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US-Indonesia: Trade Challenges



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Why is trade important?



- Nexus of economics and politics
 - Relationship between market and state
 - War by other means
 - Nexus of economics and politics
- Barometer for globalization
- Affects, defines, improves quality of life of citizens
 - Jobs
 - Education
 - Opportunities



Why do countries trade?



- **Cost base**
 - Adam Smith – absolute advantage (1776)
 - David Ricardo – comparative advantage (1815)
- **Technology base**
 - Hechsler-Ohlin
 - Factor abundance
 - Need a new technology
- **Pareto criterion**
 - Any change that makes one person better off without making any individual worse off increases welfare
 - Role of the State is to increase welfare of citizens



Comparative vs. Competitive Advantage



- Comparative Advantage – refers primarily to locational advantages, i.e., country-specific –
 - “Endowment” (classical view)
 - Market size and sophistication
- Competitive Advantage – refers primarily to individual firm advantages, i.e. -
 - Value Proposition and Business Model
 - Core competencies
 - Management Processes and Capability
- Porter’s *Competitive Advantage of Nations*



Theory of Trade

Critique of Classical View



- What's Missing from Classical Theory?
 - Technology
 - Scale economies
 - Factor & Product differentiation
 - Nature of 'National endowments'
- Raymond Vernon's Int'l Product Cycle
 - Dynamic view of technology (dissemination)
 - Distinctive post-WWII Role for MNCs
 - Home vs. Foreign Markets
- Natural vs. Acquired Advantage



Theory of Trade

Why Trade?



- Mercantilism – State Wealth View
- Adam Smith - *Absolute Cost Advantage* Among Products of Different Countries
- David Ricardo – *Comparative Advantage* – Relative Superiority Among a Country's Products
- Advantages Explained in terms of –
 - Labor (emphasis of Smith and Ricardo)
 - Land, Natural Resources (later theory)
 - Capital (later theory)
- Leontief Paradox – labor- vs. capital-intensive exports



Why countries may not want to trade?



- “Keep the money at home”
 - Jobs
 - Balance of payments
- National Security
 - Military
 - Health/environment
- Infant industry
- Diversification
- Theory of the “second best”
 - Perfect free trade doesn’t exist; therefore try to even the playing field with protection.



Reasons for Trade/Investment Controls



- Protect import-competing domestic firms (save jobs!)
- Promote import substitution
- Promote infant industries
- Reduce reliance on foreign suppliers
- Encourage local and foreign direct investment
- Achieve health and safety standards
- Reduce balance of payments problems
- Promote export-based growth
- Restrain foreign firms from dumping
- Serve political goals



Common Forms of Barriers (1)



1. Price based constraints

- Tariffs
 - A tax imposed by a government on physical goods as they move into or out of a country
 - Ad valorem, specific, compound
- Export subsidies
 - Government support in order to increase competitiveness
 - Direct payments, trade promotion, favorable financing
- Export taxes
 - levying duties on key commodities to discourage their export



Common Forms of Barriers (2)



2. Quantity limits

- Import quotas
 - Quantitative restrictions on volume of a commodity allowed
- Embargo
 - Essentially zero quota



Common Forms of Barriers (3)



3. Cartels (buyers' or sellers')

- Agreements between buyers or sellers of a good/service to fix the price
- E.g. OPEC; International Sugar Agreement, Multi-Fiber Arrangement



Common Forms of Barriers (4)



4. Nontariff barriers (NTBs)

- Less formal mechanisms to discourage imports
- More and more pervasive
- E.g. technical/administrative protection, government procurement policies, local content, standards



Common Forms of Barriers (5, 6)



5. Financial limits

- Exchange controls
- Profit remittance limits

6. Limits on Foreign Direct Investment (FDI)

- Percentage ownership
- Limitation of activities/sectors



New Trends and Problems



- No such thing as “free trade”
 - All nations restrict in some way
- Much more difficult to tell “who is us”
 - Global supply chains
 - You don’t know if you are helping or hurting “domestic” industry (because you may be hurting partners)
- ***Trade policy does not stop with “border barriers”
 - “Unfair trade” and competitiveness Issues permeate society:
 - Health standards, environmental regulations, antitrust enforcement, tax incentives, etc.
 - Trade has become the interface between different societies’ ways of structuring themselves
- Trade (economic) issues underlie tensions: talk or fight?



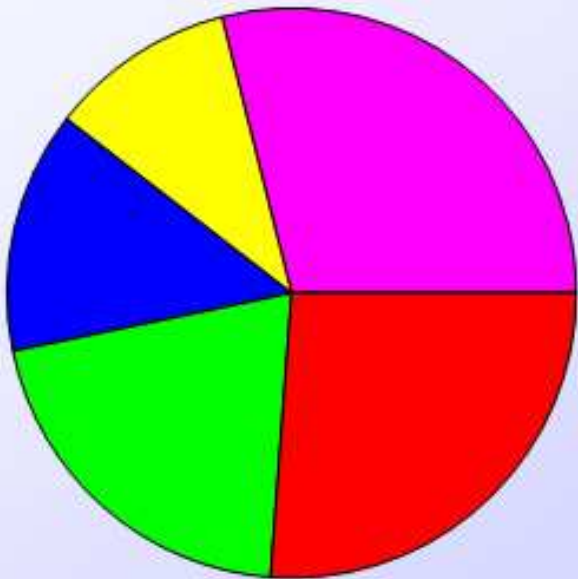
Specific US-Indo Trade Issues








- National Foreign Trade Estimates annual report published by the US Trade Representative (USTR)
- Focuses on major bilateral trade problems between US and trading partners;
- Required by law to produce this report
- Note the large number of non-tariff barriers



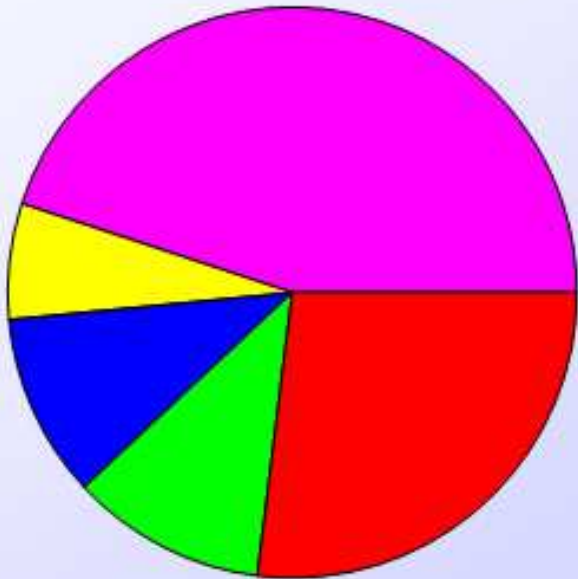
2010 US Exports to Indonesia Total All Merchandise



| | Product | Value (\$) | Percent |
|---|-------------------------------|------------------------|--------------|
|  | 336--TRANSPORTATION EQUIPMENT | \$1,818,570,309 | 26.2 % |
|  | 111--AGRICULTURAL PRODUCTS | \$1,427,341,796 | 20.5 % |
|  | 325--CHEMICALS | \$955,518,017 | 13.8 % |
|  | 311--FOOD MANUFACTURES | \$734,301,006 | 10.6 % |
|  | All Others | \$2,010,389,296 | 28.9 % |
| | Grand Total | \$6,946,120,424 | 100 % |



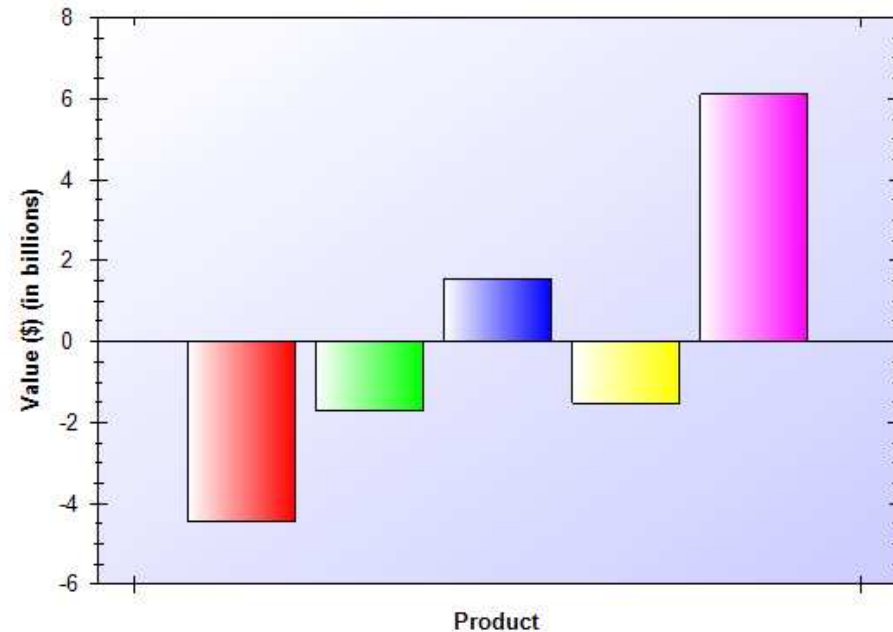
2010 US Imports from Indonesia Total All Merchandise



| Product | Value (\$) | Percent |
|---|-------------------------|--------------|
| 315--APPAREL MANUFACTURING PRODUCTS | \$4,443,305,921 | 27 % |
| 334--COMPUTER AND ELECTRONIC PRODUCTS | \$1,827,674,243 | 11.1 % |
| 113--FORESTRY PRODUCTS, NESOI | \$1,719,251,569 | 10.4 % |
| 339--MISCELLANEOUS MANUFACTURED COMMODITIES | \$1,081,039,690 | 6.6 % |
| All Others | \$7,407,042,037 | 45 % |
| Grand Total | \$16,478,313,460 | 100 % |



2010 Balances with Indonesia Total All Merchandise



| Product | Value (\$) |
|---------------------------------------|-------------------------|
| 315--APPAREL MANUFACTURING PRODUCTS | \$-4,440,369,512 |
| 113--FORESTRY PRODUCTS, NESOI | \$-1,703,158,342 |
| 336--TRANSPORTATION EQUIPMENT | \$1,562,720,924 |
| 334--COMPUTER AND ELECTRONIC PRODUCTS | \$-1,525,568,035 |
| All Others | \$6,106,374,965 |
| Grand Total | \$-9,532,193,036 |



Trade Overview



- Indonesia exports to the USA (US imports)
 - \$16,478,313,460
 - Up 27.3% from previous year
 - Indonesia imports from the USA (US exports)
 - \$6,946,120,424
 - Up 35.9% from previous year
 - Balance of trade between Indonesia and the USA
 - **-\$9,532,193,036**
 - Up \$1.7 billion from 2009 (21.8% increase – not sustainable)
- Problems?



Purpose? Impact? Agencies?



- Before we move into a discussion of some specific US-Indonesia trade issues, I want you to think about
 - What is Indonesia's purpose in enacting each of these?
 - What is the effect of the action?
 - What Indonesian agencies are involved?
 - Why might the US be opposed?
 - What can/should the US do about it?
 - What would you advise a US firm to do? An Indonesian firm?
- I will be asking you during the lecture!



Specific US-Indo Trade Issues: Import Policies



- Tariffs

- Aver. Applied tariff was 7.6%
- Bound rates: cannot go higher under WTO commitments
 - Aver bound rate: 37%; most bound at 40%
- Over past 2 years, Indonesia has raised tariffs
 - Incl certain chemicals, electronic products, electrical and non-electrical milling machines, iron wire and wire nails,
 - Incl. certain agricultural products, such as milk products, animal or vegetable oils, fruit juices, coffee, and tea
 - Motorcycles: 60% tariff, luxury tax of 75%, 10% value added tax, and prohibition of motorcycle traffic on Indo highways



Specific US-Indo Trade Issues: Import Policies



- Tariffs, cont.
 - In agriculture sector, 1,300 products have bindings at or above 40%
 - E.g. potatoes, bound at 50% (although applied rate is 25%)
 - Imported spirits, 150%
 - Reduction or elimination of tariffs would result in tens of millions of US\$ in increased sales to Indonesia.
 - E.g. beef, cheese, cooking appliances, cookware, and beverage systems



Specific US-Indo Trade Issues: Import Policies



- **Import Licensing**
 - Exporters must comply with numerous and overlapping licensing requirements that impede access to Indonesia's market
 - Non-automatic important licensing procedures [Decree 56]
 - Must get a license each time
 - Electronics, household appliances, textiles, footwear, toys, food and beverage products
 - Includes preshipment verification by designated surveyors at importers' expense, and
 - A restriction that limits entry of imports to 5 designated ports and airports
 - Approval process is opaque, ill-defined, and potentially discriminatory



Specific US-Indo Trade Issues: Import Policies



- Import licensing, cont
 - Reg. 45/2009 and 17/2010 (Min. of Trade)
 - Companies can only import goods for further distribution OR goods for their own manufacturing, but NOT BOTH
 - Concern here is that it is being applied more stringently on imports destined for distribution than on imports used in the production process, raising concerns that its application is restricting imports
- Non-automatic licensing requirements
 - Limit market access for textiles, clothing, and other “made up goods”, incl. curtains, blankets
 - Products may only be used as inputs in domestic production
 - Approval must be obtained for quantity and timing



Specific US-Indo Trade Issues: Import Policies



- Pharmaceutical Market Access
 - Min. of Health Decree 1010
 - Requirement to manufacture locally
 - In order to be qualified to apply for drug approvals
 - includes domestic packaging and labeling
 - Includes requirement for local manufacturing of all pharmaceutical products that are five years past patent expiration.



Specific US-Indo Trade Issues: Import Policies



- Quantitative restrictions
 - Import permit required from DG of Livestock Services for imports of animal-based food products:
 - Govt may “use discretion” on quantity it allows to enter.
 - Import permit required from DG of Livestock Services for imports of animal-based food products
 - Salt (banned during harvest season); seasonal ban on sugar
 - Prohibition on exports of unprocessed ore
 - Govt may “use discretion” on quantity it allows to enter.
 - Import permit required from DG of Livestock Services for imports of animal-based food products;
- Product Registration (BPOM, food and drug agency)
 - Slowed process for reviewing applications for registration



Specific US-Indo Trade Issues: Import Policies



- Customs barriers
 - Customs Service uses a schedule of reference prices to assess duties on some imports, rather than using actual transaction prices, (a WTO commitment)
 - Costly delays; requests for “unofficial” payments to customs officials
 - Motion pictures
 - Instead of imposing tariffs according to the value of the imported physical media, CS is levying duties based on the amounts paid by importers for the exclusive right to distribute files
 - Results in a dramatic increase in duties payable



Specific US-Indo Trade Issues: Import Policies



- Luxury taxes
 - Sedans 75%
 - As opposed to 10-30% on smaller cars
 - Distilled spirits [eliminated luxury tax, but increased excise taxes]
- State trading
 - Rice
 - No imports permitted before, during, and immediately after the main harvest period (effectively the first quarter of the year).



Specific US-Indo Trade Issues: Government Procurement



- Indo grants special preferences to encourage domestic sourcing and to maximize the use of local content in government procurement.
- Ministry of Industry issued a circular “recommending” that civil servants purchase domestic goods and services in their official capacities, as well as in their private purchasing.
- Foreign firms have been asked to purchase and export the equivalent value of selected Indo products if they are awarded a government contract



Specific US-Indo Trade Issues: Intellectual Property Rights (IPR)



- Indonesia – placed on Priority Watch List in the 2010 Special 301 Report
 - Inadequate enforcement
 - Widespread copyright piracy and trademark counterfeiting
 - Inadequate numbers of criminal prosecutions,
 - Non-deterrent penalties



Specific US-Indo Trade Issues: Services Barriers



- Trade and investment barriers: far-reaching
- Legal services – only Indonesians may be licensed
- Express Delivery and Logistics Services – must be majority owned by Indonesians
- Health Services – restricts foreign health care professionals from practicing in Indonesia;
 - Foreign trained physicians may only supervise and train
- Distribution – direct sellers must enter into partnership
- Cabotage – all vessels operating in Indo waters must be flagged domestically and manned by Indo crews.
 - No exceptions



Specific US-Indo Trade Issues: Services Barriers



- Financial services – providers may not establish a branch;
- Energy services – upstream oil and gas service providers must have local content of 35%
- Audit and Accounting Services – foreign firms cannot practice under international firms' names;
 - Must operate through technical assistance programs with local firms
 - Only Indo citizens can be licensed as accountants
 - Foreigners are allowed a maximum stay of 2 years, w one 1 yr renewal
 - Financial services – providers may not establish a branch;



Specific US-Indo Trade Issues: Services Barriers



- Film
 - No more than 60% of screen time for foreign films
 - Prohibitions against dubbing of foreign films
 - Prohibitions against distribution
- Construction, Architecture and Engineering
 - Only allowed as subcontractors or advisors to local firms
- Telecommunications Services
 - Limitations on for. ownership of value added and mobile com.
 - Restrictions on construction of cell towers to dom. companies
- Education
 - For. Ed. Personnel required from Min. of Ed, AND Min. of Manpower



Specific US-Indo Trade Issues: Investment Barriers



- Significant and far-reaching foreign investment restrictions:
 - Legal uncertainty
 - Economic nationalism
 - Disproportionate influence of local business interests seeking control and ownership of existing enterprises and new market opportunities
 - More sectors covered under restrictions and limitations
- Sectors include:
 - Telecommunications; pharmaceuticals, film and creative industries, and construction
- Negative list



Specific US-Indo Trade Issues: Investment Barriers



- Energy and Mining
 - Increased government control to generate higher royalties for the gov.
 - Preferences to local subcontractors
 - Unpredictable tax and royalties
 - Replaces “contract of work” with system of licensing
 - Unilateral altering of contracts in the country’s favor
- Telecommunications
 - Requirement for 40% of total capital expenditures for network development on locally sourced components or services.



Specific US-Indo Trade Issues: Other Barriers



- Some progress with Corruption Eradication Commission
- Corruption-related difficulties remain:
 - Demands for unwarranted fees
 - To obtain required permits or licenses
 - To expedite processes
 - To influence government awards of contracts and concessions
- Court system – inefficient and corrupt



US-Indonesia Trade Issues



- But not all one sided: Indonesia has serious concerns with the US also, for example:
- Palm oil: The EPA found that biofuels derived from palm oil aren't a good choice for the climate because, once the carbon footprint of palm oil production is factored in, they can no longer meet the 20% emissions-reduction standard for biofuels. [17%; 11% for diesel]
- Indonesia is already the world's third largest emitter of greenhouse gases, after China and the U.S. Some 85% of Indonesia's emissions result from clearing rainforests and draining carbon-rich peatlands, activities driven heavily by the rapid expansion of the palm oil industry.



WTO: US-Indonesia Issues



- Clove cigarettes
 - SPS and TBT agreements
 - Issue background: 2009 US law bans clove cigarettes.
 - Indonesia claims US law allows for sale of cigarettes with other additives such as menthol.
 - Requested consultations with US (7 April 2010)
 - Requested establishment of a panel (June 2010)
 - DSB established a Panel (July 2010)
 - Sept – panel composition complete
 - Indonesia said: discriminatory and unnecessary
 - Panel found US law was inconsistent with “national treatment”
 - US will appeal



So, where are we?



- Indo “too big to ignore”, and bilateral trade continues to grow
 - BRICI
 - 4th most populous nation
 - 3rd most populous democracy
- Indo likely has a long list of trade concerns with the US
- ***As volume of trade grows, trade issues likely to increase [note how many are not “tariffs”]
- Indonesia will need to act like the big player it is



Discussion Fora



- We will continue to discuss bilateral and multilateral issues in various fora:
 - Multilateral
 - WTO (World Trade Organization)
 - APEC (Asia-Pacific Economic Cooperation)
 - ASEAN (Association of Southeast Asian Nations)
 - TPP (Trans-Pacific Partnership)
 - Bilateral
- Different fora have different strengths



Various fora: WTO



- WTO (World Trade Organization)
 - Created as successor organization to the GATT (General Agreement on Tariffs and Trade),
 - Preamble to the moribund International Trade Organization 1947
 - Function is to help ensure that trade flows smoothly, predictably, and freely as possibly
 - Indonesia joined in 1950



WTO – Basic Principles



- MFN – Most- Favored Nation Treatment
- National Treatment with Member States
- Rule-Based System – objective & transparent
- Timed Dispute Settlement Procedures
- Member commitments: negotiated and bound
- Progressive liberalization through further negotiations





Advantages:

- It is an organization for trade opening.
- It is a forum for governments to negotiate trade agreements.
- It is a place for them to settle trade disputes. (rigorous dispute settlement mechanism)
- It operates a system of trade rules (for big and small!)
- Essentially, the WTO is a place where member governments try to sort out the trade problems they face with each other.
- **Above all, it's a negotiating forum for 153 members**





Disadvantages

- Too big and unwieldy to cut specific deals
 - E.g. Doha Round
- Needs “consensus” to operate
- Issues take too long to resolve
- Indonesia one of 153 members

But it beats any alternative!



APEC

Asia-Pacific Economic Cooperation



Advantages

- 21 members with regional focus
 - Australia, Brunei Darussalam, Canada, Chile, China (PRC), Hong Kong (China), Indonesia, Japan, Korea (ROK), Malaysia, Mexico, New Zealand, Papua New Guinea, Peru, The Philippines, Russia, Singapore, Taipei (China), Thailand, USA, Vietnam
- Can raise generic issues that cut across region
- Explore various alternatives
- Indonesia – a respected leader in the group

Disadvantages

- No real organizational structure
 - The “c” is not “council” or “commission”, but “cooperation”
- No teeth/ no sanctions/no dispute settlement process



TPP: Trans Pacific Partnership



Advantages:

- Group of 9 countries from APEC negotiating real agreements and commitments
 - Australia, Brunei Darussalam, Chile, Malaysia, New Zealand, Peru, Singapore, USA, Vietnam
- Serves a barometer for rest of APEC and a model of what WTO might accomplish

Disadvantages

- Indonesia not a participant



ASEAN: Assoc. of Southeast Asian Nations



- 10 Members, but still can move trade issues forward
 - Brunei Darussalam, Cambodia, Indonesia, Lao PDR, Malaysia, Myanmar, Philippines, Singapore, Thailand, Vietnam
- Does not include US
- Tends to be more political than trade/economic



Overlapping membership



WTO – all but Russia

APEC - 21

Australia, Brunei Darussalam, Canada, Chile, China (PRC), Hong Kong (China), **Indonesia**, Japan, Korea (ROK), Malaysia, Mexico, New Zealand, Papua New Guinea, Peru, The Philippines, Russia, Singapore, Taipei (China), Thailand, USA, Vietnam

ASEAN – 10

Brunei Darussalam, Cambodia, **Indonesia**, Lao PDR, Malaysia, Myanmar, Philippines, Singapore, Thailand, Vietnam

TPP – 9

Australia, Brunei Darussalam, Chile, Malaysia, New Zealand, Peru, Singapore, USA, Vietnam

In all: Brunei Darussalam, Malaysia, Singapore, Vietnam



New Trends and Problems



- No such thing as “free trade”
 - All nations restrict in some way
- Much more difficult to tell “who is us”
 - Global supply chains
 - You don’t know if you are helping or hurting “domestic” industry (because you may be hurting partners)
- Trade policy does not stop with “border barriers”
 - “Unfair trade” and competitiveness Issues permeate society:
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 - Trade has become the interface between different societies’ ways of structuring themselves
- Trade (economic) issues underlie tensions: talk or fight?



Questions?



- Any questions?
- Thank you for your attention

