped.

Other Evidence of Restraints on Competition in Rattan

Tables 5 and 6 provide additional evidence that, despite the supposed removal of all domestic trade restrictions and relaxation of rattan export restrictions under the agreement with the IMF, rattan gathered in

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93 The lowest margin (1 percent) was earned by those traders doing no sorting. Traders must furnish proof of harvesting permits and transport licenses (SAK-B) for the rattan. This entails a protracted process for both types of business activity, with traders having to visit various offices of the Ministry of Forestry and Estate Crops several times. Unofficial payments have to be made, or else there will be interminable delays, which can cost much more than the irregular payments. Moreover, as a rule, only the government-sponsored village unit cooperatives (KUD) are able to obtain harvesting licenses. This can be an unnecessary obstacle to trade, although usually no more is required than the payment of a modest fee to use the local KUD’s name.

94 For fitrit, a slightly negative net margin was estimated. However, the cost estimates are highly sensitive to the waste factor assumed, if the waste factor is large. For fitrit it is assumed to be 90 percent. If instead waste is only 80 percent, the net margin rises to Rp 5,200/kg or +48 percent. Moreover, it was reported in Palu that fitrit was no longer being produced, which is consistent with its being relatively less profitable, as indicated in Table 4.
Central Sulawesi does not behave much like an internationally traded commodity. Thus, export markets appear not to exert a substantial discipline on local prices, through legitimate trade or through actual or potential smuggling.

Table 5 shows that farmgate prices for dry cocoa and coffee were over 80% of the export price, while farmers taking their coffee to Palu enjoyed a 90% share of the export price. Even cloves offered farmers a price equal to about 50% of the export price. However, rattan forest-gate prices (assuming dry asalan) were less than 10% of the estimated export price.

Moreover, during the recent period of rupiah depreciation, in Central Sulawesi the forest price of rattan increased far more slowly than the prices of the other major tradable commodities, as shown in Table 6. On average, rattan prices in the forest less than doubled, while coffee and clove prices more than doubled. Cocoa, the main cash crop, quadrupled in price.

**Conclusions on Rattan in Central Sulawesi**

Even since the IMF agreement and related changes in national regulations in 1998, Asmindo continues to exert control over the rattan trade in Central Sulawesi. Profit margins for Asmindo members who trade in rattan are extraordinarily high, and presumably could not persist if there were free entry into the market. Particularly given the role of the provincial government in maintaining this cartel, this case merits a high priority for the KPPU.

- A starting point would be to press for the retraction of the Central Sulawesi decree that delegates regulatory authority to Asmindo. This would bring the situation into compliance with the IMF agreements and the related national government edicts.
- The KPPU could also examine more closely the limits on competition among Asmindo members. Are these limits tacit or explicit? If they are explicit, then the relevant conduct or agreements may be actionable under Article 5, Part 1 (price fixing), Article 9 (territorial division), or Article 11 (cartels) of the competition law. The conditions for membership in Asmindo should also be examined. However, Article 50, Part h, exempts small businesses from coverage by the law. It is probable that the companies involved qualify as small businesses, in which case no further action could be taken at this point.
This case is complex for two additional reasons. First is the continued existence of tax and non-tax restraints on rattan exports.\footnote{Export tariffs of 20 percent apply to rattan and wood forestry products. In many cases, the directive prices used to calculate the unit tariffs have been far in excess of actual market prices, leading to tariffs in excess of 20 percent. In addition, Decree of the Minister of Industry and Trade No. 187 of 1998 (enacted by Minister Muhammad "Bob" Hasan) authorized the imposition of quantitative limits on rattan exports, presumably to ensure sustainable production, but apparently in violation of the agreements between Indonesia and the International Monetary Fund. In reality the measure appeared to be more aimed at ensuring supplies to domestic industries rather than resource conservation. Finally, Decree of the Minister of Industry and Trade No. 440/MPP/Kep/9/1998 (enacted by Minister Rahardi Ramelan) requires that all rattan export trade be done with a letter of credit (L/C) and that the artificially-high export directive prices be used to calculate the shipment value specified in the L/C. This creates a serious obstacle to trade, and adds significantly to costs.} To leave domestic trade in rattan unrestricted while maintaining the export barriers would lead to a recurrence of the problem that motivated imposition of the domestic trade barriers in the first place—the lowering of domestic rattan prices for the benefit mainly of furniture manufacturers, which remain primarily on Java, at the expense of the rattan-producing regions. However, the remedy of imposing domestic trade barriers, which have been administered through a private cartel, leads to even lower prices for the poorest participants in the rattan trade—the gatherers in the forest itself.

The second complication is that some have argued it is important for forest-level prices of rattan to be depressed in order to discourage excessive harvesting of the resource. Bennett, Marks, and Muslimin (1998b) argue that pushing down the local price is at best a very crude conservation policy instrument that in many cases may lead to more rather than less forest loss: by leading to a lower value for rattan resources in the forest, it may encourage more rapid conversion of some forest areas to plantation estates. As Bennett, Marks, and Muslimin note, far superior solutions exist through the involvement of local communities in the resource conservation and management processes, even in protected forest areas such as national parks.

**Sandalwood in NTT**

The sandalwood (kayu cendana) sector of Nusa Tenggara Timur (NTT) has been devastated by provincial government mismanagement of the resource, which has led to extensive smuggling and illegal cutting. Since October 1997 there has been a five-year provincial ban on cutting of all sandalwood trees, in an effort to allow the sandalwood tree population to begin to recover.

The government of NTT has claimed an official monopsony for buying sandalwood for many years, and has denied officially (later informally) the people of NTT the property rights to sandalwood, even if it grew on their own private land. The NTT government has not retracted the monopsony claim, though it is a clear
violation of the 1998 national government agreements with the IMF as well as Presidential Instruction No. 2 of 1998 and the related decrees of the Minister of Home Affairs.  

In November 1997 and September 1998, staff of the TIP Project and the Ministry of Industry and Trade conducted field work on the sandalwood sector in NTT.  

**The Sandalwood Policy Regime**

The regulatory regime for sandalwood in NTT dates back to 1953, and prior to that the resource was exploited by the Dutch. The foundation for recent policy was laid in 1986. In that year, the Governor explicitly claimed ownership for the provincial government of all sandalwood that grew on government land, or that grew naturally on land owned by individuals or legal bodies. All sandalwood harvested from such land was to be turned over to the government of the area for sale.

The 1986 regulation also provided for the division of the net proceeds from sales of sandalwood after deduction of exploitation costs. For sandalwood that grew naturally on private land, the government of the area was to keep 85 percent for itself and to give the other 15 percent to the owner of the land.

The 1986 regulation also specified that each year the Governor would set a quota on the amount of sandalwood that could be harvested, based on an inventory of the stock of trees conducted every five years by Dinas Kehutanan (the office of the Ministry of Forestry that operated within the provincial government). Dinas Kehutanan would also manage and protect all sandalwood that grew on state or private land. In addition, the 1986 regulation specified that each year the Governor would set the sales price and allowable exploitation costs for sandalwood.

Under this regulation the people generally received only a fraction of the value of the sandalwood that grew on their land. Between 1986 and 1996, the people typically only got Rp 700,- per kg, and some of the

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96 Similar practices have existed in East Timor, but these are presumably no longer the concern of the Government of Indonesia.
97 This work is summarized in Stephen V. Marks, “Cendana Wood in Nusa Tenggara Timur Province: Policy Issues and Options,” Trade Implementation And Policy (TIP) Project, U.S. Agency for International Development and Ministry of Industry and Trade, Republic of Indonesia, Jakarta, July 1998. Further revisions of this study are pending, and will include findings from field research on the sector in Timor Timur as well.
99 The specific regulation was Peraturan Daerah Nomor 16, Tahun 1986, Tentang Cendana.
100 Sandalwood grown as a business activity by an individual or legal body was deemed the property of the individual or legal body. In practice, only a few plantations have been considered to be in this category.
101 Under this and later decrees, the provincial government was to share 50 percent of its part of the proceeds with the
poorest members of society received only Rp 300,- per kg, even though the official price charged by the government for sandalwood was much higher. In 1990/91, for example, the price for highest quality sandalwood (kelas pilihan) was Rp 8.500,- per kg, while that for mixed grade (kelas campuran) was Rp 4.600,- per kg.

In 1993 the Governor of NTT further regulated sandalwood. Allowable exploitation costs were specified, including courtesy payments for a variety of local officials with power over the seller. A mandatory shrinkage factor was also specified: the weight of all wood was reduced by 20 percent, in order to calculate how much the government would pay the seller, under the assumption that the wood was wet. However, Dinas Kehutanan in 1997 estimated the actual loss of weight due to drying at only 14.1 percent.

In 1996 the Governor took a step toward improvement of the regulation of sandalwood: the NTT government no longer claimed ownership of sandalwood that grew naturally on private land. Furthermore, the apportionment of income shares for sandalwood taken from such land was changed to 60 percent for the government of the area and 40 percent for the owner of the land.

Under the new compensation scheme, individuals did receive higher prices than in the past for their sandalwood. For trees on land owned by individuals, prices were reported to the TIP team in the range of Rp 1.500,- to Rp 2.250,- per kg in 1996 and 1997. However, in 1995/96, the official prices charged by the government of the area in its own sales were Rp 18.000,- and Rp 15.300,- per kg for best grade sandalwood, and Rp 9.000,- for mixed grade. Thus, as a percentage of the price charged by the government, the people did not see a substantial increase, and in many cases actually received less than previously. Table 7 summarizes the effects of the 1986 and 1996 regulations, in particular the low percentages of the revenues received by the people in both cases.

In addition, even though the government no longer officially claimed to own all sandalwood trees, in the field the old ways persisted. Moreover, the government officially retained control and effective ownership of government of the kabupaten from which the sandalwood had come.

102 This price was reported for 1986 for orang adat (original inhabitants) of the area, whose claims to land ownership (tanah adat) have been rejected by the government, and thus who have been paid only a minimal wage to cut the sandalwood trees.
104 Dinas Kehutanan (1997), Sekilas Pengelolaan Cendana di Propinsi Nusa Tenggara Timur, Pemerintah Propinsi Daerah Tingkat I, Nusa Tenggara Timur, Kupang, January.
105 The regulation was Peraturan Daerah Nomor 2, Tahun 1996, Tentang Perubahan Pertama Peraturan Daerah Propinsi Daerah Tingkat I, Nusa Tenggara Timur, Nomor 16, Tahun 1986, Tentang Cendana.
most of the economic value of sandalwood. Therefore, the incentives to cut the wood illegally and smuggle it remained very high.\footnote{57}

One of the reasons the payments to the people were lower than the official percentages was that the government managed the stock of sandalwood trees through the annual harvest quotas. If permission is required to cut down a tree, then governmental officials have leverage over the tree owners, which provides the opportunity for the imposition of unofficial charges by various governmental agencies at various levels.\footnote{58}

Finally, in addition to the official NTT government monopoly on marketing of the wood, provincial trade regulations have prohibited inter-island shipments of cut but otherwise unprocessed sandalwood logs. These regulations have been largely ineffective, as authoritative sources from NTT report that large pieces of sandalwood have been shipped from the province classified by local officials as wood chips. Sandalwood exports are taxed by the central government at a rate of 20 percent, along with many other forestry products.

**Conclusions on Sandalwood in NTT Province**

It is hard to imagine a worse example of a predatory, inefficient state monopoly than the NTT provincial policy on sandalwood. Not only have the people of the province been denied a significant portion of the income from sandalwood trees, but the regulations have heavily discouraged the replanting of trees, which can be done either by seeds or root cuttings. In some cases the regulations have even induced people to cut down young sandalwood trees before the trees are censused by the local forestry office: given the widespread use of slash-and-burn agriculture in the area, for example, some persons have feared that they could be subject to a prison term if censused sandalwood trees on their property were to be destroyed by fire.

\footnote{57} For example, some of the poorest residents of the province, as described in note 23, were able to get only Rp 475 per kg from the government in 1996. If they sold it on their own, they could get Rp 1500-2000 from smugglers.

\footnote{58} A final problem related to the quotas has been that governors of the province have been too tempted to relax the quotas, through various “legalization operations” (operasi pemutihan), in order to obtain greater sandalwood revenues during their tenure in office. Thus, in 1996 and 1997, for short periods of time, the people of NTT were invited to surrender sandalwood that had already been cut but not marketed, without legal consequence. In practice, however, the purchasing agents for the government made no distinction between sandalwood that had been previously cut and that had been very recently cut. With the short window of opportunity available for marketing their sandalwood, the people of NTT responded predictably by cutting down vast quantities of trees on their own and other land, leading virtually to the commercial extinction of sandalwood in the province.
The situation can be salvaged, but it will take many years for the population of trees to recover. The best course is complete deregulation. This will enhance the opportunities and incentives to cut trees, but it will also strongly enhance the incentives to plant, maintain, and protect trees. This is a case in which the provincial government, at least so far, has shown a complete incapacity to reform itself. Pressure will be needed from the central government.

Pursuit of a case by the KPPU would be one way to set that process in motion, but it is not entirely clear how the KPPU could proceed. If the KPPU merely suggested to the provincial government, pursuant to Article 35, Part e, that the sandalwood sector be deregulated, the suggestion would probably be ignored, as have presidential instructions and other national government edicts in the past. Monopsony is not permitted under Article 18 of the competition law, and it would be best to pursue a case through that route if feasible. Article 50, Part a, exempts from the law “perbuatan dan/atau perjanjian yang bertujuan melaksanakan peraturan perundang-undangan yang berlaku” (“conduct and/or agreements that have the goal of implementing applicable legislative regulations”). However, a strict interpretation of this clause would not exempt the NTT monopsony, as it was imposed through decrees of the governor rather than through legislation.

**Steel and Related Products**

The steel sector is dominated by the state-owned enterprise PT Krakatau Steel, which is outside the purview of the new competition law. However, to the extent that the KPPU will be an advocate for reform of governmental policies for the sake of greater competition, under Article 35, Part e, it may be able to make a positive contribution. In particular, there are concerns about the interaction of protective trade policies and domestic market concentration in the steel sector. Specifically, recent anti-dumping decisions have benefited domestic producers of steel and related products.

Antidumping duties between 4 percent and 68 percent were imposed on tin plates imported from Australia, Japan, South Korea, and Taiwan. In Indonesia there is a monopoly producer of tin plate, PT Pelat Timah Nusantara (Latinusa), which is 95 percent owned by PT Krakatau Steel and 5 percent by the Nusamba Foundation, a private interest. The duties are effective for five years, but are reviewable after 12 months. The imposition of the duties appears to have done severe damage to the domestic tin can industry, and canners of food products now are importing tins cans. Thus, these duties, and the PT Krakatau Steel

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monopoly, have distorted competition and incentives in the Indonesian economy. They have raised costs to
downstream users of steel products and ultimately to consumers.

Following the tin plate decision, the Government imposed antidumping duties of between 8.2 percent and
62 percent on certain types of construction steel imported from Russia and Poland. The Association of
Indonesian Steel Pipe Manufacturers subsequently called for antidumping action against Japan, South
Korea, and China. This is a sector that appears to be addicted to protection.

The general problem is that anti-dumping procedures in Indonesia lack transparency in terms of providing a
public rationale for a given decision. Thus, the KPPU could simply suggest that antidumping decisions be
made more transparent—that it be required that a detailed written rationale be provided publicly for all such
decisions—which would impose a very useful discipline on the decision makers.

Some Possible Misconceptions
Table 8 draws from the Indonesian media a compilation of firms with significant market shares. The data
themselves are rather selective, and in some cases must be interpreted with caution. For example, Bimoli
brand cooking oil, produced by the Salim Group, is claimed to have a 60 percent market share in the
cooking oil sector. However, data from the Ministry of Industry and Trade used to calculate export quota
shares indicate that the Salim Group had only 3.7 percent of the installed capacity on a national level to
refine crude palm oil into cooking oil.

One source of the misconception may be that Bimoli brand does have a significant presence in a relatively
small segment of the market—the market for branded, bottled cooking oil. The vast majority of cooking oil
sold in Indonesia is in bulk form. Bottled cooking oil is more expensive than bulk cooking oil, and is
targeted toward higher-income consumers in most areas. However, there are regions of Indonesia in which
bulk cooking oil is not available, such as Nusa Tenggara Timur province, presumably because it is not
economical to transport and store it for such small markets. In these cases, bottled cooking oil assumes
the pivotal role. To this point, there is no evidence that bottled cooking oil prices in NTT are any higher than
in other parts of the country. Nevertheless, because it is bottled rather than bulk cooking oil that is being
sold, average prices are much higher in NTT than in other areas in which bulk cooking oil is available.

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The main lesson is that, although certain conglomerates may have dominant positions in some markets, it is important not to draw the inference that they have dominant positions in all markets in which they are involved.

Allegations of Predatory Pricing

There is a particular kind of case that the KPPU will probably see often in the years ahead: accusations that certain suppliers are engaging in predatory pricing. Predatory pricing is covered under Article 20 of the competition law, which states:

“Pelaku usaha dilarang melakukan pemasokan barang dan/atau jasa dengan cara melakukan jual rugi atau menetapkan harga yang sangat rendah dengan maksud untuk menyingkirkan atau mematikan usaha pesaingnya di pasar bersangkutan sehingga dapat mengakibatkan terjadinya praktek monopoli dan/atau persaingan usaha tidak sehat.”

(“Business actors are forbidden to supply goods and/or services at a loss or to set a price that is extremely low with the intent to eliminate or kill off competing businesses in the relevant market with the result that this can lead to the occurrence of the practice of monopoly and/or unfair competition.”)

An example of a recent predatory pricing accusation comes from the retail sector. The relaxation of the ban on foreign investment in that sector led to increased competition for other Indonesian retailers, and in June 1999 the Association of Indonesian Retailers (Aprindo) accused the French hypermarket chain stores Continent and Carrefour of selling goods at a loss in order to drive local supermarket chains out of the market. A representative of one of the hypermarkets defended their strategy: “It’s a discount system: a low margin, big volume of sales, a performing organization.”

The Director General for Domestic Trade of the Ministry of Industry and Trade characterized the situation as follows: “It is not dumping. Those foreign hypermarkets, such as Carrefour and Continent, are not only backed with huge capital but also work more efficiently.” The Director General then suggested that Aprindo meet with managers of the hypermarkets to reach a mutually beneficial solution. Although such an approach may be strongly grounded in Indonesian culture, the clear problem is that it constitutes an invitation to collude, which is actionable under the competition law.

It will be important for the KPPU to examine such cases in the future with a skeptical eye, and to recognize the possibility that less-efficient competitors are simply looking for protection from the Government. It would

be wise for the solutions chosen to be those that most enhance the prospects for competition in the long run. Specifically, it is not enough merely that a competitor charges low prices, or even that a competitor charges low prices with intent to eliminate the competition. There must also be a high probability that in the future the competitor could engage in monopolistic practices (in other words, raise the price above unit cost and sustain it at that high level). There are very few situations that will meet that test, in the absence of barriers to entry related to governmental policies.

Concluding Remarks
As we conclude this paper, we wish to emphasize a number of general points:

• The cautionary perspective of the previous section applies more generally to the pursuit of cases under the new competition law: private parties in general may seek in a predatory manner to have their strongest competitors sanctioned under the law. For example, there may be accusations that vertical integration constitutes unfair competition in some sectors. If the competition law is used to kill rigorous competition in Indonesia, then it will be a failure.

• Too-rigid enforcement of the competition law with an anti-conglomerate or anti-bigness emphasis could cause serious harm to the Indonesian economy. It would deter both domestic and foreign investment, at least in areas in which efficiency requires the realization of economies of scale or scope. It would also make it more difficult for Indonesia, which continues to have relatively small markets in many sectors, to compete efficiently in the modern global economy.

• The exemptions granted under Article 50 of the law may present problems for the country. Cases like that of rattan in Central Sulawesi suggest that exempting small business may sometimes entail significant costs. Moreover, it may be found that some businesses will wish to reorganize nominally as cooperatives, in order to be exempt from the provisions of the law. Finally, many of the large state enterprises that remain in favored monopolistic positions within Indonesia may continue to be plagued by gross inefficiencies.

• The cases highlighted in this paper are not the only candidates for assessment. For example, continued international trade barriers in the automobile sector have facilitated continued concentration of that industry. Also, the Yayasan Lembaga Konsumen Indonesia (YLKI) or Indonesian Consumer

112 Economies of scope occur if the cost to produce one product is lowered if the firm also produces some other product or products.
Institution Foundation) is examining the pharmaceutical sector, due to concerns that there may be excessive concentration of market power in the drug distribution system.

- Openness to international trade is a crucial step toward the enhancement of competition in the domestic economy. Even so, as Indonesia moves toward a modern market economy, it needs a competition law to control private anticompetitive behavior. At present such behavior is difficult to identify, and will be even more difficult to prosecute successfully. Many of the competition problems that remain in Indonesia originate from various kinds of government interventions. At the moment, most of the effort should be directed into further deregulation and liberalization of the economy, and on educating the public about competition concerns and the benefits of competition. Both of these tasks should be major priorities of the KPPU in the years ahead.
Table 1. Prices of Cloves Sold to KUD and (Illegally) to Traders, North Sulawesi, 1984-98 (Rp/kg)

<table>
<thead>
<tr>
<th>Year</th>
<th>Illegal Sales to Traders (Dry)</th>
<th>Direct Sales to the KUD</th>
</tr>
</thead>
<tbody>
<tr>
<td>1984</td>
<td>6,697</td>
<td>-</td>
</tr>
<tr>
<td>1985</td>
<td>8,559</td>
<td>-</td>
</tr>
<tr>
<td>1986</td>
<td>6,477</td>
<td>-</td>
</tr>
<tr>
<td>1987</td>
<td>5,800</td>
<td>-</td>
</tr>
<tr>
<td>1988</td>
<td>3,950</td>
<td>-</td>
</tr>
<tr>
<td>1989</td>
<td>3,895</td>
<td>-</td>
</tr>
<tr>
<td>1990</td>
<td>7,825</td>
<td>-</td>
</tr>
<tr>
<td>1991</td>
<td>5,190</td>
<td>7,000</td>
</tr>
<tr>
<td>1992</td>
<td>3,489</td>
<td>5,500</td>
</tr>
<tr>
<td>1993</td>
<td>2,497</td>
<td>4,000</td>
</tr>
<tr>
<td>1994</td>
<td>2,661</td>
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<tr>
<td>1996</td>
<td>2,600</td>
<td>4,500</td>
</tr>
<tr>
<td>1997</td>
<td>n/a</td>
<td>5,000</td>
</tr>
<tr>
<td>1998</td>
<td>6,500</td>
<td>5,000</td>
</tr>
</tbody>
</table>

Averages:

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<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1984-90</td>
<td>6,172</td>
<td>-</td>
</tr>
<tr>
<td>1991-97 (BPPC)</td>
<td>3,165</td>
<td>4,857</td>
</tr>
</tbody>
</table>

- = none sold   n/a = not available

Table 2. Prices of Most Traded Cloves, Central Sulawesi, 1992-98 (Rp/kg)

<table>
<thead>
<tr>
<th></th>
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</tr>
</thead>
<tbody>
<tr>
<td>January</td>
<td>2,975</td>
<td>3,000</td>
<td>n/a</td>
</tr>
<tr>
<td>February</td>
<td>3,250</td>
<td>3,000</td>
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<tr>
<td>March</td>
<td>3,614</td>
<td>3,000</td>
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</tr>
<tr>
<td>April</td>
<td>2,340</td>
<td>3,000</td>
<td>6,400</td>
</tr>
<tr>
<td>May</td>
<td>2,320</td>
<td>2,750</td>
<td>7,000</td>
</tr>
<tr>
<td>June</td>
<td>2,525</td>
<td>2,750</td>
<td></td>
</tr>
<tr>
<td>July</td>
<td>2,509</td>
<td>3,000</td>
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</tr>
<tr>
<td>August</td>
<td>2,670</td>
<td>3,000</td>
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</tr>
<tr>
<td>September</td>
<td>2,830</td>
<td>3,250</td>
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<tr>
<td>October</td>
<td>2,770</td>
<td>3,300</td>
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<tr>
<td>November</td>
<td>2,905</td>
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<tr>
<td>December</td>
<td>2,960</td>
<td>3,125</td>
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<tr>
<td>Average</td>
<td>2,806</td>
<td>3,016</td>
<td>6,375</td>
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n/a = not available
Table 3. Characteristics of Highly-Concentrated or Problematic Industries

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<tbody>
<tr>
<td></td>
<td></td>
<td>Domestic Trade-Adjusted</td>
<td>Foreign State</td>
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<tr>
<td>31164</td>
<td>Wheat flour</td>
<td>100.0</td>
<td>0</td>
<td>-33</td>
<td>0.32</td>
<td>4.39</td>
<td>entry, NTB, price, distribution</td>
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<tr>
<td>31310</td>
<td>Alcoholic liquors</td>
<td>100.0</td>
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<td>0.00</td>
<td>0.08</td>
<td>entry, NTB</td>
</tr>
<tr>
<td>38430</td>
<td>Motor vehicles</td>
<td>100.0</td>
<td>50</td>
<td>0</td>
<td>600</td>
<td>3.92</td>
<td>4.33</td>
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<tr>
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<td>Musical instruments</td>
<td>98.6</td>
<td>98</td>
<td>0</td>
<td>75</td>
<td>0.16</td>
<td>1.41</td>
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<td>31330</td>
<td>Malt beer</td>
<td>97.8</td>
<td>99</td>
<td>0</td>
<td>74</td>
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<tr>
<td>38440</td>
<td>Motor cycles</td>
<td>96.5</td>
<td>16</td>
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<td>3.22</td>
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<td>31312</td>
<td>Wine</td>
<td>96.4</td>
<td>81.9</td>
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<td>31171</td>
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<td>31122</td>
<td>Ice cream</td>
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<td>85</td>
<td>0.02</td>
<td>0.39</td>
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<tr>
<td>31430</td>
<td>White cigarettes</td>
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<td>93.5</td>
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<td>1.21</td>
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<tr>
<td>31164</td>
<td>Processed vegs &amp; fruits</td>
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<td>-21</td>
<td>0.18</td>
<td>0.45</td>
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<tr>
<td>36490</td>
<td>Structural clay products</td>
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<td>0</td>
<td>12</td>
<td>53</td>
<td>0.02</td>
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<tr>
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<td>Animal slaughtering</td>
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<td>89.0</td>
<td>66</td>
<td>195</td>
<td>0.01</td>
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<tr>
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<td>Cement</td>
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<td>82.0</td>
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<td>-12</td>
<td>1.52</td>
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<tr>
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<tr>
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<td>Clove cigarettes</td>
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<td>80.8</td>
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<td>123</td>
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<td>85</td>
<td>-19</td>
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<td>Traditional medicine</td>
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<td>80.3</td>
<td>5</td>
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<td>0.07</td>
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<tr>
<td>32140</td>
<td>Carpet &amp; rugs</td>
<td>78.3</td>
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<td>0</td>
<td>-6</td>
<td>0.11</td>
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<td>74.4</td>
<td>57</td>
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<td>0.67</td>
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<td>35231</td>
<td>Soap &amp; detergents</td>
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<td>74.5</td>
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<td>1</td>
<td>386</td>
<td>0.50</td>
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<td>Tires</td>
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<td>73.4</td>
<td>44</td>
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<td>600&lt;</td>
<td>0.82</td>
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<td>38411</td>
<td>Shipbuilding</td>
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<td>20.6</td>
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<td>2</td>
<td>1.06</td>
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<tr>
<td>31112</td>
<td>Processed meats</td>
<td>71.5</td>
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<td>-1</td>
<td>0.03</td>
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<td>3</td>
<td>0.07</td>
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<tr>
<td>39060</td>
<td>Stationery etc</td>
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<td>40.3</td>
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<td>31270</td>
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<td>99</td>
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<td>6.85</td>
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<tr>
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<td>175</td>
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<tr>
<td>35140</td>
<td>Pesticides</td>
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<td>2</td>
<td>45</td>
<td>0.32</td>
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<tr>
<td>38320</td>
<td>Electronics etc</td>
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<td>5.8</td>
<td>49.7</td>
<td>12.6</td>
<td>81</td>
<td>1.62</td>
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<td>Soft drinks</td>
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<td>386</td>
<td>0.46</td>
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<td>32330</td>
<td>Leather products</td>
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<td>36110</td>
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<td>34120</td>
<td>Paper board products</td>
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<td>41</td>
<td>0.69</td>
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<tr>
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<td>70</td>
<td>0</td>
<td>n/a</td>
<td>0.23</td>
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<tr>
<td>32400</td>
<td>Footwear</td>
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<td>31.0</td>
<td>47</td>
<td>0.3</td>
<td>7</td>
<td>3.60</td>
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<tr>
<td>31181</td>
<td>Sugar processing</td>
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<td>19.4</td>
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<td>74</td>
<td>55</td>
<td>1.60</td>
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<td>33113</td>
<td>Plywood</td>
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<td>11</td>
<td>0.8</td>
<td>52</td>
<td>6.02</td>
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</tbody>
</table>

**Averages**

|       |               | 53.5                                         | 41.1                                    | 22.5                                           | 9.4                                           | 23                                   |                             |

Source: Bird (1999). n/a: not available. (a) Measured as the ratio of non-wage value added per employee to the manufacturing average.
Table 4. Trading/Processing Margins for Rattan in Central Sulawesi, May 1998

<table>
<thead>
<tr>
<th></th>
<th>Rattan Prices</th>
<th>Net Margin</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Input (Rp/kg)</td>
<td>Output (Rp/kg)</td>
</tr>
<tr>
<td><strong>Gatherers</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Forest to Au</td>
<td>-</td>
<td>200</td>
</tr>
<tr>
<td>Forest to Gimpu</td>
<td>-</td>
<td>400</td>
</tr>
<tr>
<td><strong>Local Traders</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Gimpu to Palu</td>
<td>500</td>
<td>1,000</td>
</tr>
<tr>
<td>Gimpu to Palu</td>
<td>650</td>
<td>1,050</td>
</tr>
<tr>
<td>Oloboju to Palu</td>
<td>500</td>
<td>900</td>
</tr>
<tr>
<td>Makmur to Palu</td>
<td>700</td>
<td>900</td>
</tr>
<tr>
<td><strong>Dryers</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Palu</td>
<td>700</td>
<td>1,545</td>
</tr>
<tr>
<td>Poso</td>
<td>500</td>
<td>1,300</td>
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<tr>
<td><strong>Semi-Processors, Palu (b)</strong></td>
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</tr>
<tr>
<td>Polished Batang</td>
<td>1,500</td>
<td>6,050</td>
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<td>Sand Polished Batang</td>
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<td>Core Lambang</td>
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<td>5,800</td>
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<tr>
<td>Fitrit Lambang</td>
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<td>10,800</td>
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<tr>
<td>W&amp;S Batang (c)</td>
<td>1,500</td>
<td>5,800</td>
</tr>
</tbody>
</table>

Notes:
Source: Data from Bennett, Marks, and Muslimin (1998b), based on interviews with market participants; some recalculations performed for the present study.
- = insignificant amount
(a) For gatherers, local traders, and driers, the net margin is shown as a percentage of the output price of polished batang for semi-processors in Palu. (Polished batang is the most common variety produced, as Table 3 shows). For semi-processors, the net margin is shown as a percentage of their output price for the actual product.
(b) For Palu semi-processors, output prices are assumed to equal the Surabaya price less transport costs of Rp 200/kg. With the rattan purchased wet, there is also an initial 50 percent weight loss due to drying.
(c) W&S means washed and sulfured, a simple form of processing. Rattan processed in this way is officially classified as rotan asalan.
<table>
<thead>
<tr>
<th>Commodity</th>
<th>Location</th>
<th>Sale Price (Rp/kg)</th>
<th>Export Price (FOB)</th>
<th>Producer Share (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td>(US$/Kg)</td>
<td>(Rp/kg) (b)</td>
</tr>
<tr>
<td>Rattan (a)</td>
<td>Au</td>
<td>200</td>
<td>0.90 (c)</td>
<td>7,200</td>
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<tr>
<td></td>
<td>Gimpu</td>
<td>400</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>1.30 (d)</td>
<td>10,400</td>
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<tr>
<td></td>
<td>Gimpu</td>
<td>5,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Kulawi</td>
<td>6,000</td>
<td>(Surabaya)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Palu</td>
<td>7,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cocoa</td>
<td>Gimpu</td>
<td>11,500</td>
<td>1.54</td>
<td>13,090</td>
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<tr>
<td></td>
<td>Palu</td>
<td>12,000</td>
<td>(Ujung Pandang)</td>
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<tr>
<td>Coffee</td>
<td>Gimpu</td>
<td>11,000</td>
<td>1.66</td>
<td>13,280</td>
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<tr>
<td></td>
<td>Palu</td>
<td>12,500</td>
<td>(Surabaya)</td>
<td></td>
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</tbody>
</table>

Notes:
Source: Bennett, Marks, and Muslimin (1998b), based mainly on interviews with market participants.
(a) Wet batang rattan sold by riverside in Au and Gimpu sold by gatherers; Dry rattan sold in Palu.
(b) Assumes exchange rate US$1.00 = Rp 8,000, on 8 May 1998.
(c) Calculated from Hong Kong price of US$1.20/kg.
(d) According to a major trader in Singapore.
<table>
<thead>
<tr>
<th>Commodity (Type)</th>
<th>Location (Seller Type)</th>
<th>1998 (Rp/kg, dry)</th>
<th>1997 (Rp/kg, dry)</th>
<th>1997-98 Change (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rattan (dry asalan, &gt;30mm, Batang)</td>
<td>Gimpu</td>
<td>1,300</td>
<td>700</td>
<td>86%</td>
</tr>
<tr>
<td></td>
<td>Palu</td>
<td>2,100</td>
<td>1,100</td>
<td>91%</td>
</tr>
<tr>
<td>Cloves (15% moisture, 3% defects)</td>
<td>Kulawi</td>
<td>6,000</td>
<td>2,500</td>
<td>180%</td>
</tr>
<tr>
<td></td>
<td>Gimpu</td>
<td>5,000</td>
<td>2,500</td>
<td>100%</td>
</tr>
<tr>
<td></td>
<td>Palu</td>
<td>7,000</td>
<td>n/t (b)</td>
<td>-</td>
</tr>
<tr>
<td>Cocoa (slightly fermented beans)</td>
<td>Gimpu</td>
<td>11,500</td>
<td>2,000</td>
<td>475%</td>
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<tr>
<td></td>
<td>Palu</td>
<td>12,000</td>
<td>2,750</td>
<td>336%</td>
</tr>
<tr>
<td>Coffee (Robusta beans)</td>
<td>Gimpu</td>
<td>11,000</td>
<td>4,000</td>
<td>175%</td>
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<td></td>
<td>Palu</td>
<td>12,500</td>
<td>5,250</td>
<td>138%</td>
</tr>
</tbody>
</table>

Notes:
Source: Bennett, Marks, and Muslimin (1998b), based on interviews with market participants.
(a) 1997/1998 price comparisons are for the periods July to December 1997 (just before and in the run up to the sharp fall in the Rupiah of January 1998) and May 1998 (just before another sharp fall in the Rupiah).
(b) n/t = not traded because of obstacles created by BPPC clove monopoly system.
Table 7. Summary of the Impact of Sandalwood Regulation in Nusa Tenggara Timur Province

<table>
<thead>
<tr>
<th></th>
<th>Under the 1986 Regulation</th>
<th>Under the 1996 Regulation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Official owner of the trees</td>
<td>the Pemda</td>
<td>the people</td>
</tr>
<tr>
<td>Official division of revenues</td>
<td>85%-15% in favor of Pemda</td>
<td>60%-40% in favor of Pemda</td>
</tr>
<tr>
<td>Typical prices for the people</td>
<td>Rp 700</td>
<td>Rp 1,500 - Rp 2,250</td>
</tr>
<tr>
<td>Official sale prices for Pemda</td>
<td>Rp 4,600 - 8,500 in 1990/91</td>
<td>Rp 9,000 - Rp 18,000 in 1995/96</td>
</tr>
<tr>
<td>Total revenues to the Pemda</td>
<td>Rp 2.9 billion in 1990/91</td>
<td>Rp 2.6 billion in 1995/96</td>
</tr>
<tr>
<td>Percentage for the people</td>
<td>Around 6.5 - 8 percent</td>
<td>Around 3 -12.5 percent</td>
</tr>
</tbody>
</table>


(a) Pemda refers to Pemerintah Daerah Tingkat 1, the First Level Government of the Area (the provincial government).
(b) Assumes entire harvest was *kelas campuran* and uses official cutting figures from Dinas Kehutanan Kupang. Note that the value of the harvest in 1996/97 was roughly six times the value in 1995/95, or about Rp 16 billion.
### Table 8. Sejumlah Perusahaan Yang Menguasai Pasar Lebih Dari 30%

<table>
<thead>
<tr>
<th>Jenis Produk</th>
<th>Pemain Utama</th>
<th>Grup Perusahaan/ Pemilik</th>
<th>Merek</th>
<th>Pangsa Pasar</th>
</tr>
</thead>
<tbody>
<tr>
<td>Minyak Goreng</td>
<td>PT Intiboga Sejahtera</td>
<td>Grup Salim/Liem Sioe Liong</td>
<td>Bimoli</td>
<td>60%</td>
</tr>
<tr>
<td>Mi Instan</td>
<td>PT Smart PT Indofood</td>
<td>Grup Sinar Mas/ Eka Tjipita Widjaya PT Indofood Sukses Makmur</td>
<td>Filma</td>
<td>30%</td>
</tr>
<tr>
<td>Tepung Terigu</td>
<td>PT Bogasari Flour Mills</td>
<td>Grup Salim</td>
<td>Segitiga Biru</td>
<td>90%</td>
</tr>
<tr>
<td>Air Mineral</td>
<td>PT Aqua Golden Mass.</td>
<td>PT Tirta Investama/ Alm. Tirto Utomo</td>
<td>Aqua</td>
<td>83,7%</td>
</tr>
<tr>
<td>Minuman Ringan</td>
<td>PT Coca-Cola Tirtalina Bottling Company</td>
<td>Grup Teknik Umum</td>
<td>Coca-Cola</td>
<td>40,9%</td>
</tr>
<tr>
<td>Detergen</td>
<td>PT Unilever</td>
<td>Unilever</td>
<td>Rinso</td>
<td>58,9%</td>
</tr>
<tr>
<td>Kopi Instan</td>
<td>PT Santos Jaya Abadi</td>
<td>n/a</td>
<td>Kapal Api</td>
<td>50%</td>
</tr>
<tr>
<td>Rokok</td>
<td>PT Gudang Garam (Rokok Filter)</td>
<td>Surya Wonowidjojo</td>
<td>Gudang Garam</td>
<td>43%</td>
</tr>
<tr>
<td>Makanan siap saji</td>
<td>PT Fastfood Indonesia</td>
<td>Grup Gelael</td>
<td>Kentucky Fried Chicken</td>
<td>44,9%</td>
</tr>
<tr>
<td>Ritel</td>
<td>PT Matahari Putra Prima</td>
<td>Grup Matahari/Hari Darmawan</td>
<td>Matahari Dept. Store</td>
<td>40%</td>
</tr>
<tr>
<td>Kertas</td>
<td>PT Tjiwi Kimia PT Indocement Tunggal Prakarsa</td>
<td>Grup Sinar Mas</td>
<td>Sinar Dunia</td>
<td>45%</td>
</tr>
<tr>
<td>Semen</td>
<td>PT Gajah Tunggal</td>
<td>Grup Sinar Mas/Aji Sjamsul/ Nursalim</td>
<td>Tiga Roda</td>
<td>40,8%</td>
</tr>
<tr>
<td>Ban</td>
<td>PT Asahimas Flat Glass Co.</td>
<td>Grup Roda Mas</td>
<td>Asahi Glass</td>
<td>65%</td>
</tr>
<tr>
<td>Kaca</td>
<td>PT Pertamina</td>
<td>BUMN</td>
<td>Mesran</td>
<td>60,1%</td>
</tr>
<tr>
<td>Otomotif</td>
<td>PT Astra Motor</td>
<td>Grup Astra</td>
<td>Toyota, Daihatsu, Isuzu, BMW, Peugeot, Nissan Diesel</td>
<td>49,4%</td>
</tr>
</tbody>
</table>


n/a: not applicable