

**The Challenges for Trade Policy in a Dynamic World and  
Regional Setting: an Indonesian perspective**

**Mari Pangestu**

**Richard Snape Lecture**

*22 November 2010*

*Melbourne*

**Hard copies of this paper will be published by the Commission shortly**

# **The Challenges for Trade Policy in a dynamic world and regional setting: an Indonesian perspective**

*Mari Pangestu*

*I am honored today to give the 2010 Richard Snape Lecture. As someone who knew Professor Snape initially by reading his work and later having the privilege to interact with him as a young academic working in the trade policy area, this is of course a special privilege. There were various seminars and events where we would meet under the auspices of various regular meetings such as those organized by PAFTAD, PECC, Australia Japan Research Centre and NBER East Asian Seminar on Economics.*

*As a young scholar coming up the ranks of seniors in the trade economist network, I greatly appreciated Professor Snape's great intellect and wisdom in the trade policy area. In fact I still recall the last time we met, at the Twelfth Annual East Asian Seminar on Economics: Privatization, Corporate Governance, and Transition Economies. This was an NBER seminar organized by Ann Krueger and sponsored jointly with Productivity Commission and a number of other regional organizations in Hong Kong, June 28-30, 2001. I remember being a discussant on a paper on Railway Reforms by Helen Owens also of the Productivity Commission and Professor Snape was a discussant on telecommunication privatization.*

*But above all I remember Professor Snape as a very kind hearted and warm person. He never made us fall in awe of the Great Professor Richard Snape and he always had the time of day for us. I recall on two distinct occasions where he graciously hosted me at Monash University and also at the office of the Productivity Commission.*

*One of the reasons for my visit at the time to the Commission was to understand the institutional set up and experience of trade policy making in Australia. At the time I was doing work on this subject in light of what Indonesia needed. In the end the Indonesian government did set up a Tariff Team to undertake the analysis of tariff setting. Even though it is not an independent agency, the process is relatively independent involving various Government Ministries. Of course I did not imagine at the time that I would become Trade Minister and be an important "user" of this process and also still continuing to think of ways to improve the process, with the Productivity Commission very much in mind as a model.*

*In tribute to Professor Snape I would like to share my thoughts with you of a personal journey of a Trade Minister and the challenges trade policy making in a dynamic regional and global setting.*

## **Introduction**

The job of a trade policy maker has become more complex compared with ten to fifteen years ago. The challenges post global crisis has made it even more challenging to deal with keeping protectionism, whether the traditional form or otherwise, at bay. Trade policy issues have also now become more complex because it extends beyond the traditional cross border measures. Furthermore, trade policy has become more complex in terms of not just substance but also processes and institutions.

In this paper three themes will be explored. First is to assess the current setting facing trade policy. It is the context of trade policy in the last two decades, existing conditions post-global crisis and the next generation of issues we face to establish true economic integration. Second is to evaluate the context of a dynamic and changing world and regional setting. This will of course need to take into account domestic changes that have happened in a country like Indonesia, as well as the political economic setting. Finally to conclude with analyzing what the recent past and dynamic changes mean for multilateral, regional and national processes of trade policy. In terms of the national process, the implications are drawn for a country like Indonesia.

## **The Current Context facing Trade Policy: an Assessment**

### **The Empirics – Increasing Openness, Increasing flows of Trade and Investment**

There are at least four trends that need to be noted.

One of the significant trends of this decade is that world trade has shifted from European Union (EU) and United States (US) to Asia as indicated by the increase in the share of world trade accounted for by Asia from 26 to 31 percent over the 2004-2009 period. This pattern is likely to continue.

Second is the increase in intra regional trade. Intra regional East Asia trade has also increased from 37 percent to 42 percent over the 1980-90 period, and to 54 percent in 2008, led by trade in parts and components (ADB 2010). In comparison, over the 1990-2003 period the share of intra regional trade out of total trade, went down from 65 to 60 percent for EU, from 37 to 45 percent for North America Free Trade Area (NAFTA) and went from 10 to 15 percent for Mercosur (World Bank, 2010).

Similarly intra Asia Pacific Economic Cooperation (APEC) trade has also increased from 22.6 percent to 36.5 percent for exports and from 21 to 33 percent for imports over the 1996-2009 period. Furthermore, trade in goods in APEC increased by more than fivefold from US\$ 1.2 trillion to US\$ 6.2 trillion, while trade in services in APEC tripled from 1994 to 2009, reaching \$1.2 trillion. FDI inflows have increased fourfold from 1994-2008 to reach \$791 billion (APEC 2010).

Third there has been progress towards opening up many of the economies in East Asia and the Asia Pacific. Tariffs and non-tariff barriers as well as restrictions have come down in East Asia and the developing countries in APEC. This year, 2010, is considered to be the first milestone of the Bogor Goals and that is the reason that Japan as the Chair of APEC has initiated an assessment by APEC of the progress made towards Bogor Goals.

The assessment undertaken by APEC (2010) indicates that there has been progress toward the Bogor Goals.

- Tariffs have fallen from an average of 16.9 percent in 1994 to 10.8% in 1994 and to 6.6 percent in 2008. In the case of Indonesia, tariffs have fallen from an average of around 30 percent to 6 percent.
- Business sector perceptions on the incidence of non tariff barriers have improved and out of the NTM (Non Tariff Measures) surveyed by UNCTAD TRAINS, the most prevalent NTM, are technical barriers to trade, customs and administrative procedures, and Sanitary and Phytosanitary Standards/Measures (SPS).
- Some improvement in progressive broadening of market access and/or national treatment for trade in services based on multilateral and regional commitments, as well as unilateral domestic reforms.
- Liberalization and opening up of investment regime: progressively providing for MFN and national treatment, ensuring transparency and streamlining investment procedures
- From the first Trade Facilitation package in APEC the costs of doing business have declined by 5% over 2002-6. The target is to reduce costs of doing business 10% by 2010 and 25% by 2015. As for Indonesia, a great deal of progress was achieved with the National Single Window (NSW) for export and import procedures. By the year end most of the clearance of documents will be done on line in the major ports.

Although its difficult to pinpoint what are the main driving forces leading to the resulting openness and flows of trade and investment, most analyses would point to a combination of unilateral reforms driven by increased competition, APEC peer pressure and fulfilling of multilateral commitments. It would also seem that more recently, increased regionalism has also had an impact.

Let us review these different driving forces and their interactions, from an Indonesian perspective.

### **Unilateral Reforms: synergies with regional processes and WTO**

Unilateral reforms in the region have been driven by competition for investment flows, fulfilling multilateral commitments, and in response to multilateral commitments. Competition for investment in the region that took place in the 1980s and 1990s as many economies in the region followed an export oriented industrialization strategy. Whilst the Northeast Asian economies tended to use more government initiatives to push certain sectors, in Southeast Asia the process has been more about market based deregulation and reforms, often catalyzed by a shock or crisis.

In the case of Indonesia for instance the first series of deregulation and opening up came in the aftermath of the oil price shock in the mid 1980s, which led to a series of deregulation and dramatic institutional changes to reduce the dependence on oil exports and revenues towards non-oil. One of the dramatic reforms at the time was the effective closure of the customs administration and replaced by the Swiss Surveyor company SGS. These reforms were successful in diversifying Indonesia's exports from 85 percent from oil and gas, to 25 percent by the 1990s and which still holds today. At the time Indonesia also introduced an export subsidy scheme, which was a combination of subsidized export credit and return on duties paid for inputs used in producing exports. However, some of these schemes were deemed to violate the Subsidies and Countervailing Duties Agreement at the time, and the schemes had to be phased out to one which is acceptable

by GATT/WTO, and replaced by the current scheme of refund to the exact amount of duty and VAT paid for inputs used in production for export.

A number of important trade and investment reforms were undertaken in 1993 and 1994, or one year prior and in the year during which Indonesia hosted the APEC meeting. In 1993 the deregulation package included the removal of import monopolies and also tariff reductions, as well as some deregulation on investment restrictions. However, the dramatic change in removal of investment restrictions came in 1994, the year Indonesia hosted the APEC meeting. After a period of strong nationalistic pressure since the anti Japanese riots in the early 1970s, the deregulation allowed for 100 percent foreign ownership for a number of categories and relaxed the divestment requirements.

A number of regulatory and legal changes were also adopted after the formation of the WTO in 1995, including the elimination of domestic content regulations, which were linked to investment under the Trade Related Investment Measures (TRIMS) agreement. The WTO also provided an important check on the national car policy introduced around that time, which would have violated the non discrimination principle of the multilateral trading system, since a joint venture with a car-maker from one country (Korea) was given special preferences over other countries and domestic producers. This led to a dispute settlement process in the WTO, which Indonesia ultimately lost and provided an important precedent to the role of international commitments vis a vis national vested interests.

The next wave of deeper and broader reforms came in the aftermath of the Asian financial crisis. Under IMF conditionalities the government was obliged to undertake a host of measures and reforms, including removal of a number of non-tariff measures, import monopolies and investment restrictions as well as major institutional changes. Korea and Thailand experienced similar processes of reforms. After the exit from the IMF program there were no major reversals, and the thrust of the policies remain today with some adjustments to reflect the political economy developments.

In terms of the process of reforms, under the Soeharto regime, deregulation and reforms were top down. The technocrats in government played an important role in strategically using crisis, external pressures or expectations such as the hosting of the APEC meeting, to push for strategic and important reforms. However in the post Soeharto era, the political economy of reforms face different challenges. Other than the substance of reforms, the challenges of how to make it happen and how to make it “stick” are greater.

The real process of comprehensive reforms under a democracy really began in 2004 with a comprehensive reform mandate. In the economic area the major reforms were in investment, customs, tax and trade. The coverage also extended to anti corruption, legal, political, bureaucratic and institutional reforms. The process of reforms can clearly be no longer top down. Reforms take a much longer time frame through a process of consultations with all stakeholders, including the Parliament, regional governments, private sector (domestic and foreign, large and small), civil society, local government and media. Once the laws and regulations are changed, the implementation of the changes becomes another set of challenges.

An example in the trade and investment policy area is the new investment law passed in 2007, which provides clearly for national treatment, transparency and streamlining of investment procedures. Similarly with customs and taxation a number of reforms have

been introduced in the same vein of greater transparency, clear recourse in disputes, and institutional and bureaucratic reforms.

On the trade side, it was the implementation of the tariff harmonization schedule of tariff reduction introduced after Indonesia exited from the IMF plan and designed its own reform program of reducing tariffs by 2010. It also involved the national single window initiative, which provides for the integration of export and import procedures. Importantly this initiative was borne out of the commitment under the ASEAN Economic Community Blue print. The streamlining involved some 25 government agencies of which customs, trade, quarantine and health ministries were the major institutions. The reform process was mainly led by the Finance and Trade Ministries. There is now a single window to process export and import documents, which will be hopefully also on line by the end of the year. The intention is of course to facilitate trade flows by making it easier, faster, less costly and also reduce the potential for corruption or side payments.

The processes introduced have also been important. This includes carrying on the tradition of the exit program from IMF with a matrix set up of deliverables in the reform agenda and clearly outlining the deliverable, the time line, the responsible agencies and the coordination points. This is formalized as Presidential Decrees, and this has also included our regional commitments under the ASEAN Economic Community Blueprint.

Furthermore the process of trade policy making has been much improved with the Tariff Team under the Ministry of Finance and Trade which also includes inter ministerial meetings, and a technical team that undertakes the analysis not just for import tariffs but also for export duties and other similar fiscal instruments. The Ministry of Finance and Trade have reformed their research divisions to undertake the policy analysis as separate from the implementation divisions in each Ministry and the process, human resource capacity and participatory processes are continuously being improved with very much the Productivity Commission model in mind.

### **Asia Pacific Economic Cooperation and APEC: an assessment**

The APEC vision and the Bogor Declaration are both about achieving the long term goal of free and open trade and investment in the Asia-Pacific. Our far sighted Leaders at the time, outlined that APEC is to pursue this goal by strengthening the multilateral trading system, enhancing trade and investment facilitation, and development cooperation to provide capacity to the less developed members.

The progress made to the Bogor Goals was achieved through a combination of WTO commitments, regional trade agreements and unilateral reforms.

It is well recognized that APEC contributed to the conclusion of the Uruguay Round in 1994 and to the creation of the WTO. Supporting the implementation of the commitments of APEC members under the WTO, has been an ongoing process in APEC. In turn, the existence of the WTO created an environment of an open and rules based trading system, which allowed many of the Asia Pacific economies to prosper through dynamic flows of trade and investment. It is also worthy to note that two APEC economies worked hard prior to hosting the APEC meeting to complete their accession to the WTO. China acceded to the WTO in 2000 right before hosting APEC in 2001 and similarly Vietnam in 2005 right before hosting APEC in 2006. A similar result could be expected for Russia as the host of APEC in 2012.

The APEC principle and spirit also have provided confidence and peer pressure for APEC economies to pursue unilateral reforms. Whilst much more needs to be done, most of the APEC economies have undergone a comprehensive process of deregulation, greater transparency, streamlining of licensing, structural reforms and bureaucratic reforms. As noted above, Indonesia underwent a process of deregulation and reforms from the mid 1980s up to the time of the financial crisis in 1997. One of the significant deregulation and reform measures involving opening to foreign investment was achieved in 1994, the year that Indonesia hosted the second APEC Economic Leaders Meeting and the time the Bogor Goals were launched.

The notion of peer pressure and champions of reform was part of the APEC way of achieving reforms, and not because economies were necessarily “bound” to an agreement. Other economies have also chosen to announce reform measures when they host an APEC meeting or around the time of an APEC meeting, such as China in 1995. The most recent example being the APEC meeting in Japan whereby Japan has announced its intention to study reforming the agriculture sector as a preparatory step for considering joining the Trans Pacific Partnership (TPP) Agreement. Arguably this is a very sensitive topic for Japan.

### **Assessing Regionalism: building blocks or stumbling blocs**

In 2000 there were only three Free Trade Areas (FTA) in East Asia already concluded and implemented, one signed but not yet implemented, five under negotiations and four proposed. Today in 2010, the number has increased close to ten fold, with 44 concluded and implemented FTA and six more signed to be implemented. Furthermore there are 48 FTA under negotiations and 30 more proposed (ADB, 2010).

A similar picture emerges in the APEC region. At the time when Bogor Goals were agreed upon in 1994 there were similarly only three agreements involving APEC economies. By 2005 there were 45 FTA involving APEC economies and today this number has gone up to 100 out of which 40 are in force between APEC members and an estimated 59 with non APEC members. A large number of additional intra-APEC agreements are also currently being negotiated. For instance Korea has seven agreements in the pipeline, out of which bilateral agreements with India and Malaysia being recently concluded, and the one with the US still pending.

Indonesia has chosen to focus on the regional based trading arrangements with ASEAN as the core, and with the six dialog partners of China, Korea, Japan, Australia and New Zealand and India. Deepening and broadening the ASEAN Free Trade Area to the ASEAN Economic Community occurred in 2003 and implemented in 2006 with the AEC blueprint, whereas out of the other ASEAN plus one agreements, China and Korea have been implemented the longest. The other ASEAN plus one agreements are in the first or second year of implementation.

Indonesia has also taken the ASEAN Economic Community blueprint and translated the milestones and timelines to national policy through the Presidential Instruction mechanism, which provides clearly for deliverables and a process of coordination. Whilst implementation is far from complete, the introduction of a framework and process has been important in pushing some of the important initiatives such as the National Single Window. Moving ahead, it will be important for Leaders to be made aware of the

priorities in the scorecard from the AEC Blueprint and provide political will domestically to move and implement in a timely manner.

In terms of bilateral free trade area agreements, Indonesia has initially focused on its largest trading partner (Japan). In terms of bilateral agreements in the pipeline, the focus has been to seek complementary top ups of ASEAN wide agreements (e.g. Australia and India), to prepare or “training ground” for more comprehensive agreements in future (e.g. EFTA) and other strategic alliances (e.g. Chile, Turkey, Egypt). Given limited negotiating resources, the priority has been to commence negotiations with Australia and EFTA, and commencing with Chile and India are being evaluated after the joint study was completed. As for Egypt and Turkey, the joint study is in process.

Intra regional trade in East Asia has increased over the last two decades and the main driver has been the process of unilateral opening up and what was termed as market driven regionalism. That is, the integration has happened in the absence of formal regional free trade agreement connecting these economies, but has occurred because of pull and push factors and technological developments in production processes, telecommunication and logistics. Push factors being rising costs (i.e. labor, land, exchange rates) and pull factors include resource endowments such as supply of labor and skill sets, as well as the degree of opening up and investment climate. Until recently the story of East Asia is one of intraregional trade driven by production networks with China as the hub. The evidence is the high share of parts and components in intra East Asia trade.

Market driven integration is more recently also being influenced by the conclusion and implementation of the growing number of regional FTA in the last decade. Furthermore, there will be increasingly a shift from a production based regional network importing and exporting parts and components and capital goods, and exporting final goods to third markets outside of the region such as the US and EU, to increasingly exporting final goods to the regional market.

It would seem that the debate of multilateralism vs. regionalism, and whether they are stumbling or building blocks is no longer relevant. Regional and Bilateral trade agreements are here to stay, and will continue to proliferate. This is due to a number of factors such as the uncertainties of the conclusion of the Doha Round. It is also most probably due to what is termed as “entrepreneurial bureaucrats” (Findlay, Pei and Pangestu 2003), that is the desire to have concrete deliverables in terms of market access, job creation and investment flows. Politicians are apt to want to bring home from overseas trips and visits by major partners, some results in the form of an agreement or investment and trade deals.

Interestingly in East Asia, the regional trade agreements have evolved in a distinctive pattern. The longest regional agreement is one between the ASEAN countries and the ASEAN Economic Community, which talks about free flow of goods, services, investment and professional labor, and freer flow of capital by 2015. Other than being entrepreneurial bureaucrats, there is also now a stronger belief that the FTA are needed to deepen and widen the structure of production networks that are already in existence in the East Asia region.

However the proliferation of regional trade agreements, are not without concern. The proliferation and different schedules of tariff reduction, tariff nomenclature and regional

content have raised question regarding the costs it raises for businesses. The same product destined for different markets face different administration and rules of origin as well as other requirements. This reality is inconsistent with economies of scale and scope and it is what Jagdish Bhagwati has termed as spaghetti bowl effect and what in Asia has been referred to as the noodle bowl effect.

A recent ADBI study (Kawai and Wignaraja, 2010) looks at the business impact of the noodle bowl effect on businesses from six East Asian countries. The study tries to see how much of preferences under FTA are being used, what are the costs and benefits of FTA, and whether administration of rules of origin are cumbersome and adding costs.

The result of the survey shows that out of the sampled firms, 28 percent stated that they used FTA preferences. However around 53 percent plan to use FTA preferences. In terms of benefits, wider market access leading to higher exports and importing intermediate inputs with lower tariffs were identified. Whereas the main costs identified, are increased competition from imported products and administrative procedures for utilization of FTA.

In the case of Indonesia as of 2010, the utilization rate for Indonesia's exports to the various countries that it has regional or bilateral trade agreements with, averages 32 percent out of total non-oil exports. In terms of utilization the lowest is the bilateral Indonesia-Japan EPA at 17 percent and the highest is the ASEAN-China FTA at 42 percent and ASEAN-Korea FTA at 37 percent, AFTA at 36 percent. The low utilization for IJEPA is related to the low margin of preference or level of preferential tariff over the MFN tariff. A number of existing high tariffs and non tariff measures are also seen as impediments to increasing trade.

Another statistic shows that the utilization rate of ASEAN imports coming into Korea using the ASEAN Korea FTA (AKFTA) increased from 9.5 percent in 2007 to 29 percent in 2010 (latest data being July). As for Korean exports going to ASEAN, the utilization rate is only 9.5 percent of imports from ASEAN. The factors identified for low utilization are low awareness of exporters regarding AKFTA, high compliance costs and practical difficulties related to customs, and the fact that there are already duty exemptions for raw materials used in manufacturing for exports. Peer reviews for AKFTA and ASEAN China FTA (ACFTA) observed that lack of awareness, administrative difficulties, low margin of preference and significant trade in the sensitive sectors as main issues.

The ADBI (2010) study also reveals some interesting micro level results:

- higher utilization of FTA for firms in the machinery and automotive industry compared with those in the food, electronics or textile and garment firms (related to higher margin of preference for the former group of sectors).

- higher percentage of firms from Peoples Republic of China using FTA preferences compared with Japanese firms at 45 percent compared with 29 percent (linked to regional production networks) and firms from other countries with 20 percent utilization rate.

- higher usage of FTA amongst larger firms compared with smaller firms, and also with higher foreign ownership.

- higher level of knowledge of FTA for Japanese firms compared with other companies from other countries.

- lack of information ranked as the most important impediment to utilization of FTA, followed by small margin of preference, while delays and administrative costs linked to FTA and non tariff measures seemed less important.

- multiple rules of origin (ROO) in existing FTA impose a “modest” burden on firms in East Asia or 20 percent who said that it added significantly to business costs

The recommendations from the study are not surprising: reduce MFN tariffs, rationalize ROO, upgrade and simplify the administration of ROO, increase knowledge of FTA provisions especially for small and medium sized enterprises (SME), improve business participation in FTA consultations and improve institutional support for SME.

In addition the wisdom of Professor Richard Snape regarding comprehensiveness and openness for new members or “open club”, as follows, is still valid and are resounded in the 2005 APEC Model Measures for RTAs/FTAs:

“There is little doubt that a free trade agreement will complement and facilitate multilateral trade if the following conditions are met: (a) there is full liberalisation of trade between the participants in all goods and services; (b) external barriers against non-participants are not raised under the agreement or subsequently, and the barriers are transparent, (c) there is a willingness and capacity to negotiate barrier reduction against non-members; (d) there are homogeneous rules of origin and dispute settlement procedures; and (e) the agreement is open to new members on conditions similar to those required of existing members.” ( Snape (1996), p.3)

The APEC Model Measures (2005) includes: consistency with APEC and WTO principles and rules, agreements that build on existing WTO commitments and explore commitments in additional areas not covered by WTO, comprehensive coverage including liberalization in all sectors including elimination of tariff and non tariff barriers in sensitive sectors, transparency efforts to improve trade facilitation and simple rules of origin.

Despite the above results there are some positive observations regarding the proliferation of FTA. First is that it reinforced the process of opening up and reforms undertaken under multilateral commitments and unilaterally. Second many of the regional trade agreements in Southeast and East Asia in the last decade has been “inspired” by the three pillars of APEC. That is they are not limited FTA focusing just on cross border liberalization, but are what is known as Comprehensive Partnership Agreements which includes facilitation and economic cooperation or capacity building as an integral component.

Third many initiatives in regional trade agreements, even at the proposal stage such as the feasibility of the Free Trade Area of the Asia Pacific and Trans Pacific Partnership Agreement, raises questions and issues that the country has to deal with in any case. As noted Japan has used the potential for joining TPP to put pressure or inform domestic reforms in agriculture. Others who have joined TPP such as Malaysia have done it for the same reason.

## **II. Changing Dynamics of Regional and Global Setting**

The goal of increasing openness as envisioned by the APEC Vision and Bogor Goals of open trade and investment are as valid today as when our far-sighted Leaders created them in 1994. The statement of our far-sighted leaders talked about regional economic integration in “the spirit of openness and partnership” and finding “cooperative solutions to the challenges of our rapidly changing regional and global economy” remain valid today. The Blake Island APEC vision and Bogor Declaration was also very clear about the need to avoid inward looking and discriminatory trading blocs, which now have been enshrined in the APEC Model Measures. Furthermore, the far sighted leaders have always seen the APEC vision as a long term goal and that it must be reached through equally strong three pillars of APEC: liberalization, facilitation and economic cooperation.

Therefore whether we are talking about the future of APEC, regional agreements or how national policies must be designed, the APEC vision and Bogor Goals remain valid. However for APEC, regional FTA and national policies to remain relevant, one has to recognize the challenges of the current dynamic global and regional setting.

### **Global Crisis and Fears of Protectionism**

In the aftermath of the global financial crisis of 2008/9, the great recession has been avoided. However, the prospects for a sustained recovery remain thwarted with downside risks. Economic recovery has progressed at different speeds, with emerging economies rebounding faster and having higher rates of growth. The sources of growth have shifted to emerging economies and there is also growing pressure for so called surplus countries to increase domestic demand and increase imports. At the same time, developed countries continue to experience record high unemployment rates as well as having to manage budget deficits and high debt to GDP ratios. Macro imbalances, especially current account imbalances, also mean to continued tensions including a potential currency war and protectionist measures.

At the start of the global crisis one of the fears was a rise of protectionism. However, fortunately there was only “benign” protectionism and a rise in the use of trade remedies. Some countries also used the opportunity of the crisis to undertake reforms, especially in opening up to more investments. The surveillance of self reporting under the WTO for the G20 economies and resulting peer group pressure has also influenced the outcome. However, it was also evident that WTO consistent measures could also have protectionist outcomes through fiscal, monetary policy and other instruments.

Given the fragile and differentiated recovery, current account imbalances, the high unemployment rates and the continued threat of protectionism, the current global and regional setting for trade policy remains full of uncertainties.

### **The Remaining Agenda: Next Generation Issues beyond cross border**

The APEC Bogor Goal assessment and our review above show that there has been progress toward the goal of open trade and investment in the region. However, the assessment as well as the various inputs from the business sector, also stress that *more needs to be done*. In particular more progress needs to be achieved in the other two pillars of APEC – facilitation and economic co-operation.

Economic cooperation is also referred to as capacity building or development issues, because simply put, it allows for lesser developed members of any group or smaller companies compared with larger companies, the time and capacity to undertake the necessary liberalization or to enjoy the benefits of liberalization. Since the global crisis, this point has even come more to the forefront. The use of the word inclusion, including financial inclusion and the set of development Issues identified at the recent G20 Summit as reflected in the Seoul Development Consensus for Shared Growth attests to the growing recognition of the need for “balance”.

Achieving regional economic integration means continuing to progress on trade facilitation measures including standards and customs; behind the border issues including structural reforms and greater transparency; and investment facilitation and ease of doing business. To have economic integration and seamless flow of goods, services and people, more also needs to be done on greater connectivity between economies. This means physical construction of infrastructure; institutional coordination such as customs, quarantine and standards agencies, systems, and procedures; and greater mobility of people to people movement which is related to visa, immigration and border controls.

For large countries like Indonesia, our major concern is how to ensure domestic integration and connectivity takes place as we become more regionally and globally integrated. This is a key challenge given the geographic span of Indonesia over 3000 km and spread out over 17,000 islands. The objective of national connectivity for Indonesia is to ensure competitiveness by increasing the efficiency of the flow of goods and people, as well as reducing disparities between regions. The latter means inclusion in all respects by reducing price disparities, income gaps, digital divide and lack of access to capital and financing. These issues are more complex and difficult to deal with including needs of finance, institutional reforms, land acquisition and human resources to support implementation. It is also often much more challenging in the political economy and coordination sense.

The next generation of issues also must include the nexus between climate change and environmental objectives and trade. In the absence of an agreement on Climate Change, there will be a proliferation of national policies on sustainability and climate change such as the use of carbon cap and taxes. Privately set standards will also emerge. Thus, it will be important to guard that there is no discrimination or violation with WTO rules. For instance, developed countries are introducing standards which are related to CO2 emission and it will be important to ensure that they are based on scientific criteria. Consumers are also advocating and requesting for environmental and climate change friendly products and services. Here the challenge is to balance the objectives of climate change and environment protection with development including the need to provide sufficient time and capacity building for sustainable practices to be adopted.

The changing pattern of competition and trade needs to also be observed and responded to and can be summarized as follows:

- changing regional production networks to increasingly supplying final goods to Asia. Consumption demand manifested also in increase demand for food, energy and consumer goods
- the greater fragmentation of the supply chain and that it is not just about the lowest cost of production but also the related services, and that services and outsourcing opportunities are now all part of the supply chain

- China moving out of the low end and low cost to higher end, including services and outsourcing
- Demographics with aging population in Japan and increasingly in China, compared with demographic dividend in Indonesia, India and other Southeast Asia.

### **Dynamics of World and Regional Order**

When APEC was created economies were categorized as developed and developing. The major economic powers were part of the G7, which then became G8. The main players were countries from Western Europe, Japan, USA and Canada. Now a number of developing countries have become fast growing emerging economies, which are fast catching up with the developed countries.

Empirically, since 1990 the average annual growth rate of trade between developing countries grew twice the rate of growth of world trade and developing country trade with each other is now 39 percent of their total trade. The share of trade to GDP for developing countries doubled since 1985 and the share of manufactured exports out of total exports are also approaching that of the advanced country proportions with the increase going from 22 to 60 percent since 1990s, compared with developed countries of 75 percent.

This trend is evident in the trade recovery story after the recent global crisis. After contracting 12 percent in 2009, world trade is expected to recover at 13.5 percent out of which the growth of trade for developed countries is 11.5 percent and for developing countries 16.5 percent. Indonesia has experienced this shift and diversification of markets, where the share of exports going to developing countries increased from 29 percent to 39 percent over 2005-9 and imports from developing countries increased from 29 percent also to 39 percent over 2005-9 period. China's share of south-south trade out of total trade is currently around 25 percent but is expected to go up to 50 percent in 2020 and 60 percent by 2027. South-south trade with China as a hub will drive global trade in future.

Intermediate goods and parts are important part of south-south trade, but intra industry trade with production chain localized and specialized in different countries have become a very important part of the process. International trade is also increasingly done through firms, with one third of IT transactions and 46 percent of US imports being intra firm. The degree of intra firm is also sector specific, with intra firm trade in textiles and apparel and footwear of 10-15 percent, and for electronics and transportation, 60-70 percent.

There has also been a growth in trade in services from developing countries with the share of export of services out of GDP going up from 2 to 4 percent for developing countries compared with 7 percent for OECD economies.

The increased trade with each other is also a reflection of increased fragmentation of global production and has increased the elasticity of trade with respect to income, and with the larger impact from external shocks being transmitted through trade.

Second, since the global crisis of 2008, the premier forum on global economic order has shifted to the G20. It is made up of developed, emerging and developing countries, which in total account for 85 percent of the world GDP, 80 percent of world trade and two thirds of global population. The global crisis has led to a call for reform in the financial architecture and in the governance of international financial institutions. This is a clear recognition of the growing role of emerging economies. The G20 has clearly been recognized as preventing the great recession post global crisis but has been facing increased challenges in maintaining unity and concerted effort in the recovery. This is mainly because of continued imbalances and different situations faced by the different sets of economies.

While the jury may still be out on the strengths and weaknesses, and deliverables of the Seoul G20 Summit, a number of important decisions and turning points were reached. First was the IMF reforms, one could say this was a successful deliverable and reflected the changing global governance to have more representation by emerging economies. Second on trade, the political commitment to resume negotiations and recognizing the critical window of opportunity in 2011 can still be considered as a positive development. Leaders discussed trade in one session and were clear regarding their commitment to start negotiations where things had been left in December 2008, and to complete it within the time frame set. Third whilst there is no conclusion on the currency and current account imbalances, a currency war and tensions have been averted by the indication that there is a willingness to come up with some indicative indicators sometime next year.

Most important result is the introduction of development issues. It is a significant point that Korea is the first non G-7 country to host the G20 summit and along with other developing emerging countries such as Indonesia, has worked hard to include financial safety net and development issues. This is after all the third pillar of APEC and now in comprehensive partnership agreements in the region. It is probably important to keep G20 focused on a few priority areas such as macro framework, financial sector, trade and development.

Third, at the time APEC was created in 1989 and up to the launch of the Bogor Goals in 1994, the WTO did not exist yet. The Uruguay Round of negotiations had been going on for a number of years. To its credit, APEC contributed to the conclusion of the Round and the creation of the WTO in 1995, which created an open and rules based trading system enjoyed by APEC economies. APEC has often been described as acting as the “cheer leader” and champion of the multilateral trading system. Since the global crisis, this system has faced the pressures of protectionism. However, the discipline and framework of the WTO has enabled prevention of a surge of protectionism. APEC can play a similar role in ensuring the successful conclusion of the WTO, Doha Round of negotiations.

Fourth, as already noted, there are now a proliferation of regional trade agreements compared to when APEC was created. There is also the deepening and widening of ASEAN to include comprehensive economic partnerships with China, Japan, Korea, India, Australia and New Zealand. The issue is how to ensure that we avoid the “spaghetti” or “noodle bowl” effect of overlapping regulations, schedules and different rules of origin.

### **III. Conclusions: Responding to the Changing Setting and Implications for Indonesia**

The main conclusion is that there are many challenges and risks, but also opportunities to create open trade and investment with equally strong three pillars.

One obvious conclusion is that there needs to be synergy between all the on going processes with similar objectives, whether it is G20, APEC and other regional processes. The processes can also strengthen and build on each other. National policy then also has to bear these different processes and adjust as well as respond to take benefit from these processes.

On the trade front, it is well worth repeating that the first short term priority is to complete the Doha Round of negotiations. It is the surest way to ensure sustainable and strong recovery through flows of trade and investment, and does not need any fiscal outlay. The DDA negotiations have also anticipated the development pillar within the negotiations as well as in the complementary aid for trade package which will also needs to be effective.

Concluding the Doha round of negotiations and utilizing this “critical window of opportunity” will require political will to build on what is already on the table, resolve pending issues and add in a balanced way, what some countries still need to be on the table. Both at the APEC and G20 (9 APEC members and 6 East Asia economies are members of G20) there was a strong call by Leaders for the completion of the negotiations in 2011 given this is the critical window of opportunity. This must be translated into implementation and action that shows willingness to begin to negotiate, something which has been absent for some time.

A major contribution that APEC can make is to further strengthen the multilateral trading system by ensuring the conclusion of the long stalled DDA. This is the surest way to deal with protectionist pressures, increase trade flows including between developing countries and achieve the development objective. The tariffs facing low income countries is 15 percent in middle income countries compared with 9 percent in high income countries. Whilst Free Trade Area of the Asia Pacific (FTAAP) and Trans Pacific Partnership Agreement (TPPA) may serve a purpose to capture a comprehensive agreement in the Asia Pacific sometime in the future, there are a number of issues that cannot be done regionally or bilaterally, such as the sensitive sectors, removal of subsidies and domestic support in agriculture, and rules.

However, to date despite pronouncements to the effect of completing the Doha Round of negotiations, there has not been a strong push through APEC. This has not been for lack of trying as APEC Ministers Responsible for Trade meetings always put this item high on the agenda. The last meeting of APEC preceding the leaders summit and G20 meetings was no different. One can only hope that like what happened in 1993 when the US hosted the first historic APEC Economic Leaders Meeting and provided the political will for breaking the deadlock in the Uruguay Round, the US as the host next year could exhibit the necessary political will. Of course this will necessitate collective political will, especially by a number of major players. The statements of leaders coming out of the APEC and G20 summit provided a strong message on this count, recognizing the critical window of opportunity of 2011.

APEC can also support and move on the G20 outcomes. This can be done in various ways and through the Finance and Trade Ministers processes, as well as other sectoral ministerials. For instance APEC member economies can actively support the reform of the International Financial Institutions, to enhance these outcomes. We should also refrain from protectionism and stand still on new protection. And, we should continue building confidence and capacity to do unilateral structural reforms, which has been one of the strengths of APEC.

In realizing open trade and investment in the region it will also be important for APEC, in the spirit of open regionalism, to push for the further development and consolidation of the various regional agreements and the model measures for RTAs developed by APEC a few years ago and in the spirit of Professor Snape's seminal paper. This can be translated into actions such as consolidating rules of origin and multilateralizing preferences after a certain period.

As for the other so called pathways to regional integration such as FTAAP and TPPA, even sectoral initiatives such as ITA2, there are a number of principles if we are to keep to the APEC spirit. First is that APEC could act as an "incubator" where the ideas and the principles for such agreements has and could continue to be discussed, including developing the evolutionary building block approach mentioned above. However, if there are to be negotiations, then it should take place outside of APEC. One should also be aware of the difficulties of negotiations. The complex, politically sensitive issues that are causing difficulties in the WTO negotiations will also be faced in such sub regional negotiations with less room for comprehensive trade offs in a single undertaking involving all WTO members. Furthermore, as already mentioned particular issues such as subsidies, domestic support and rules can only be done multilaterally. APEC also has a not so successful experience with sectoral negotiations, the EVSL (Early Voluntary Sector Liberalization). It was unsuccessful because in the negotiations, there continued to be requests to exclude the sub sectors within the wider sector and when we are just negotiating particular sectors, there is not enough trade offs on the table to make it worthwhile.

In negotiating regional agreements it is important to ensure the spirit of open regionalism and the APEC model RTA/FTA principles in mind, and adopt what has now already been adopted in a number of East Asia FTAs. That is comprehensive does not necessarily mean just scope and coverage, but also that it includes the three pillars of APEC, especially the capacity building and development economic cooperation pillar.

In East Asia there is more action, which are inspired by the APEC model measures. After undertaking reviews of the current ASEAN and ASEAN plus one agreements, there is a political will and commitment to consolidate the ASEAN and ASEAN plus one agreements in various ways. The process begins with the creation of four working groups for the three RTAs which are most advanced, that is with China, Korea and Japan. The four working groups focus actually on the three legs of APEC. The first working group focuses on trade in goods and ensuring that the tariff preferences are utilized optimally by looking carefully at the rules of origin with the objective of consolidating, simplifying and making it more liberal. The second and third working groups focus on facilitation by harmonizing tariff nomenclature and customs harmonization. The fourth working group is on economic cooperation and capacity building, which can be directly linked to the objectives of the other working groups.

Most importantly, at the end of the day, APEC is about an ongoing process to reach long term goals. Therefore APEC should take concrete and practical steps at realizing the APEC vision. This can be done by identifying priority areas that would have the greatest impact on business and growth, and spelling out clear targets, timelines and capacity building programs. This is the evolutionary approach to APEC that we often talk about where the building blocks can all contribute to greater economic integration – it is the pathway of least resistance

Some of the initiatives on the table and which could be developed comprehensively are:

- an APEC Single Window of export and import procedures. This could build on the ASEAN Single Window and be linked to capacity building.
- full implementation of the APEC Business Travel Card by all APEC economies.
- outlining the action plan to reach the target of reducing by 10 percent the costs of connectivity agreed on at this Summit, with clear deliverables and time lines, as well as capacity building, financing and so on.

The US has proposed a number of initiatives in clean energy, standards and investment principles. Russia is also focusing on energy issues. Indonesia as the host in 2013 plans to develop a better framework and blueprint for the evolutionary building blocks concept with a sense of priority as to the impact it will have on regional economic integration, without ever forgetting the issue of development cooperation.

The three largest economies in the world, the G2 economies of US and China, and nine out of the G20 economies are in APEC. Therefore to be relevant in the future, East Asia and APEC need to be the anchor and pillar of the world economy, as well as the cushion in times of crisis and shocks. This must mean these regional processes need to be resilient and responsive to the above mentioned dynamics in the setting and challenges.

As for Indonesia, it is clear that the past shows that trade policy in Indonesia has been shaped by a combination of external challenges, commitments and soft as well as hard pressures. However, external influence alone is not sufficient without a receptive domestic process and supporting infrastructure, institutions and human resources. In the Soeharto period, the technocrats played an important role. In the current situation, the coordination and stakeholder outreach process play an important role.

What about ahead? The issues are going to become more complex. The importance of domestic stakeholders becomes much more important in moving ahead. Therefore, the priority is now to prioritize the WTO and the Doha round, and to consolidate and maximize the benefits of the current RTAs/FTAs. It is also about ensuring that certain sectors, regions and groups which can be affected by liberalization, understand the implications and take anticipatory and preparatory actions. The pressures of competitiveness will also become more complex and it is no longer about low cost of production, but how to create value added and move up the value chain. It must include manufactured goods as well as services. Sources of increased efficiency and innovation have to come from improved hard and soft infrastructure (especially human resources), reforms and streamlining of institutions, the appropriate incentive framework.

All this underlines the importance of good policy analysis and an effective communications strategy involving all the key stakeholders. This is exactly the principles and values that is part of the Snape legacy. In the policy making arena in

Indonesia this also constitutes of what we are striving to build at the moment, very much in line with the vision of Professor Richard Snape and the Productivity Commission.

## References

Asia Pacific Economic Cooperation (APEC), *The Report on APEC's 2010 Economies' Progress toward Bogor Goals*, (November, 2010, [www.apec.org](http://www.apec.org)).

Christopher Findlay, Haflah Pei and Mari Pangestu, Trading with Favourites: Free Trade Agreements in the Asia Pacific, East Asia Trade Strategy Conference, The Australian National University, March 20-21, 2003.

Indermit Gill and Homi Kharas, An East Asian Renaissance: Ideas for Economic Growth, World Bank 2007.

Masahiro Kawai and Ganeshan Wignaraja (eds.), *Asia's Free Trade Agreements: How is Business Responding*, (ADB, Tokyo 2010).

Pacific Economic Cooperation Council, *State of the Region 2010-2011*, (PECC International Secretariat, 2010, [www.pecc.org](http://www.pecc.org))

Mari Pangestu, "Bogor Goals and the Future of APEC: an Indonesian Perspective", *APEC CEO Summit*, Yokohama, November 13, 2010.

Richard H. Snape, NAFTA, The Americas, AFTA and CER: Reinforcement or Competition for APEC, Australia-Japan Research Center, Pacific Economic Paper No. 254, April 1996.