

CHAPTER I

INTRODUCTION

1.1. Background

During the past three decades, a remarkable globalization of the world economy has taken place. Economic liberalization, which is marked by global market context, has preceded by AFTA in the year 2002, GATT and/or WTO in the year 1995 for the developed nations while developing country have just gone into effect in the year 2004, then APEC which is began in the year 2020 for developing country. Obviously, it would generate consequences which are responsible for all its member nations. The increasing integration of national economies into global market promises to alter the volume and character of international resource flows. As consequences, the trading systems, including agricultures commodity, are progressively transparent and, then, it requires the quality improvement to be able to compete in the global market.

Table 1.1: Summary of the World Output*
(Annual percent change)

	1998	1999	2000	2001	2002
World	2.8	3.7	4.7	2.4	3
Advanced economies	2.7	3.5	3.8	1.1	1.7
United States	4.2	4.4	3.7	0.5	2.2
Euro area	2.9	2.8	3.5	1.6	0.9
Japan	-1.2	0.2	2.8	0.4	-0.3
Other advanced economies	2	4.6	5.2	1.7	3
Other emerging market and developing countries	3	4	5.9	4.1	4.6

* Real GDP

Source: IMF World Outlook 2003

Recently, global economy contraction slowed from 4.7% growth in 2000 to estimated 2.4% in 2001 since the recession of Japan's economy in 1998 and the

tight money policy in the United States (US) and European countries. It has slowed down world economic activities. The US economy declined from 3.7% growth in 2000 to 0.5% in 2001, while Euro area, in the same year, declined from 3.5% growth to estimated 1.6%, and so did Japan, from 2.6% growth in year 2000 to 0.4% in 2001, respectively. In such condition, it therefore brings significant impact to the world commerce.

IMF (2003:187) in its report informs that the volume of goods commerce, including agriculture commodity, drastically turned down from 12.5% growth in 2000 to only 0.1% in 2001. It was due to decreasing in demand in the US and Euro area markets. As a result, the prices of agriculture commodity in international market decreased and worsen off. These situations eventually threaten Indonesia and other developing countries of which the economy are dependent on export.

In contrast, Indonesian export, particularly agriculture products, which is believed to be able to accelerate the Indonesian economy, in the reality, does not give real contribution to the economic recovery. Very often, agriculture products incurred rejection by major importing countries with the reasons of SPS (Sanitary and Phytosanitary) and TBT (Technical Barrier to Trade).¹ Moreover, internal problems, such as the degradation in extensive harvest; less-supported infrastructure; low productivity; unprofessional post-crop management, etc., had made agricultural sector unable to compete globally.

¹ Pejabat Eselon III dan II lingkup Deptan dan Depperindag (September 2003), Telaah Bersama "Aksi Pemenuhan Kebutuhan Dalam Negeri dan Peningkatan Ekspor Komoditas Pertanian Prioritas".

Considering Indonesian agriculture product represents one of backbones to boost up the economy and foreign exchange, it needs further effort to overcome various existing problems. Therefore, the government should support it by using their instruments to deal with competitive agriculture export.

International agreement of GATT encourages agriculture product being traded without any restraints in international market. As a consequence, since ill-assorted low domestic production growth relative to the demand, various foreign agriculture commodities would be simply entering Indonesian market. However, it needs an effective policy to keep domestic producers survive (Meuthia Rachmaniah, October 2004).

In this situation, the policy makers, government, have to maintain agriculture sector to be able to contribute more against the process of the economic recovery. Promoting over domestic market, beside exports, is not impossible to be applied because it relates to people prosperity, which is about 60 percent of Indonesian labor force, smallholder, are in agriculture sector.

Besides, Indonesia beckons as a potential market, a country with more than 212 million people estimated in 2002, and the fourth most populous nation in the world. The most densely populated island is Java with an average of 870 inhabitants per square kilometer. However, Irian Jaya has only five inhabitants per sqm. Indonesia is the largest country in South East Asia consisting of more than 17,500 islands and spread over 5,000 kilometers of ocean.² These favorable circumstances, potential domestic market, give opportunity to agriculture sector to

² IMF, "Indonesia Agri-Food Market Assessment Report", *Agri-Food Trade Service*, (May 2000).

make use of the benefits. Indeed, it depends on how the related parties could exploit the advantage owned.

There are some alternatives to determine the commodity requiring support in making-up of both domestic and international market, and/or support to allow import protection (Siswono Yudo Husodo, April 2004). The selections are based upon some following reasons: pay attention on consumption within the country; improve foreign exchange acquirement; absorb a lot of labor; improve the farmer prosperity; protect the consumer interest from security aspect, health, safety and environment; Insusceptible to the crisis and having value-added.

There are some agriculture products which are reasonably given attention by the government in the form of policies. They are food crop covering rice, soy, maize; cash crop covering sugar, palm oil, palm kernel, coconut, rubber, coffee, cacao, tea, pepper, tobacco, cloves; animal husbandry covering the husk, chicken flesh, and milk; horticultures covering the shallots, and oranges.

The research object in this study will be focused on one of the potential cash crop commodities, namely natural rubber, which traditionally has been an export crop and the consumption is mainly in the industrialized countries. Mostly, Indonesian natural rubber is exported, while only a small amount is domestically consumed by businesses which are natural rubber as the raw material.

A significant new trend has emerged in the recent years whereby most of the natural rubber-producing countries are moving "downstream", converting a significant proportion of their production into manufactured products for domestic

use and export with the result that the three largest exporting countries, Thailand, Indonesia and Malaysia, have now joined the ranks of the 12 largest consuming countries.

ANTARA (April 14, 2004), with its highlight “North Sumatra’s Rubber Export up”, stated an official of the North Sumatra industry and trade office, in the meantime, he said Indonesia's rubber consumption is still quite low reaching only 250,000 tons per year, including 136,000 tons of natural rubber. The low rubber consumption in the country is particularly due to the fact that industries producing rubber goods, except tyres, have not developed properly, as it is very costly to develop such industries these days.

1.2. Problem Identification

This study will just discuss about factors affecting domestic consumption for natural rubber. The term of *consumption* here has a meaning of the absorption of industrial businesses producing natural rubber goods in Indonesian market since the commodity is not ready to consume. Instead of consumption function, the study thoroughly discusses about *the demand model of economy*. However, the terms of consumption, industrial business absorption, and demand will be used in the same connotation.

There are two reasons why the researcher interested in conducting the research. *First*, it is because of little attention of the academic researchers on the demand side of natural rubber commodity. They are much concern on export demand rather than domestic demand. *Second*, market of elastomer, particularly

the natural rubber, tends to be *oligopsoni* when there are only few buyers in a given number of sellers. This situation is not beneficial to Indonesia as the natural rubber producing country because it can make the potential commodity of NR very dependent on the development of other countries. Indonesian will be better to encourage or stretching out the market in domestic along with the international market.

Concerning to the overview, hence, the researcher would like to present thesis which is entitled “**An Analysis of Factors Affecting Total Domestic Consumption for Indonesian Natural Rubber (1980-2003)**”.

1.3. Problem Formulation

Based on some facts above, the problems that will be analyzed in this study are:

- A. Does domestic price of natural rubber (NR), in Rp/Kg, affect total domestic consumption for NR?
- B. Does Indonesian total real GDP, in billion USD, affect total domestic consumption for NR?
- C. Does the world price of synthetic rubber, at London, in USD/tonne, affect total domestic consumption for NR?
- D. Does dummy affect the fluctuation of domestic consumption for NR?

1.4. Research Objectives

This thesis intends to analyze the behavior of variables affecting domestic consumption. The research objectives are:

- A. To know how far changes in domestic price of natural rubber, total real GDP, and the world price of synthetic rubber influence the total consumption for natural,
- B. To know how far the externalities influence the total consumption for natural rubber,
- C. To predict the development of consumption in the future to optimize the domestic market.

1.5. Research Benefits

The research are purposed to give an erudite contribution as well as base for encouraging strategy of market stretching of natural rubber in Indonesia. As this approach, Indonesia is able to maintain the agriculture sector in both local and international market.

In addition, to the researcher himself, this thesis is set to fulfill the partial requirements to obtain the bachelor degree in Faculty of Economics, International Program, Islamic University of Indonesia.

1.6. Writing Systematic

This thesis is presented in 6 chapters, which are divided into:

- **Chapter I**, which discusses the background of the study, the topic, the reasons why the researcher interested in, the problem formulation, the objectives, the benefits and the writing systematic
- **Chapter II**, which presents literatures review, theoretical foundation, hypotheses and assumptions.
- **Chapter III**, which presents research methodology selected as guidance in conducting the research.
- **Chapter IV**, which discusses more detail description of the research subject. That is the uses and the brief history of both natural and synthetic rubber, and its development in the world and domestic market.
- **Chapter V**, which presents the core of the study containing the analysis, testing, and the interpretation.
- **Chapter VI**, which contains the conclusion, implications outlining the whole chapters of the thesis.