The Challenges for Trade Policy in a Dynamic World and Regional Setting: An Indonesian Perspective

Mari Pangestu

Richard Snape Lecture
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Foreword

Richard Snape capped a long and distinguished career as Professor of Economics at Monash University with a new and accomplished career at the Industry Commission, and then as Deputy Chairman of the Productivity Commission. In the eight years that he spent at the Commission before his untimely death in October 2002, he played a pivotal role in overseeing our research program, as well as participating in major public inquiries.

This is the eighth in a series of lectures in memory of Richard Snape. With Richard’s own interests and high standards in mind, the lecture series elicits contributions on important public policy issues from internationally recognised figures, in a form that is accessible to a wide audience.

We are privileged to have Mari Pangestu present the eighth lecture in this series. Dr Pangestu has been Minister of Trade for Indonesia since 2004. She is the lead Indonesian negotiator at the World Trade Organisation, and Chair of the G33 coalition of developing countries. Dr Pangestu knows Australia well. She obtained her undergraduate and Masters degrees in economics at the ANU in Canberra. And, as a specialist in international trade and finance, she has had much interaction with Australian academics over the years, including Professor Snape.

In this lecture, Dr Pangestu draws on her unique experience as a trade negotiator, policy advisor and researcher, to provide an incisive assessment of the challenges facing further trade policy reform.

I am grateful that Dr Pangestu was able to take time out of her very busy schedule to come to Australia to present the Richard Snape Lecture for 2010.

Gary Banks AO
Chairman

December 2010
Richard Snape 1936 – 2002

Richard Hal Snape was Deputy Chairman of the Productivity Commission and Emeritus Professor of Monash University. He was a Board Member of the Australian Research Council, Fellow of the Academy of the Social Sciences in Australia and a Distinguished Fellow of the Economic Society of Australia.

Dr Mari Elka Pangestu
Minister of Trade
Republic of Indonesia

Dr Mari Pangestu has been Indonesia’s Minister of Trade since 2004. She is also lead Indonesian negotiator at the World Trade Organization, and is currently Chair of the G33 coalition of developing countries. Dr Pangestu’s previous positions include membership of the Governing Board of the Centre for Strategic and International Studies, Jakarta and Program Coordinator for the Pacific Economic Cooperation Council (PECC). From 2002 to 2004, she was the Co-coordinator of the Task Force on Poverty and Development for the United Nations Millennium Project.

Dr Pangestu obtained a Bachelor and Master of Economics from ANU and a PhD from the University of California, Davis. She is a specialist in international trade and finance, focusing on ASEAN, China, and the Asia Pacific. She has published widely in Indonesian and international journals.
The challenges for trade policy in a dynamic world and regional setting: An Indonesian perspective

Mari Pangestu

I am honoured 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 a special privilege. We would often meet at seminars and events held under the auspices of organisations and meetings such as the Pacific Trade and Development Conference Series, the Pacific Economic Cooperation Council, the Australia-Japan Research Centre and NBER’s East Asian Seminar on Economics.

As a young scholar coming up the ranks of seniors in the trade economists network, I greatly appreciated Professor Snape’s intellect and wisdom in the trade policy area. I still recall the last time we met, at the Twelfth Annual East Asian Seminar on Economics titled ‘Privatization, Corporate Governance, and Transition Economies’. This was an NBER seminar held in Hong Kong in June 2001, organized by Ann Krueger and sponsored jointly by the Productivity Commission and a number of regional organizations. I remember being a discussant for a paper on railway reform by Helen Owens also of the Productivity Commission, and Professor Snape was a discussant on telecommunications privatization.

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

One of the reasons for my visit to the Commission at that time 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 analysis of tariff settings. 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 that I would still be 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 with you my thoughts on the personal journey of a Trade Minister, and the challenges of trade policy making in a dynamic regional and global setting.

1 Introduction

The job of a trade policy maker has become more complex compared with ten to fifteen years ago. The challenges post global crisis have made it even harder to deal with keeping protectionism — whether the traditional form or otherwise — at bay.

Trade policy issues have also now become more complex because they extend beyond the traditional cross border measures. Furthermore, trade policy has become more complex not just in terms of substance, but also processes and institutions.

In this paper three themes will be explored. The first is to assess the current settings facing trade policy — that is, the context of trade policy over 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 and 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, implications are drawn for a country like Indonesia.

2 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 should be noted.

First, one of the significant trends of this decade is that world trade has shifted from the European Union and the United States to Asia, as indicated by the increase in the share of world trade accounted for by Asia from 26 per cent to 31 per cent over the period 2004 to 2009. This pattern is likely to continue.

Second is the increase in intra-regional trade. Intra-regional East Asian trade has increased from 37 per cent to 42 per cent over the period 1980 to 1990, and to
54 per cent in 2008, led by trade in parts and components. In comparison, over the period 1990 to 2003, the share of intra-regional trade in total trade declined from 65 to 60 per cent for the European Union, went from 37 to 45 per cent for the North America Free Trade Area (NAFTA) and from 10 per cent to 15 per cent for Mercosur.

Similarly, intra-Asia Pacific Economic Cooperation (APEC) trade has increased from 22.6 per cent to 36.5 per cent for exports, and from 21 to 33 per cent for imports over the period 1996 to 2009. Furthermore, trade in goods in APEC increased 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 increased fourfold from 1994 to 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 Japan, as the Chair of APEC, has initiated an assessment by APEC of the progress made towards achieving the 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 per cent in 1994 to 10.8 per cent in 1994 and to 6.6 per cent in 2008. In the case of Indonesia, tariffs have fallen from an average of around 30 per cent to 6 per cent.

- Business sector perceptions of the incidence of non-tariff barriers have improved, and out of the NTMs (Non-Tariff Measures) surveyed by the UNCTAD Trade Analysis and Information System (TRAINS), the most prevalent NTMs are technical barriers to trade, customs and administrative procedures, and sanitary and phytosanitary standards (SPS) measures.

- There has been 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 the 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 per cent over 2002–06. The target is to reduce costs of doing business by 10 per cent by 2010 and 25 per cent by 2015. As for Indonesia, a great deal of progress was achieved with the National Single Window for export
and import procedures. By the end of 2010 most of the clearance of documents will be done on-line in the major ports.

Although it is difficult to pinpoint 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 the 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 the 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 occurred 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 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 measures and dramatic institutional changes to shift 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, which was replaced by the Swiss surveyor company SGS. These reforms were successful in diversifying Indonesia’s exports, with the share of oil and gas falling from 85 per cent of total exports to 25 per cent by the 1990s, 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 replaced with the current scheme, acceptable to the GATT/WTO, 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 — one year prior to, and 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 of investment restrictions. However, a dramatic change in the removal of investment restrictions occurred 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 1994 deregulation reforms allowed for 100 per cent 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 for 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 reform. After exit from the IMF program there were no major reversals, and the thrust of the policies remain today with some adjustments to reflect 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 crises, 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 reform faces 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 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 reform 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, the 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 reform.

On the trade side, it was the implementation of the harmonization schedule of tariff reductions 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 born out of the commitment under the ASEAN Economic Community Blueprint. 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 hopefully will be 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 to reduce the potential for corruption or side payments.

The processes introduced have also been important. This includes carrying on the tradition of the IMF exit program with a matrix set up of deliverables in the reform agenda, 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 has reformed its 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 very much with 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 for the less developed members.

The progress made on 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 the 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 worth noting 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 notions of peer pressure and champions of reform were 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 where Japan has announced its intention to study reform of 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 blocks?

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

A similar picture emerges in the APEC region. When the Bogor Goals were agreed in 1994 there were only three agreements involving APEC economies. By 2005 there were 45 FTAs 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 have been recently concluded, and the one with the United States is still pending.

Indonesia has chosen to focus on regional-based trading arrangements with ASEAN as the core, and with the six dialog partners of China, Korea, Japan, Australia, 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 ASEAN Economic Community 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 into 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 ASEAN Economic Community 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 (for example, Australia and India), to prepare a ‘training ground’ for more comprehensive agreements in future (for example, with the European Free Trade
Agreement (EFTA) and other strategic alliances (for example, with Chile, Turkey and Egypt). Given limited negotiating resources, the priority has been to commence negotiations with Australia and EFTA. Commencement of negotiations with Chile and India is being evaluated after the completion of reports by Joint Study Groups on the feasibility of FTAs with these countries. As for Egypt and Turkey, joint studies of the feasibility are 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 market-driven regionalism. That is, the integration has happened in the absence of formal regional free trade agreements connecting these economies, but has occurred because of pull and push factors and technological developments in production processes, telecommunications and logistics. Push factors being rising costs (that is, labor, land, exchange rates) and pull factors include resource endowments such as the supply of labour and skill sets, as well as the degree of opening up and the investment climate. Until recently the story of East Asia is one of intra-regional trade driven by production networks with China as the hub. The evidence is the high share of parts and components in intra East Asian trade.

Market-driven integration is more recently also being influenced by the conclusion and implementation of the growing number of regional FTAs in the last decade. Furthermore, there will increasingly be 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 the region (such as the United States and the European Union), to increasingly exporting final goods to the regional market.

It would seem that the debate about multilateralism versus 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 ‘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 the free flow of goods, services, investment and professional labor, and freer flow of capital by 2015. Other than the ‘entrepreneurial bureaucrats’ factor, there is also now a
stronger belief that the FTAs 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 is not without concern. The proliferation and different schedules of tariff reduction, tariff nomenclature and regional content have raised questions regarding the costs this raises for businesses. The same product destined for different markets faces different administration and Rules of Origin (ROO) as well as other requirements. This reality is inconsistent with economies of scale and scope, and it is what Jagdish Bhagwati has termed the ‘spaghetti bowl’ effect, and what in Asia has been referred to as the ‘noodle bowl’ effect.

A recent Asian Development Bank Institute (ADBI) study looks at the business impact of the ‘noodle bowl’ effect on businesses from six East Asian countries (Kawai and Wignaraja 2010). The study tries to see how much preferences under FTAs are being used, the costs and benefits of FTAs, and whether administration of ROO is cumbersome and adding costs.

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

In the case of Indonesia, as of 2010, the utilization rate of FTA preferences averages 32 per cent of total non-oil exports. In terms of utilization, the lowest is the bilateral Indonesia-Japan Economic Partnership Agreement at 17 per cent, and the highest are the ASEAN-China FTA (ACFTA) at 42 per cent, the ASEAN-Korea FTA (AKFTA) at 37 per cent, and AFTA at 36 per cent. The low utilization for the Indonesia-Japan Economic Partnership Agreement 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 AKFTA increased from 9.5 per cent in 2007 to 29 per cent in 2010 (latest data being for July). As for Korean exports going to ASEAN, the utilization rate is only 9.5 per cent of imports from ASEAN. The factors identified for low utilization are low awareness of exporters regarding the 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 the ACFTA observed that lack of awareness, administrative difficulties, low margin of preference and significant trade in the sensitive sectors are the main issues.

The ADBI study also reveals some interesting micro level results.

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

- Higher percentage of firms from the People’s Republic of China using FTA preferences compared with Japanese firms, at 45 per cent compared with 29 per cent (linked to regional production networks), and firms from other countries with a 20 per cent utilization rate.

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

- Higher level of knowledge of FTAs by Japanese firms compared with companies from other countries.

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

- Multiple ROO in existing FTAs impose a ‘modest’ burden on firms in East Asia or 20 per cent 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 (SMEs), improve business participation in FTA consultations and improve institutional support for SMEs.

In addition, the wisdom of Professor Richard Snape regarding comprehensiveness and openness for new members or ‘open club’, as follows, is still valid and resounds 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 2005 APEC Model Measures include consistency with APEC and WTO principles and rules; agreements that build on existing WTO commitments and explore commitments in additional areas not covered by the 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 ROO.

Despite the above results, there are some positive observations regarding the proliferation of FTAs. First is that it reinforced the process of opening up and reform undertaken under multilateral commitments and unilaterally. Second, many of the regional trade agreements in Southeast and East Asia in the last decade have been ‘inspired’ by the three pillars of APEC. That is, they are not limited FTAs focusing just on cross border liberalization, but are what is known as Comprehensive Partnership Agreements, which include 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 the TTP Agreement, raise questions and issues that the country has to deal with in any case. As noted, Japan has used the potential for joining TPP to increase pressure for or inform domestic reforms in agriculture. Others who have joined TPP such as Malaysia have done it for the same reason.

3 Changing dynamics of the 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 APEC Leaders created them in 1994. The statement of our far-sighted Leaders — which 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’ — remains valid today. The Blake Island APEC vision and Bogor Declaration were also very clear about the need to avoid inward looking and discriminatory trading blocks, 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 that must be reached through three equally strong 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 FTAs and national policies to remain relevant,
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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 2008–09, the great recession has been avoided. However, the prospects for a sustained recovery remain threatened 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 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, high unemployment rates and 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 cooperation.

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 come even 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 the 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, 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, the digital divide and lack of access to capital and financing. These issues are more complex and difficult to deal with including finance needs, 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 of WTO rules. For instance, developed countries are introducing standards that 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 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 also needs to 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 increased demand for food, energy and consumer goods.

- Greater fragmentation of the supply chain — 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 is moving out of the low end and low cost to higher end, including services and outsourcing.

- Demographics, with an ageing population in Japan and increasingly in China, compared with the demographic dividend in Indonesia, India and other Southeast Asian countries.

**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 the G8. The main players were countries from Western Europe, Japan, the United States 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 increased at twice the rate of growth of world trade, and developing country trade with each other is now 39 per cent 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 is also approaching advanced country proportions, with the increase going from 22 to 60 per cent since the 1990s, compared with developed countries of 75 per cent.

This trend is evident in the trade recovery story after the recent global crisis. After contracting by 12 per cent in 2009, world trade is expected to recover at 13.5 per cent, out of which the growth of trade for developed countries is 11.5 per cent and for developing countries 16.5 per cent. Indonesia has experienced this shift and diversification of markets, where the share of exports going to developing countries increased from 29 per cent to 39 per cent over 2005–09, and imports from developing countries also increased from 29 per cent to 39 per cent over the period 2005–09. China’s share of south-south trade out of total trade is currently around 25 per cent but is expected to go up to 50 per cent in 2020 and to
60 per cent by 2027. South-south trade with China as a hub will drive global trade in the future.

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

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

The increased trade with each other is also a reflection of the 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 per cent of the world GDP, 80 per cent 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 recognize 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.

The most important result is the introduction of development issues. It is a significant point that Korea is the first non G7 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 is 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, and 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. 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 is 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 ROO.

4 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 the 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 Doha Development Agenda (DDA) negotiations have also anticipated the development pillar within the negotiations, as well as in the complementary aid for trade package, which will also need 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 APEC and the G20 (9 APEC members and 6 East Asian economies are members of the 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 that has been absent for some time.

A major contribution 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 are 15 per cent in middle-income countries compared with 9 per cent in high-income countries. Whilst the Free Trade Area of the Asia Pacific (FTAAP) and the TPP Agreement may serve 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 about 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 United States hosted the first historic APEC Economic Leaders Meeting and provided the political will for breaking the deadlock in the Uruguay Round, the United States 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 summits 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 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 ROO and multilateralizing preferences after a certain period.

As for the other so-called pathways to regional integration such as FTAAP and the TPP Agreement, 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 have been and could continue to be discussed, including developing the evolutionary building block approach mentioned above. However, if there are to be negotiations, then they should take place outside 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) 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 are 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 with the APEC Model Measures for RTA/FTAs in mind, and adopt what has now already been adopted in a number of East Asian FTAs. That it 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, inspired by the APEC Model Measures. After undertaking reviews of the current ASEAN and ASEAN Plus One agreements, there is 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 that are most advanced, that is with China, Korea and Japan. The four working groups actually focus 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 ROO 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 on-going process to reach long-term goals. Therefore APEC should take concrete and practical steps towards 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 that 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 per cent the costs of connectivity agreed at the 2010 Summit, with clear deliverables and timelines, as well as capacity building, financing and so on.

The United States 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, 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 means these regional processes need to be resilient and responsive to the above mentioned dynamics in the global and regional settings 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 processes 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 now is 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 that 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 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), reform and streamlining of institutions, and 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 are part of the Snape legacy. In the policy making arena in Indonesia this also constitutes what we are striving to build at the moment, which is very much in line with the vision of Professor Richard Snape and the Productivity Commission.
References


