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Indonesia's Textile Industry Provides Material Market for U.S. Cotton

By Christopher Rittgers and Rosida Nababan

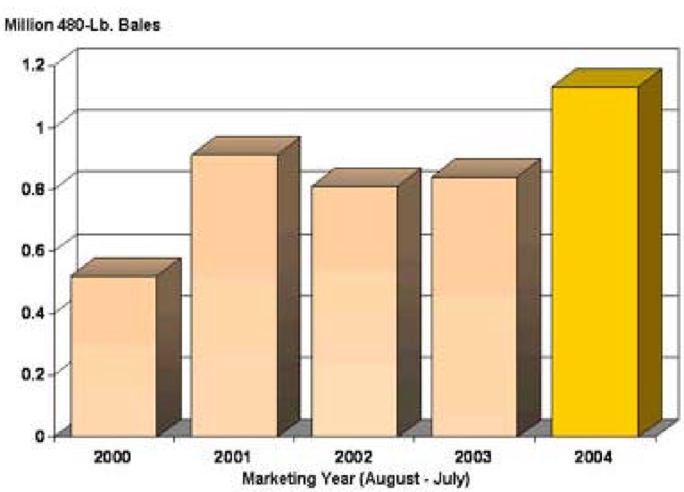
Like most business sectors in Indonesia, which continue to struggle in an uncertain business climate, many textile companies faced ups and downs in 2004. But despite the problems, general prospects for the textile sector are encouraging. In calendar 2004, exports of Indonesian textiles and related products reached about $7.3 billion, up 5 percent from the previous year, and textile exports remain the largest non-oil, export-based contributor to national income.

Off With the Old, On With the New

While there were many positive developments in the sector, in general calendar 2004 proved difficult, particularly for Indonesia's least productive textile operators. Some mills shut down, and others had to cut back significantly on production. Indonesian textile mills are now running at about 80 percent of capacity.

Most textile companies face similar constraints: difficulty in obtaining credit and trade financing from banks, increasing operational costs (for oil, electricity, terminal handling and so on) and dependency on imported raw materials (such as cotton, yarn, fabric and machinery).

U.S. Cotton Exports to Indonesia Climbed 117% in Volume From Marketing Year 2000 Through 2004



In marketing year 2004, Indonesia was the fourth-largest foreign market for U.S. cotton, with sales of 1.13 million bales, up about 35 percent from the previous year.

Indonesia continues to face stiff competition from other textile exporters, especially China, and imports of low-priced finished textile products into the country have hurt the domestic industry. Furthermore, generally unstable economic conditions have hampered Indonesian consumers' purchasing power and have limited domestic demand growth.

Adaptation

Nonetheless, most Indonesian mills have succeeded in finding ways to survive and compete, especially export-oriented companies. Some mills have changed strategy from operating in all sectors (such as integrated spinning, weaving and garment fabrication), to focusing on one or two areas in which they excel. Some are concentrating on high-end markets and looking for new markets abroad, instead of attempting to compete on a price basis with China, India and Pakistan.

Most Indonesian textile companies realize that they need to upgrade their equipment and facilities to produce high-quality products efficiently. Expansion is slow, however, partly because of limited domestic financing. The Indonesian banking sector has still not fully recovered from the regional financial crisis in the late 1990s, and many of Indonesia's larger textile companies continue to be heavily debt ridden.

Raw, Intermediate Goods Interwoven With Industry

The Indonesian textile industry imports almost all of its cotton needs. In marketing year 2003 (August 2003-July 2004), Indonesian cotton consumption fell about 5 percent from the previous year to 2.15 million 480-lb. bales.

But export markets grew slightly in marketing year 2004, and total cotton consumption is estimated to have risen about 4 percent to 2.25 million bales. Consumption for marketing year 2005 is projected at 2.3 million bales. Imports could trend upward if high world oil prices affect prices for polyester and other synthetic yarns.

Indonesian yarn and fabric production grew by 3 percent in calendar 2004. The domestic yarn market remains depressed, in part because of competition from low-cost yarn from Pakistan. Sixty percent of Indonesia's yarn production goes to domestic producers of fabric and garments, most of which are subsequently exported. Indonesian garment production rose about 11 percent in calendar 2004. Indonesian spinners currently keep around two months' worth of cotton in stock.

U.S. Cotton Integral Part of the Fabric

The outlook for U.S. cotton in this market is positive, buoyed by competitive U.S. prices and increased Indonesian demand for cotton in export products such as denim. U.S. cotton supplied about 50 percent of Indonesia's total domestic consumption in marketing year 2004; Brazil, India and African countries also increased their exports.

In marketing year 2004, Indonesia was the fourth-largest foreign market for U.S. cotton, with sales of 1.13 million bales, up about 35 percent from the previous year. The Export Credit Guarantee Program (GSM-102), once an important means of facilitating U.S. cotton sales to Indonesia, has played a declining role lately and was used to underwrite only 10 percent of sales in fiscal 2004. Restructuring of USDA's export credit programs may further limit GSM-102 use in this market.

Traders note that the comparatively long shipping times (averaging one month) for U.S. cotton to reach Indonesia hinders trade. In contrast, Australia, China and other exporters offer more flexible contracts and more frequent shipping. The future position of U.S. cotton in this market will hinge on its price relative to supplies from other countries.

Indonesia's imports of cotton yarn dropped about 30 percent in calendar 2004, but imports of cotton fabrics rose 7 percent. Pakistan and China remained the major yarn suppliers (with market shares of about 30 and 20 percent, respectively). China and Hong Kong were the major suppliers of cotton fabric. The United States ships almost no cotton yarn or fabric to Indonesia.

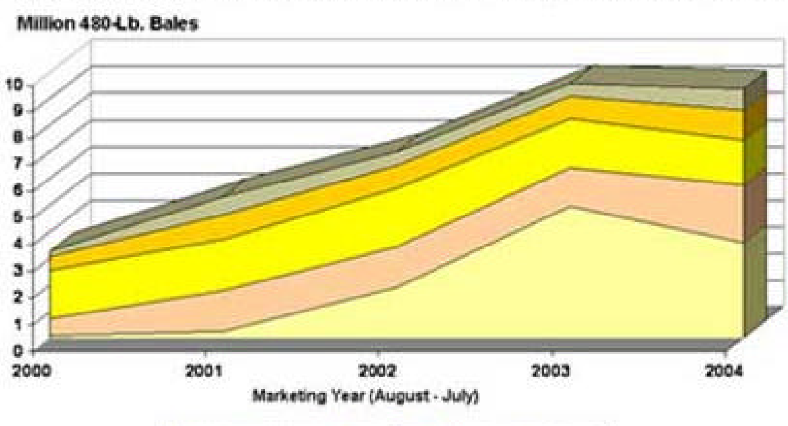
Indonesia's cotton yarn exports declined about 15 percent in calendar 2004. But yarn production is growing, and exports are expected to recover in 2005. Cotton fabric exports held steady.

The major foreign markets for Indonesia's cotton yarn are Japan, Hong Kong, China and South Korea, with only about 4 percent destined for the United States. Italy, Bangladesh, Japan and Hong Kong are the major markets for Indonesian cotton fabric, while the United States is the top destination for garments.

Policy Changes and Challenges Intertwined

In accordance with the Uruguay Round Agreement on Textiles and Clothing, all quotas on textiles and apparel were removed for all members of the WTO (World Trade Organization) on Jan.1, 2005. Indonesia attempted to delay removal of the international textile quotas because the government was concerned about declining market share for Indonesian textile products in the United States and competition from China. However, many Indonesian companies think the new non-quota system creates opportunities for expansion and encourages greater efficiency, quality and

Indonesia Consistently Has Ranked Among Top Foreign Markets for U.S. Cotton



productivity. The end of the quotas will likely bring more Indonesian yarn and fabric into the U.S. market.

The United States, the EU and other countries have imposed safeguard quotas on Chinese textiles and garments under China's WTO accession agreement. These quotas will likely limit damage to the Indonesian textile industry and help buoy its share of the U.S. market. To compete with China in the domestic market, the Indonesian textile association has asked that the import tariff for garments be increased to 25 percent.

Indonesia's value-added tax discourages its mills from expanding export-oriented production. Moreover, procedural requirements often delay the process of getting refunds based on exports.

Smuggling of imported textile products and secondhand garments continues to be a serious issue. Demand for these lower-priced products is high in Indonesia, giving traders strong incentives to import them. New documentation requirements have been largely ineffective in halting import smuggling.

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