"Market Research and Monitoring on the leather industry in selected Asian countries: China, Indonesia, Philippines, Vietnam"

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STUDY REPORT: MARKET SURVEY ON INDONESIA

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Section A

I N D O N E S I A

COUNTRY REPORT

1. Political background

The Japanese conquest of the Dutch East Indies in 1942 and the subsequent defeat of Japan enabled the pan-Indonesian nationalists, under the leadership of Sukarno, to proclaim Indonesia's independence on August 17th 1945. This was followed by an extended armed struggle against returning Dutch forces. It was not until late 1949 that the Dutch formally transferred sovereignty over the archipelago, excluding Dutch New Guinea, to Indonesia.

The first 15 years of Indonesia's history as an independent state were marked by political instability and economic decline.

In March 1966 the New Order was established when the executive power of government was transferred to Major-General Suharto. He became acting president in March 1967, and was elected for six further five-year terms, the last of which began with his election by the People's Consultative Assembly (Majelis Permusywaratan Rakyat, MPR) on March 1998. Increasingly vocal opposition to the regime that had been mounting over the previous two years (including during an unprecedentedly violent parliamentary election campaign in May 1997) was given added momentum by the severe economic crisis that gripped Indonesia in late 1997. Four days of rioting in Jakarta in mid-May 1998 convinced even Suharto's most loyal supporters that a change was needed. At the end on May 1998, having lost the backing of the military high command and most of his cabinet, the president resigned, to be succeeded by his vice-president, B J Habibie.

After becoming president, Mr Habibie had to distance himself from his former mentor, Suharto. His survival depended on his ability to play to the diverse constituencies (armed forces, economic policymakers, multilateral institutions, political opposition) that forced Suharto to step down.

Despite these gestures Mr Habibie's hold on power was not fully secure. The backing of the various constituencies remained conditional and the new president was vulnerable to sudden shifts in support. Despite some populist gestures he had no real control over the social upheavals occurring at the grassroots level.

Violence became endemic. It is often difficult to disentangle the motives behind it: political, religious, ethnic, criminal, tribal or economic. In this contest developed the movement for the independence of Timor Est. A specific referendum took place in August 1999 and a large majority voted for the independence. Demonstrations and killings followed.

Concerning international relations, until the mid-1980s Indonesia was content to focus its foreign policy within the regional context of the Association of South-East Asian Nations (ASEAN) and to permit its wider foreign policy initiatives to be taken under the auspices of the organisation. Having made much progress towards its primary aim of domestic economic development, the government began to seek a more prominent international role from the second half of the 1980s onwards. It chaired the Non-Aligned Movement from 1992 to 1995 and played a leading part in attempts to develop the Asia-Pacific Economic Co- operation (APEC) forum, hosting its second annual summit in November 1994. It has also taken the initiative in attempts to resolve regional disputes, in Cambodia, the Spratly Islands in the South China Sea and the Muslim insurgency in the southern Philippines.

2 Economic background

Main economic indicators, 1997

Real GDP growth (%)	4.6
Consumer price inflation (av; %)	7.5
Current-account balance ($ bn)	-4.8
Foreign debt ($ bn)	136.1(a)
Exchange rate (av; Rp:$)	2,909
Population (m)	201.4

(a) Bank Indonesia estimate; end-year.

Sources: Central Bureau of Statistics, Indikator Ekonomi; Bank Indonesia, Indonesian Financial Statistics.

Indonesia has a reasonably well-balanced economy in which all major sectors play an important role. Agriculture (including animal husbandry, fishing and forestry) has historically been the dominant activity, in terms of both employment and output. There is a vast range of mineral resources, the extraction and exploitation of which have proceeded rapidly during the past three decades, enabling the mining sector to make an important contribution to the balance of payments. The manufacturing sector also expanded dramatically during the New Order period, and especially since the mid-1980s. In 1991 the share of manufacturing in GDP exceeded that of agriculture for the first time. The services sectors jointly accounted for approximately 41% of GDP in 1996, and 30% of the working population was engaged in these sectors.

Because of the low levels of disposable income domestically, exports have traditionally constituted the primary engine of growth. Before the mid- 1970s exports consisted mainly of a small number of primary commodities, including natural rubber, coconut oil and copra, tin and crude oil. The decline in petroleum prices after 1983 resulted in a concerted push towards export-oriented industrialisation, as a result of which semi- processed and manufactured products increasingly came to dominate exports. A determined effort to promote tourism since the mid-1980s has also had a big impact on invisibles export earnings during the past decade.

Comparative economic indicators, 1997

	Indonesia	China	India	Malaysia	Philippines	Thailand
GDP ($ bn)	228	902	379	98	83	154
GDP per head ($)	1,140	730	400	4,544	1,132	2,540
Consumer price inflation (%)	7.5	2.8	7.2(a)	2.7	5.1	5.6
Current-account balance ($ bn)	-4.8	29.7	-6.1	-4.8	-4.3	-2.9
Merchandise exports fob ($ bn)	56.3	182.7	34.1	77.8	25.2	56.7
Merchandise imports fob ($ bn)	46.2	136.4	45.1	73.8	36.3	-55.1
Foreign trade (b) (% of GDP)	45	35	21	155	74	3

(a) Wholesale price inflation. (b) Merchandise exports plus merchandise imports.

Source: EIU.

Both external and internal trade have traditionally been subject to a variety of levies and controls. A wide range of duties and taxes, quantitative controls, sole trading licences and other restrictions have been imposed on exports and imports. Domestic trade has been similarly regulated: foreign nationals and enterprises have been barred from engaging in retail trade; ethnic Chinese entrepreneurs have been
discouraged from trading in rural areas; and exclusive trading privileges for a number of products have been granted to publicly or privately owned monopolies.

The sharp deterioration in the balance of payments caused by the decline in oil prices in the mid-1980s, and the consequent need to develop non- oil/gas export revenue, prompted the introduction of a programme of trade policy reforms aimed at reducing the cost of imported inputs for export-oriented industries. This resulted in the steady replacement of non-tariff barriers with a more transparent tariff regime, as well as a gradual reduction in the degree of tariff protection granted to domestic producers. Little was done to relax the export restrictions, however, which remained widespread, but particularly in the timber-based industries. The liberalisation of domestic trade also proceeded very slowly, and in some cases was even reversed in response to pressure from politically well-connected business interests.

A breakdown of the economy's growth performance by sector shows that industry was the principal engine of growth. Manufacturing expanded much more rapidly than the economy as a whole. The need to ensure matching growth of infrastructure stimulated a sharp acceleration in the rate of growth of the utility and construction sectors. The electricity, gas and water component of GDP expanded by an average of around 14% per year between 1986 and 1996, while the construction sector expanded by more than 10% per year during the same period.

The growth of the other sectors, while not so dramatic, was also impressive. Agriculture grew steadily, although the food-crop subsector was held back for much of the 1990s by unfavourable climatic conditions and the increased conversion of paddy fields to other uses.

The expansion of the mining and quarrying sector also began to slow in the early 1990s as a result of the gradual depletion of known petroleum reserves. This decline in the oil industry was partly offset by the rapid expansion of a number of other mining activities, including coal, copper and gold. The services sector also grew rapidly, fuelled both by the demand generated by the expanding primary and secondary industries, and by the growth in personal disposable incomes, the effect of which was reinforced by the booming tourism industry.

In a reform package issued in June 1994, foreign investment is permitted in virtually all sectors, including infrastructure; wholly-owned foreign investments are allowed; the equity limits on foreign partners in joint-venture enterprises have been raised to 95%; an earlier minimum capital requirement of $250,000 for foreign investors has been scrapped; and the divestment requirement has been eased to a token 1% of equity after 15 years.

Rising domestic interest rates and a narrowing inflation differential prompted strong inflows of foreign capital and an appreciation of the rupiah's real effective exchange rate in the first half of 1996. This phenomenon was short-lived, however, as political events in mid-1996 caused investors to reassess Indonesia's political risk. By early 1997 concerns about Indonesia's political stability were reinforced by fears that the country's economy, while exhibiting healthier fundamentals than those of its neighbours, was overheating to a point where its internal and external stability might be threatened.

This rendered the rupiah susceptible to contagion by the currency crisis that began in Thailand in mid-1997 and rapidly spread throughout South-east Asia. After withstanding this pressure for a short period, the currency eventually buckled. On August 14th 1997 the rupiah was allowed to float freely, setting off a decline that was eventually to surpass those suffered by the currencies of the other stricken Asian economies.

Prudent economic management enabled Indonesia to record consistently high rates of economic growth, well in excess of the rate of population growth, for more than three decades.

3. Foreign trade

After the oil price increases of 1973-74 Indonesia's external trade was dominated by oil and gas exports, which consistently enabled it to register a surplus on its merchandise account, even though the non-oil/gas account remained in deficit. Until the early 1980s the growth of the overall surplus permitted the rising deficit on the non-oil account to be overlooked. After the slump in global oil markets in the mid-1980s a major effort was, however, launched to reduce the non-oil/gas deficit, mainly by promoting non-oil/gas exports. This effort was very successful and the resulting surge in non-oil/gas exports caused the non-oil/gas deficit to fall sharply even though the rapid growth in domestic consumption and investment also brought about a sizeable increase in non-oil/gas imports.

Foreign trade, 1997
($ m)

Exports, fob

Agricultural goods	3,133
Industrial goods	34,985
Minerals	3,107
Oil & gas	11,623
Total incl others	***53,443***

Imports, cif

Consumer goods	2,166
Raw materials	30,230
Capital goods	9,284
Total	***41,680***
Balance	***11,763***

Source: Central Bureau of Statistics, Indikator Ekonomi.

Although the impact of the crisis on both the productive and financial sectors prevented Indonesia taking full advantage of the increased competitiveness arising from the devaluation of the rupiah, non-oil/gas exports rose by 5.7% in the first seven months of 1998 compared with the same period of 1997. In view of the weak prices for most export goods during that period, that implied a stronger increase in volume terms. The benefits of this growth were more than offset by a sharp (nearly 32%) fall in oil/gas exports, reflecting weak oil and gas prices. The net effect of these developments was a 2.9% fall in overall export earnings in the first seven months of 1998. The impact of the decline in export earnings has been more than offset by a 37% fall in the value of imports in the first seven months of 1998.

A breakdown of exports by product reveals a growing diversification of the product mix, with 26 separate products achieving export revenue of $100m or more in 1997. Oil and natural gas continue to make an important contribution to Indonesia's exports, accounting for 21.7% of their total value in 1997. In the non-oil/gas sector a large number of products have emerged as major exports, these include various forms of processed wood, textiles, garments, electrical products, processed foods, coal and copper.

Among imports, raw materials and other intermediate goods have been the leading category, followed by capital goods. This reflected the high rate of investment and manufacturing growth taking place in the country until recently. It also reflected the heavy dependence of many of the country's manufactured exports on imported inputs, which made increasingly large swathes of manufacturing industry vulnerable to a rupiah devaluation. Imports of consumer goods were also increasing steadily in response to growing levels of disposable income.
Indonesia has a relatively open economy, although the import of certain goods is prohibited or limited by quota restrictions while other goods may be imported only by approved importers. Goods particularly affected are those for which adequate domestic production capacity has been installed. Tariffs and surcharges are also imposed to regulate the flow of imports, which are divided into four categories ranging from those regarded as essential to unclassified. Duties levied on these imports range from nil to 100%.

Other surcharges ranging from 50% to 400% may also be imposed, often depending on how competitive the imported product is with its Indonesian counterpart. Imported goods may also be subject to value-added tax and an additional tax on luxury goods. Since May 1986 the restrictions on imports of capital and intermediate goods have been eased progressively in order to enable domestic exporters to import more competitively priced inputs from abroad.

Indonesia's external trade has been heavily biased towards three countries, Japan, the US and Singapore, which accounted for nearly 47% of exports and 41% of imports in 1997. However, Indonesia's dependence on these countries has been declining steadily. The increasing development of direct trading links between Indonesia and its major import suppliers has caused Singapore to lose some of its importance as a transshipment centre.

The exports that have been doing well appear to be ones in which foreign investors or suppliers play an important role (such as textiles and electrical goods) and some natural-resource based goods where low domestic input costs, the weak rupiah and new capacity (often outside Java) have allowed Indonesia to undercut competitors. Paper and pulp is in the second category: US and European producers have been complaining that they are unable to compete with the Indonesian product. Among non-manufactures it is not only oil and gas that have been losing ground: coal was the only non-oil and gas commodity to retain its place in the top ten exports in January-May 1998. Copper and palm oil both suffered from weak prices, but export bans and taxes will also have hit palm oil sales, which fell by 55% in dollar terms in the first five months.

Top ten exports
(% of total)

1997 **Year**		**1998** **Jan-May**	
Crude petroleum	10.3	Textiles	9.9
Gas	9.1	Gas	8.4
Textiles	6.8	Crude petroleum	7.0
Plywood	6.4	Clothing	4.8
Clothing	5.4	Plywood	4.1
Processed rubber	3.7	Processed rubber	3.1
Copper	2.8	Electrical apparatus	2.9
Coal	2.8	Coal	2.7
Palm oil	2.7	Paper, paper goods	2.5
Electrical apparatus	2.6	Chemicals	2.0
Total incl. other	***100.0***	***Total incl. others***	***100.0***

Source: BPS, Indikator Ekonomi.

Top ten manufactured exports, Jan-May
($ m unless otherwise indicated)

	1997	1998	% change (a)
Textiles	2,766	3,048	10.2
Forestry products	2,391	1,933	-19.5
Jewellery	405	1,226	202.3
Electronics	1,349	1,139	-15.6
Machinery & mechanical appliances	765	995	30.1
Pulp & paper	573	849	48.0
Leather, leather goods & footwear	950	665	-30.0
Chemicals	413	641	55.4
Processed rubber	846	630	-25.5
Processed coconut & palm oil	732	573	-21.7
Top ten manufactures	11,191	11,699	4.5
Total manufactures	***13,428***	***14,433***	***7.5***
Total merchandise exports	***21,143***	***20,088***	***-5.0***

(a) Calculated from unrounded data.

Sources: Kompas; BPS, Buletin Ringkas.

Imports have fallen across the board. Partly this too reflects weak dollar prices, but the size of the decline in all import categories indicates that volumes were well down in the first seven months of 1998. The fall in intermediate goods imports was the sharpest. The relatively low decline in consumer goods imports probably reflects the large volumes of staples such as rice and sugar that have been imported in 1998. The fall in capital goods imports confirms the scale of the downturn in investment that other indicators have shown.

Incomplete current-account data for the first half of 1998/99 fiscal year (April-September) suggest that non-oil and gas exports have begun to falter, while import growth is not declining as sharply as it was. In addition to the familiar list of obstacles facing exporters, diminishing stocks of intermediate goods needed for exports may also account for this downturn. The slowdown in the rate of decline of imports may reflect the need to replenish these stocks as well as the large volumes of rice imports in August-September 1998. Despite the fall in trade turnover and a probable decline in repatriated earnings, the data also show an increase in the deficit on invisibles. This is probably the result of low services earnings, particularly from tourism, diminished workers remittances (as Indonesians working elsewhere in the Asia region lose their jobs) and continued high interest payments. Despite this increase in the invisibles deficit, the current account was still in healthy surplus in the first half of 1998/99 thanks to the massive trade surplus.

Exports
($ m; fob)

Products	1993	1994	1995	1996	1997
Food	*2,923*	*3,558*	*3,583*	*3,767*	*3,546*
Beverages & tobacco	*193*	*137*	*196*	*229*	*253*
Crude materials	*2,554*	*3,235*	*5,035*	*5,082*	*4,357*
Mineral fuels	*10,391*	*10,524*	*11,508*	*12,860*	*13,353*
Animal fats & oils	*848*	*1,374*	*1,384*	*1,577*	*2,280*
Chemicals	*829*	*1,010*	*1,524*	*1,726*	*1,883*
Manufactured goods	*9,668*	*9,470*	*10,438*	*10,796*	*9,703*
Machinery & transport equipment	*2,206*	*3,048*	*3,828*	*4,999*	*4,622*
Miscellaneous manufactures	*7,031*	*7,550*	*7,876*	*8,688*	*6,982*
Other goods	*180*	*147*	*46*	*90*	*6,569*
Total exports	***36,823***	***40,053***	***45,418***	***49,814***	***53,444***

Sources: Central Bureau of Statistics, Indikator Ekonomi; Buletin Ringkas.

Imports
($ m; cif)

Products	1993	1994	1995	1996	1997
Food	1,342	1,897	3,023	3,931	2,983
Beverages & tobacco	118	142	178	220	250
Crude materials	2,428	2,728	3,643	3,478	2,979
Mineral fuels	2,156	2,425	3,007	3,670	4,047
Animal fats & oils	101	104	105	102	116
Chemicals	4,045	4,854	6,251	6,031	5,913
Manufactured goods	4,841	5,222	6,669	6,630	6,491
Machinery & transport equipment	12,158	13,450	16,290	17,497	17,573
Miscellaneous manufactures	1,133	1,145	1,426	1,367	1,324
Other goods	6	16	37	3	4
Total imports	***28,328***	***31,983***	***40,629***	***42,929***	***41,680***

Source: Central Bureau of Statistics, Indikator Ekonomi.

Main trading partners
($ m)

	1993	1994	1995	1996	1997
Exports to:					
Japan	11,172	10,929	12,288	12,885	12,485
US	5,230	5,829	6,322	6,795	7,148
Singapore	3,372	4,150	3,767	3,867	5,468
South Korea	2,220	2,593	2,917	3,281	3,462
China	1,249	1,322	1,742	2,057	2,229
Asia	23,798	25,599	29,084	31,674	33,918
of which:					
ASEAN(a)	4,918	5,900	6,334	7,549	9,037
Europe	5,708	6,332	7,201	8,204	8,536
of which:					
EU	5,391	5,948	6,760	7,724	8,056
Australasia	852	772	1,071	1,320	1,632
America	6,003	6,712	7,440	7,939	8,502
Africa	463	638	621	639	775
Total	***36,823***	***40,053***	***45,418***	***49,814***	***53,443***

	1993	1994	1995	1996	1997
Imports from:					
Japan	6,248	7,740	9,217	8,504	8,252
US	3,255	3,588	4,756	5,060	5,441
Singapore	1,793	1,877	2,368	2,875	3,411
Germany	2,072	2,473	2,819	3,001	2,629
Australia	1,399	1,542	2,016	2,535	2,427
Asia	15,071	17,775	21,821	22,313	22,024
of which:					
ASEAN(a)	2,642	3,006	4,110	5,088	5,393
Europe	7,266	7,312	9,323	10,258	9,259
of which:					
EU	6,651	6,612	8,175	9,234	8,332
Australasia	1,561	1,726	2,222	2,780	2,661
America	4,290	4,840	6,654	6,935	7,050
Africa	140	332	608	643	685
Total	***28,328***	***31,984***	***40,629***	***42,929***	***41,680***

(a) Brunei, Malaysia, Philippines, Singapore, Thailand, Vietnam.

Source: Central Bureau of Statistics, Indikator Ekonomi.

4 Commercial relations with Italy

The Italian trade with Indonesia shows normally a deficit. In the period 1995/1998, it was remarked a constant increasing of import with the exception of the 1996. In particular 1998 marked an important reduction of Italian export and a more important growth of import that cause a strong deficit.

Italian export essentially consists in different sectors mechanical equipment: textile, marble, wood, footwear, machines tools, electrical machinery, etc..

Italian import are represented by oil and oil products, unmanufactured wood, manufactured wood, furniture, textile yarn, clothing, footwear, etc..

Italy is placed as the 13th suppliers and the 11th client of Indonesia.

Trade between Italy and Indonesia
(It Lire bn)

	1995	1996	1997	1998
Italian Export	1219	1697 (+39,2%)	1598 (-5,9%)	478 (-70,1%)
Italian Import	1590	1435 (-9,7%)	1597 (+11,3%)	1882 (+17,8%)
Balance	-371	262	1	-1405

Note: % change year on year

Source: Italian Official Statistics.

Section B

I N D O N E S I A

MARKET STUDY ON THE LEATHER INDUSTRY

1. EXECUTIVE SUMMARY

- Indonesia has a **potential sources of raw hide and skin**, but still have not be took advantage of as a whole. Finally get a net loss of export for the country.

  Indonesia hide and skin has a specific fine grain with strong fiber bundles, it very nice used for kind of leather and leather goods (shoe, garment, glove and others). Java cow hide to be claimed to have something of niche abroad market especially in Europe.

  However most tanners have less skill for finishing to get high quality for abroad market, still on crust currently. As a whole quality for local cow leather still for local market to consume medium and low classes community, with a relatively low price. While in the fact it can be finished to high quality and performance especially for shoes. Even sometime the price of local cow leather is only a little above the price of crust on abroad. It mean that country get a net loss value. But in reality these problem has not been solved yet both Government or industry.

  Exception on sheep and goat sector, where the leather of Indonesian hair sheep and goat have higher quality than cow leather. Even have a good market on abroad like Italy, Germany, Hongkong and USA.

- Golf glove from sheep and goat made in Indonesia have to share predicted more than 50% from the total consumption in the world.

  The net loss of added value also seem in the **leather product** industry like shoes, garment, bag and leather handicraft. Leather goods is still consumed also by medium and low classes with a low price.

  Most of human resources involved in the **leather goods industry** have no skill to look at well the characteristic of leather concerning quality and performance of leather (natural felling and natural appearance). They still claim that good leather is leather without defect on the area. They don't care with natural felling and appearance, in which the two factor is the very importance to decide the real quality of leather. So they have not initiative to make and cut the pattern on the leather used efficiently.

  Exception the **sport shoe product** (Nike and Reebok) which have been established by transferring high technology from Korea to Indonesia. The sport shoe which been export have gave a high sharing to the world market.

- By these above condition Government have to decide a **new strategy to develop leather industry** in Indonesia.

  However due to Indonesia still facing with the severe monetary crisis and has crippled with a devaluation of local currency, adding by bad political condition, the planning to develop leather industry will be hampered.

2. COUNTRY REGULATION

2.1 Import and Export Activity

Since 1986 Indonesian Government has carried out to develop leather industry by imposing prohibited taxes on export of hide and skin (US$ 4,00/kilograms), pickle (US$ 10,00/kilograms), crust (50% value), while it charges 5% for finished leather. Government hope that it will replace export on raw hide/skin into finished leather or leather products.

However by these tax structure the result that not all the effort get a helpful, even on the country get a harmful, especially on the cow and buffalo sector.

Since for a long time before 1986 cow and buffalo in crust stage have been accepted in Europe market like Holland and Germany, but by the tax structure the export stop totally, finally they process to finished leather for local market with a low price. Around 50% from the total production of buffalo raw hide to be consumed by the food industry.

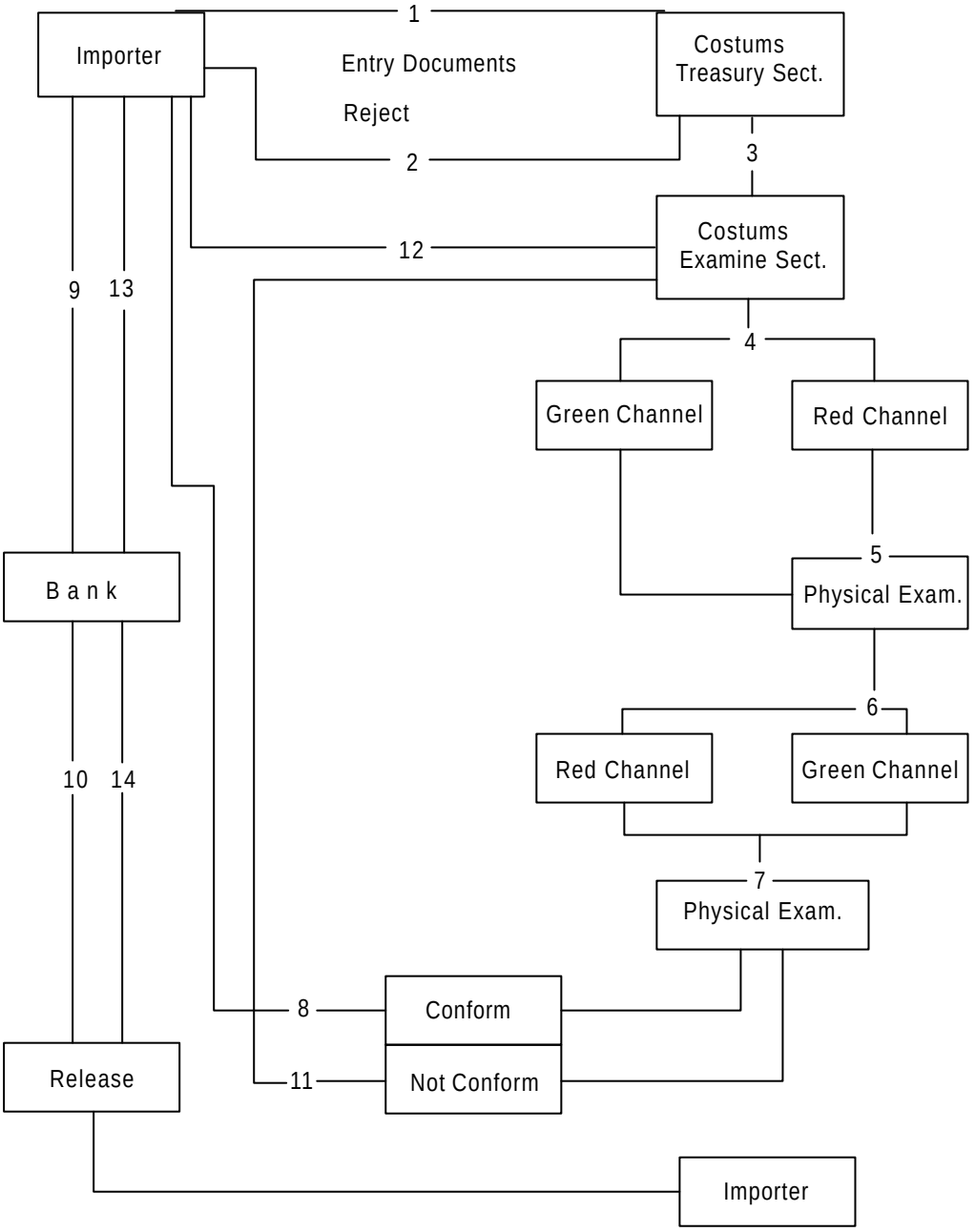
Look at to unsuccessfull regulation above the Government try to change the tax structure by Decision of Finance Ministry on 1998, in which the tax of all kind leather included raw hide and skin is free (0%). As a result in the short time export raw hide and skin, pickle and wet blue going up drastically carried out by a speculator, even though with a small benefit. Shortage of raw material with a very high price faced by tannery and they don't understand how to calculate in their production cost. In these case Government has made a big mistake and seen as a unconsistence action. These problem cause a great problem for tannery, because the regulation to coincide with economic crisis in the end of 1997.

2.2 Customs Regulation

Customs Regulation for export and import adhere to the on arrival inspection system.

Exception export in which get a facility from the Government (free on duty, getting back of duty, delay payment of VAT) obligate for using report of inspection by the Indonesian surveyor.

In the next page it is possible to find the distribution channel of the On Arrival Inspection System for import purposes.



Current regulation on import of hides and skins is shown on the Book of Indonesian Costumes Tariff, that all kind of leather can be imported from other country with no import duty.

For carrying out to import raw hide/skin and pickle requires a permit from Department of Agriculture to impose a quarantine to inspected for tooth and mouth diseases. However inspection don't in fact never made, so quarantine often leads to serious delay in carrying out the goods from the port.

Sometime tanners will get a problem on raise cost, delay production and risk for the putrefaction on raw material in the port. For wet blue and finished leather don't require permit and not be quarantined.

Chemicals for tanning industry regulated on the Indonesian Costumes Tariff with import duty range 0 to 25%. Twenty percent of chemicals import with 0% and the balance with 5% to 25% import duty. Chemicals is the most important input for tanning industry, accounting around 30% of total cost, and bear an average duty around 10%. More than 75% chemical used in the tanning industry must be imported from other country.

Government regulate duties on most chemicals tanning are targeted for maximum rates of 5% on year 2003, laid out in the Deregulation Package of June 1996. Due to the chemicals is the high load for tanneries, Indonesian Tanners Association request to the Government to accelerate the reduction of duties before 2003 to help tanneries in the economic crisis.

Import of tanning machinery has no duties as shown in the Costumes Tariff. Import for rebuilt machine require recommendation from Department of Industry and Trade.

Shoes and leather goods from other country beard high duties to protect domestic products.

2.3 Foreign Investments

On the Government Regulation No. 10/1994 regarding the liberalism investment, the investor both from abroad and local has given easily to invest in Indonesia by making List of Negative Investment.

The leather industry doesn't appear on the List. It means that investor is free to invest for setting up leather industry in Indonesia.

Total investment until 1997 before Indonesia face the economic crisis shows the figures Rp.8.018.830 Mio, but as long as crisis still no investment for leather industry in Indonesia.

2.4 Environmental Regulation

Environmental regulation for tanning industry issued by Ministry of Environmental of Life under Decision No : 51/Men-KLH/1995 by laid out the qualification of waste out from tanning industry into two Tables List as follows :

Tables I

Parameter	**Chrome tanning with wet salted as raw material**
BOD	Maximum content 150 mg/L
COD	Maximum content 300 mg/L
Total suspended solid	Maximum content 150 mg/L
Fat	Maximum content 5 mg/L
Chrome total	Maximum content 2 mg/L
Sulfide (H_2S)	Maximum content 1mg/L
Ammonia (NH_3N)	Maximum content 10 mg/L
pH	6,0 – 7,0

Tables II

Parameter	**Chrome tanning with wet salted as raw material**
BOD	Maximum content 50 mg/L
COD	Maximum content 100 mg/L
Total suspended solid	Maximum content 50 mg/L
Chrome total	Maximum content 0,4 mg/L
Fat	Maximum content 5 mg/L
Sulfide (H_2S)	Maximum content 0,4 mg/L
Ammonia (NH_3N)	Maximum content 0,5 mg/L
pH	6,0 – 9,0

For the tanning industry operated currently based on the Tables I until 2003, after these year based on the Tables II.

For tanning industry set up currently based directly on the Tables II. Besides central regulation, some of Regional Government which carried out Clean River Programs, issued the qualification more strict or directly on the Tables II.

3. STATE OF INDUSTRY

3.1 Tanning Industry

3.1.1 Raw Material Supply and Trade

Raw hide and skin is the by product of slaughterhouse industry.

Supply of raw hides and skins can be analysed through three main aspects :

- growth of livestock population;
- growth of slaughter of cattle;
- growth of production of hides and skins.

3.1.1.1 LIVESTOCK POPULATION

Livestock Population
(000)

Year	Kind of cattle			
	Cow	Buffalo	Goat	Sheep
1993	10.829,0	3.057,0	11.502,0	6.240,0
1994	11.367,0	3.104,0	12.770,0	6.741,0
1995	11.534,0	3.136,0	13.167,0	7.168,0
1996	11.816,0	3.171,0	13.840,0	7.724,0
1997	12.148,0	3.238,0	14.540,0	7.963,0
1998	12.338,0	3.347,0	14.092,0	9.942,0
1999	12.612,0	3.429,0	14.363,1	8.218,4
2000	12.893,6	3.513,4	14.639,4	8.503,9
2001	13.180,5	3.559,7	14.921,0	8.799,3
2002	13.473,8	3.688,1	15.208,1	9.105,0
2003	13.773,6	3.778,7	15.500,7	9.421,3
var (%)	2,2	2,5	1,9	3,5

Note : 1993-1998 real figure
1998-2003 projection figure

As long as eleven years period with projection figure on six years latest, the growth of livestock population shows for cow 2,2%; buffalo 2,5%; goat 1,9% and sheep 3,5%. Raising of the livestock population depend on the stage of breeding stage of death and import of cattle.

3.1.1.2 CATTLE SLAUGHTERING

Cattle Slaughtering
(000)

Year	Kind of cattle			
	Cow	Buffalo	Goat	Sheep
1993	1.855,6	256,2	5.694,9	3.204,0
1994	1.706,5	232,4	6.515,2	3.607,7
1995	1.761,1	242,0	6.858,0	3.969,4
1996	7.872,0	243,9	7.605,5	4.326,6
1997	1.990,0	245,9	8.434,6	4.716,0
1998	2.115,4	249,9	9.353,9	5.140,5
1999	2.248,6	249,8	10.373,9	5.603,1
2000	2.390,3	251,8	11.504,2	6.107,4
2001	2.540,9	353,9	12.758,1	6.657,1
2002	2.701,0	255,9	14.148,8	7.256,2
2003	2.871,7	257,9	15.691,0	7.909,3
var (%)	4,6	0,1	10,7	9,5

Note : 1993-1998 real figures
1998-2003 projection figures

Slaughtering depend on the consumption of meat. Slaughtering is carried out in the slaughter house and outside. Around 70% cow and buffalo slaughter in the slaughterhouse, 30% slaughter outside. For sheep and goat 30% in slaughterhouse and the balance in the outside.

Total slaughterhouse in Indonesia : Type A (more than 100/day) 6 unit, Type B (50-100/day) 9 unit and Type C (5-10/day) 723 unit.

The growth of slaughtering until 2003 under 6 years projected : Cow 4,6%, buffalo 0.1%, goat 10.7% and sheep 9.5%.

3.1.1.3 PRODUCTION OF HIDES AND SKINS

Production of hides and skins
(Tons)

Year	Kind of cattle			
	Cow	Buffalo	Goat	Sheep
1993	11.133,6	2.562,0	2.847,5	1.602
1994	10.239,0	2.324,1	3.257,6	1.803,9
1995	10.566,6	2.420,0	3.429,0	1.984,7
1996	11.232,3	2.439,4	3.802,8	2.163,3
1997	11.939,9	2.458,9	4.217,3	2.358,0
1998	12.692,1	2.478,5	4.676,9	2.570,2
1999	13.491,8	2.498,4	5.586,7	2.801,6
2000	14.341,7	2.518,4	5.752,1	3.053,7
2001	15.245,3	3.538,5	6.373,1	3.328,5
2002	16.205,7	2.558,8	7.074,4	3.628,1
2003	17.226,7	2.579,3	7.845,5	3.954,6
var (%)	4,6	0,1	10,7	9,5

Note : 1993-1997 real figures
1998-2003 projection figures

Production of raw hide and skin are based on the conversion figure that for cow hide 6 kilogram/hide, buffalo 10 kilogram/hide, goat 0,5 kilogram/pieces and sheep 0,5 kilogram/pieces, in dry weight.

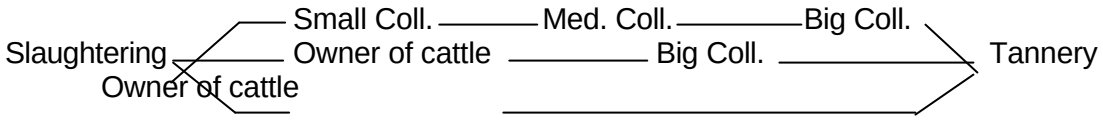
3.1.1.4 FLAYING AND CURING

Most of cow and buffalo are flayed in the slaughter house (70%) while the residual part in outside slaughter house (30%). Sheep and goat flayed in slaughter house are 20%, the others in outside.

All hides and skins are flayed without machine, but by hand knife. So the characteristic of Indonesian hides and skins have much knife cut defect on the flesh side. To remove meet and fat waste in the flesh side is also be done by hand knife.

Curing is carried out by the collector with salt curing system majority and sun dried curing system minority. Curing is not directly done after flaying, but it need 1-8 hours due to in transportation from slaughtering to the collector. In this condition there are possibilities of putrefaction of the skin. Resalting is done by the big collector to get a proper curing. So in these case standard quality of wet slated can't be controlled by accordingly.

Scheme of raw hide and skin distribution channel from slaughtering to tannery is the following:



Trade of hides and skins in Indonesia has a quality, size and weight standard, but it is not implemented in the market. Collectors and tannery have adopted a simple standard and followed it in the market generally.

3.1.2 Geographical Location

3.1.2.1 CLUSTERS

Tanneries in Indonesia are small scale and are mainly concentrated in three districts:

City/Region	Total unit	Maximum Cap. mio.	Real Cap. mio.	Market Oriented
Garut/West Java	322	41,63	22,50	local
Magetan/East Java	50	5,37	2,90	local
Masin/Central Java	12	0,74	0,4	local
Total	***384***	***47,74***	***25,80***	

3.1.2.2 Sector Segmentation

Cow and Buffalo tanning sector

Region	Unit	Maximum Capacity mio.	Real Capacity mio.	Scale			Market Oriented	
				B	M	S	EX	L
Jabotabek	23	65,50	35,40	2	16	5	4	19
West Java	11	29,04	15,70	1	5	6	2	9
Central Java	9	14,06	7,60	2	4	3	2	7
Yogyakarta	6	3,15	1,70	-	2	4	-	6
East Java	20	97,20	54,50	3	12	5	5	15
Out of Java	3	1,00	0,6	-	1	2	-	3
Total	***72***	***209,95***	***115,50***	***8***	***40***	***24***	***13***	***59***

Sheep and Goat tanning sector

Region	Unit	Maximum Capacity mio.	Real Capacity mio.	Scale			Market Oriented	
				B	M	S	EX	L
Jabotabek	3	4,63	2,5	1	1	1	2	1
West Java	5	23,13	12	-	3	2	4	1
Central Java	6	13,32	50	-	1	5	4	2
Yogyakarta	5	32,00	7,20	1	2	2	4	1
East Java	5	23,31	17,30	-	4	1	5	-
Out of Java	1	1,80	12,60	-	1	-	1	-
Total	***25***	***98,19***	***1,00***	***2***	***12***	***11***	***20***	***5***

Note: 1. *Capacity mio/month*
- *B - Big scale - 300.000 Sq.ft Up/month*
- *M - Medium scale - 50.000 to 300.000 Sq.ft/month*
- *S - Small scale - less than 50.000 Sq.ft/month*
- *EX - Export oriented*
- *L - Local oriented*

2. *Total unit 384 in the cluster tannery produce mixed cow, buffalo, goat and sheep.*

3.1.3 Current Processing capability

From the tables above it is possible to infer that total real capacity in current for cow/buffalo is 115.500.000 Sq.ft/month and total real capacity for goat and sheep are 53.100.000 Sq.ft/month. The total are 168.600.000 Sw.ft/month.

Total maximum capacity for cow/buffalo 209.950.000 Sq.ft/month and total maximum capacity for goat/sheep 98.190.000 Sq.ft/month and grand total of maximum capacity 308.140.000 Sq.ft/month.

3.1.3 Current Situation of the Industry

At the moment all tanneries in Indonesia are facing close because of shortage problem of raw material both in quantity or quality. Even though they get in the market, the price have been going up around 300% comparing to the price in normal condition.

They also face with the high price of chemicals particularly small scale industry, they have not capability to import directly from abroad and buy in big quantity from the supplier. They buy from retailer with high price.

Even in the buffalo sector still all the buffalo tannery stop their activity and ironic that buffalo hides going too the food industry (Java call it 'krupuk').

Most of tannery drop their capacity to around 50%, they still maintain only the survival level of their company. They have also to make at home their workers for a time being until back to normal condition. Exception the big scale make integrated with the down stream industry by making export of leather goods used their own leather finished.

All these problems are caused by :

1. The removal of the export tax on raw hides and skins, pickled, wet blue from the high percent before to zero percent. In the same time local tannery had to pay 5-15 percent import duties on chemical, of which majority was only available abroad.

2. The political crisis adding heavily to the deterioration of the economic condition. It is not conducive to the business environment, affecting buyers stopped placing orders because they did not trust to receive the goods.

3. The two basic government sponsored institutions IRDLAI and ALT have no real incentive to be more practical, due to the unrespect tanneries to the RD doing by IRDLAI.

4. Environmental issues pushing hardly, due to the uncompleted processing their effluent treatment plant.

5. Without any access to global market, marketing intelligence, and at the mercy of their buyer abroad.

6. There is a lack of synergies in the activity of the cluster tanning industry.

3.1.5 Profile of Major Companies

Almost all tanneries in Indonesia are a domestic investment, only PT ECO and AVA SAMWHO tanneries is a foreign investment. Five tanneries are owned by the Government, one in Yogyakarta and four in East Java.

The form of company is Limited Company and private company without name. Scale of production is 10 big scale, 52 medium and the others is small scale, with criteria big tannery have 500.000 Sq.ft up capacity/month, medium tannery have 100.000 to 500.000 Sq.ft capacity/month and small tannery have 100.00 Sq.ft less/month.

3.1.6 Development plan of the Industry

As long as in the economic crisis, development plans carried out by most tanners are almost insignificant, they still only maintain their survivability. Generally most tanners try to make planning for short term to improve quality, fasten lead time of process and maintain in giving good service to costumers. They also try to save cost in process. All these efforts has a little bit helping for tanneries in the sustainable.

Particularly the tanneries in Yogyakarta region seriously will relocate together to one area decided fixtly for industrial zone to solve the problem of environmental by setting up together the common effluent treatment plant. They still waiting the Government preparing the land.

3.1.7 Environmental Issues

Currently most tanneries have already operated Effluent Treatment Plant (ETP), although they are still in simple construction consisting of filter tanks and sedimentation tanks with simple treatment as well. With a simple treatment, of course the affluent test results don't fullfill the minimum requirements decided by Government.

Attention from Government for environmental has already given to tanneries, however the enforce of the issued legislation is not powerfully. It causes the tanneries don't treat the effluent seriously.

To solve the problem of environment pollution by tanneries the Government planned to relocate tanneries by centralized all tanneries in two region Jabotabek (Jakarta and around) and Yogyakarta to the industrial zone. However still not be realized yet.

3.2 Leather Footwear Industry

The starting commentary of shoe industry in Indonesia, using the term footwear, that mean all their products as shoes, sandal and component of shoes.

3.2.1. Brief History of Footwear Industry in Indonesia

Indonesian footwear industry started in 1960, generally still a people handicraft industry with low quality. Until 1980 was oriented almost exclusively toward the highly protected domestic market. Than has become one of the country most successful manufactured export industries which export currency on 1994 running at almost USD 2 billion.

The footwear industry is segmented into two different types of firms: one is domestic market oriented and the others export market oriented.

The domestic market oriented firms are generally smaller and much more likely to be domestically owned than the export market oriented firms, while a number of which are owned and managed by Korean and Taiwanese investor. EMO firms concentrate on production of sport shoes for International buyers, while DMO firms produces a wide range of footwear generally low value and quality for local market.

Supply of raw material for EMO are imported from other country, however now they want to start reduce import material to increase local source to be produce by local tanneries. In fact that local tanneries has not enough to substitute the import material because in the principle the local raw hide has not acceptable for sort shoes.

3.2.2 Geographical Location

No.	Region	Total Unit	Capacity (pairs)	Total Workers		Total Investment
				Local	Foreign	
1	North Sumatra	6	13.957.000	5.615	17	6.035.390
2	Riau	1	300.000	205	5	1.500.000
3	DKI Jakarta	55	101.087.050	31.257	270	238.557.300
4	West Java	213	684.137.600	248.630	22.218	1.877.248.750
5	Central Java	13	27.601.000	8.547	91	91.206.500
6	DI Yogyakarta	3	699.000	484	-	2.850.000
7	East Java	97	435.051.400	83.260	350	589.535.000
	Total	***388***	***1.262.833.050***	***416.998***	***2.951***	***2.806.732.940***

The above companies are big and medium scale.

Moreover there are 4.579 unit small scale footwear industry spreading mostly in Java island with 22.034 workers and total production value arr. Rp.112,77 billion.

3.2.3 Current Situation of the Industry

As long as in the Indonesian crisis the production of footwear industry has gone down generally.

Sport shoes with export oriented drastically dropped in production, due to the high content of import raw material and accessories. These also happened for the producers with domestic market oriented. Some of them maintain their capacity for stock only and don't sell the products.

3.3 Leather Goods Industry

3.3.1 Geographical Location

No.	Region	Total Unit	Capacity (000)	Total Workers		Total Investment (USD)
				Local	Foreign	
1	North Sumatra	1	18.000	75	-	220.000
2	Jakarta	20	21.671.447	7.166	46	26.376.000
3	West Java	47	121.989.318	17.680	268	156.714.000
4	Central Java	7	9.431.000	2.533	42	11.434.000
5	Yogyakarta	7	5.089.000	1.170	11	11.431.000
6	East Java	19	12.281.000	4.735	40	40.446.000
7	Riau	2	630.000	303	14	2.000.000
	Total	***103***	***171.110.385***	***33.661***	***420***	***248.621.000***

Sources : Department of Industry and Trade – Indonesia

The above companies are big and medium scale.

In addition there are 3.385 unit of small scale leather goods industry spreading in Java island mostly and around 1.245 unit grouped on the two cluster industry in Yogyakarta (Manding village) and East Java (Tanggulangin village) with 14.506 workers and total production value arr. Rp.47 billion.

3.3.2 Current Situation of the Industry

Due to the high price of import material and shortage of local leather products the main leather goods producer is at present changing to synthetic leather to maintain business especially bags and others.

The small industry in the cluster with home workers and no machinery is very hardly facing the shortage material condition and some of them have closed their activity.

Export garments probably come from a little main producers only, using sheep and goat leather is also going down in the early of crisis. The products still in retail waiting the tourists from abroad.

Production of cow leather garments is small quantity, because there is no suitable sources of cow nappa leather. Production of golf gloves from sheep and goat in the two last years is going up, vertically integrated with local skins.

Export gloves is also going up, earning net more than USD 100 million in 1998.

3.3.3 Current Processing Capability

Most workers in the leather goods industry have a high capability in the processing for making a leather goods like cutting, stiching, shaving and other mechanical capabilities.

The problem causing low quality of the final product is the low quality of raw material and accessories used.

3.4 Upholstery Industry

Production of upholstery leather from Indonesian tannery showsmall figures, because most of cow and buffalo hide from Indonesia are not accepted for upholstery purposes due to the small size (arr. 25 Sq.ft/hide for cow and 30 Sq.ft/hide for buffalo in average) and will get a less yield.

There's only one tannery producing upholstery leather in a whole hide without cutting on the backbone with arr. 50.000 Sq.ft per month. This tannery is PT Budimakmur Jaya Murni in Yogyakarta, with unconsistant products.

It was shown that upholster industry in Indonesia has not developed yet currently.

4. STATE OF MARKET

4.1 Market Features

Distribution system of the leather market in cow sector is : broker, manufacture, importer/distributor and retailer, and to be predicted shown the figures as broker 10 percent, manufactures 70 percent, importer/distributor 1 percent and retailer 4 percent. The biggest amount sell to leather goods manufactures.

By the above system cow leather have not a hard competition. The producer still distributes to the almost fixed buyer as if a constant subscriber. They have a weak effort to spread the market, due to their hasitation in the payment transaction. Still now payment in the leather market is a crucial problems.

The sheep and goat sector has a different figures in their distribution. The figure shows that for broker percent, manufacture percent, importer/distributor percent and retailer percent. They are a largely different from the cow sector.

Seeing the system above, trade of leather in Indonesia have not a hard competition, at least the market of leather is slowly in the raising. The leather producer still distributes to the almost fixed manufacture, as if a constant subscriber. They have a weak effort to spread the market. The delay payments from the buyer is also the hasitation of the seller.

As to be understood that price of leather based on the area measured by square foot system. In these case there are something to be sadness that leather market in Indonesia used various sq. foot measures, don't based to the international sq. foot measure (30,14 x 30,14 CM square), most they use less than international sq. foot ei 28 x 28 Square CM, 25 x 25 sq CM, even bad measures in 15 x 15 Sq CM. It was very difficult to standardizes the sq. foot.

4.2 Local Consumption

Consumption of leathers needed by the leather goods industry in the form of cow shoe upper, sol leather, bag leather, both on chrome tanned or vegetable tanned, cow nappa leather, parchment and cow suede. While from goat and sheep in the form of cabreta, nappa, suede, shoe upper, liming and other sport glove or dress glove.

Shoe upper and sol leather consumed by non sport shoes included 'sandal'. These product is 80% for domestic market oriented and around 20% for export.

4.3 Leather Supply

Kinds of leather needed by footwear and leather goods industry from cow sector are shoe upper, sole leather, bag leather both on chrome and vegetable tanned, cow nappa leather, upholstery leather, cow suede and parchment for puppet handicraft. While from goat and sheep sector in form of nappa, shoe nappa, suede both for shoe and garment, glove leather (cabretta), lining and other sport and dress glove.

The quantity of leather supplied originate from the domestic and import raw hides and skins process by tanneries and the balance to grant the downstream to be imported from abroad.

Estimated leather production from local livestock
(based on Ministry of Agriculture data for 1999)

Cowhides	2.248.600 hides at 25 sq. ft each	56.215.000 sq. ft.
Buffalo hides	249.800 hides at 30 sq. ft each time to 50% (50% for food industry)	3.747.000 sq. ft.
Goat skins	10.373.900 pieces at 5 sq. ft each	51.869.500 sq. ft
Sheep skins	5.603.000 pieces at 5 sq. ft each	28.015.500 sq. ft.
Total		***139.847.000 sq. ft.***

Estimated leather production from import of raw material

Cattle live import	208.000 cattle at 40 sq. ft each	8.320.000 sq. ft.
Raw hides and skins import	4.916.630 kgs salted at 2 sq. ft. each	9.833.260 sq. ft.
Wet blue import	3.012.200 kgs at 5 sq. ft. each	15.060.000 sq. ft.
Pickle sheep and goat	412.065 kgs at 8 sq. ft./kg	3.296.520 sq. ft.
Split from total hides	20% grain area	3.630.652 sq. ft.
Total		***40.140.432 sq. ft.***

Local leather base + imported raw material = Total leather produces
151.183.400 sq.ft + 40.140.432 sq.ft. = 191.132.832 sq.ft.

Note that imported finished leather estimated at least 200.000.000 sq.ft./year used for sport shoes 180.000.000 sq.ft. and for garment 20.000.000 sq.ft.

Note that 20% from the sheep and goat finished leather production is for export (20% x 79.885.000 sq.ft = 15.977.000 sq.ft.)

Total leather used = local leather base + imported raw + imported finished – export leather
375.155.832 sq.ft = 151.183.400 sq.ft + 40.140.432 sq.ft + 200.000.000 sq.ft – 15.977.000 sq.ft.

Estimated consumed by : footwear industry = 185.621.500 sq.ft.
leather goods industry = 174.415.900 sq.ft
others = 15.118.340 sq.ft.

Asia-Invest Secretariat
Rue Archimède, 17 Archimèdststraat
B-1000 Brussels • Belgium
Tel: +32 2 282 17 50 • Fax: +32 2 282 17 60
E-mail: asia.invest@asia-invest.com
Website: http://www.asia-invest.com