



INTERNATIONAL CHALLENGES FACED BY INDONESIA AND NEEDED RESPONSES ON TRADE POLICY AND REFORMS

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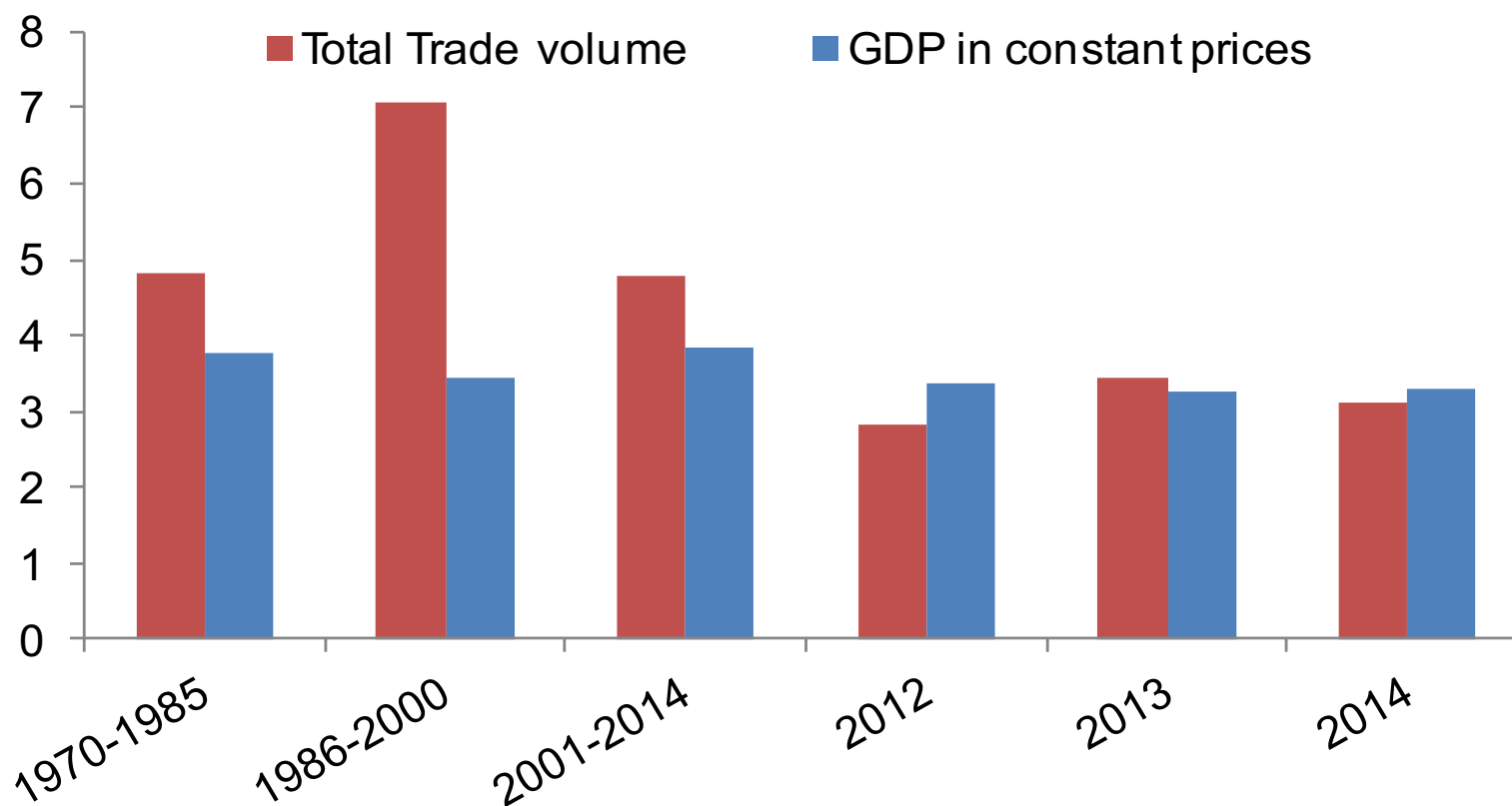
INTERNATIONAL CHALLENGES

The new normal?

The GLOBAL CONTEXT (the new normal): the need for diversification and new sources of growth, productivity and innovation

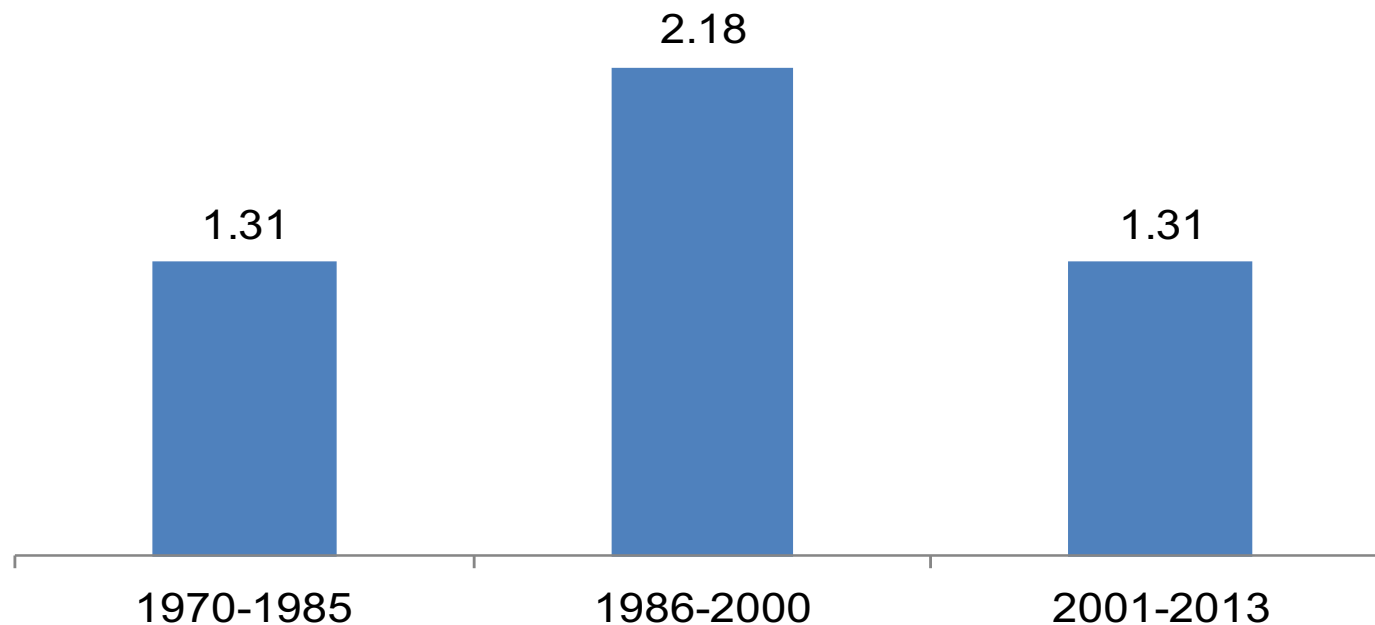
- slow growth of world trade and seeming delinking of world trade and growth (structural not cyclical): goods trade growth half previously and services more resilient
- Permanent weakening of commodity prices and demand
- Slowdown in China more than predicted, and future of structural reforms, leaving labor intensive production as China moves to services and innovation
- Changing nature of GVCs and role of China as hub: greater fragmentation of GVCs

Average Growth Rates in Trade compared to GDP (percent) declined in recent years, partly due to cyclical downturn



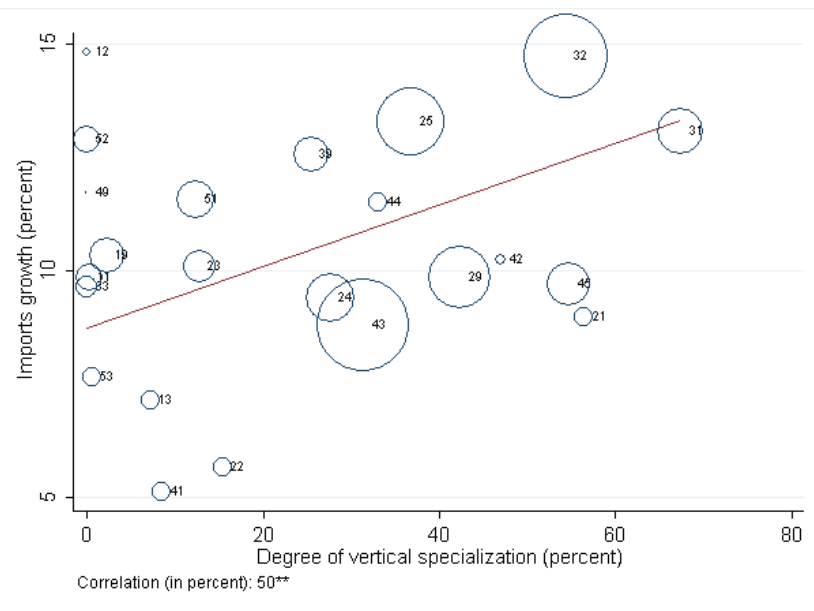
Source: IMF World Economic Outlook (Prospects for Global Trade, World Bank and IMF, May 2015). Note: long 1990s (1986-2000)

**But also changing relationship between trade and income
(decline in Long Run Elasticity Trade to GDP i.e. 1% of
growth lead to 1.3% trade growth)**

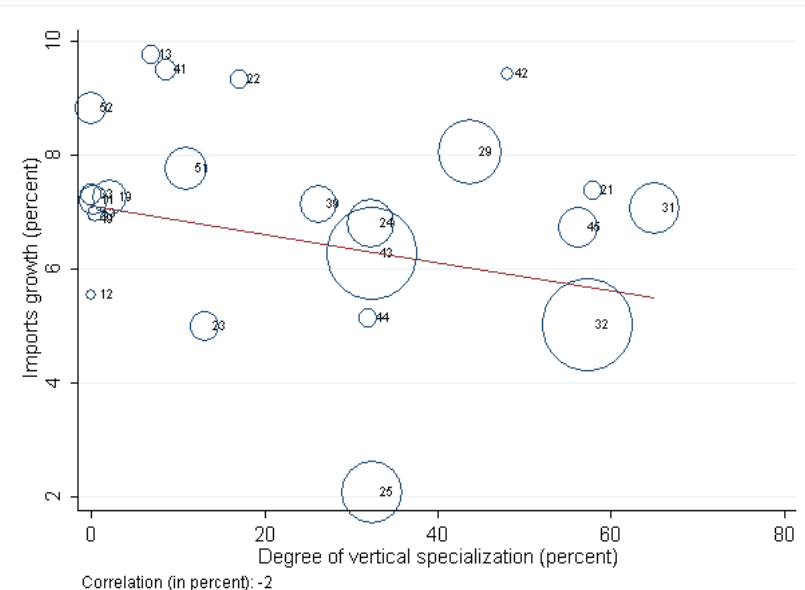


Source: IMF World Economic Outlook and authors' calculations
(Constantinescu, Mattoo and Ruta (2015))

Within manufacturing, trade growth declined more in subsectors with greater vertical specialization

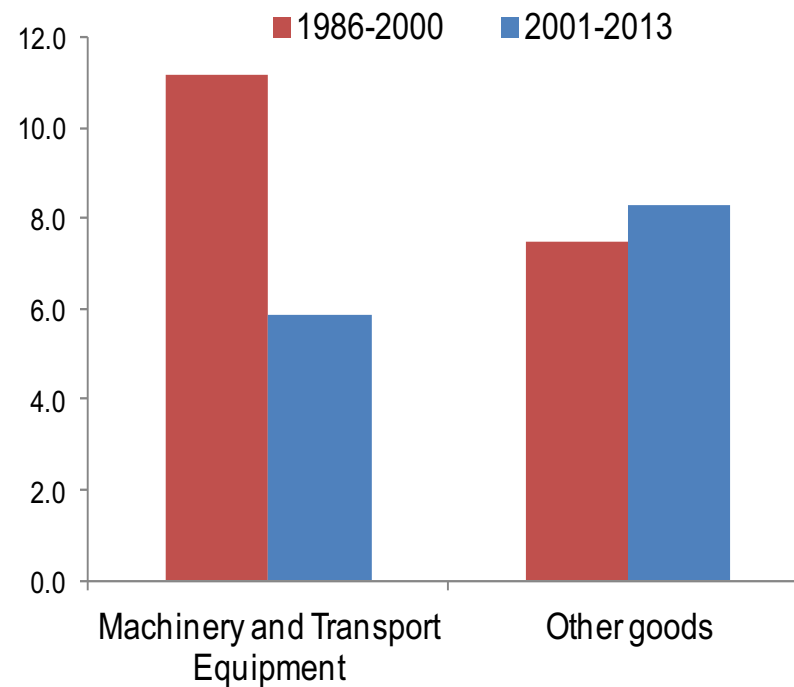
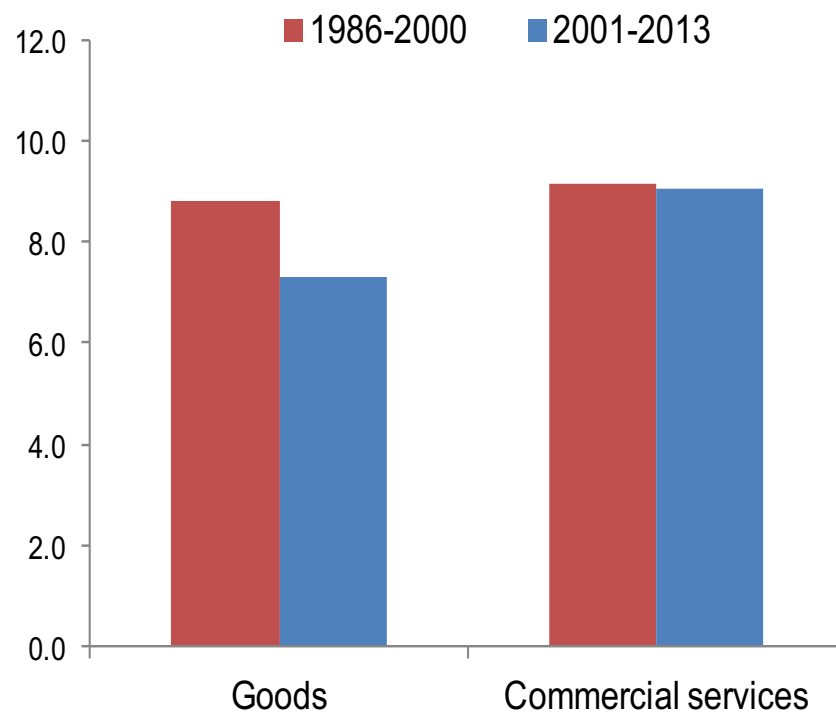


In the long 1990s, trade in the most vertically specialized sub-sectors saw much faster rates of growth than sub-sectors where GVCs were less developed

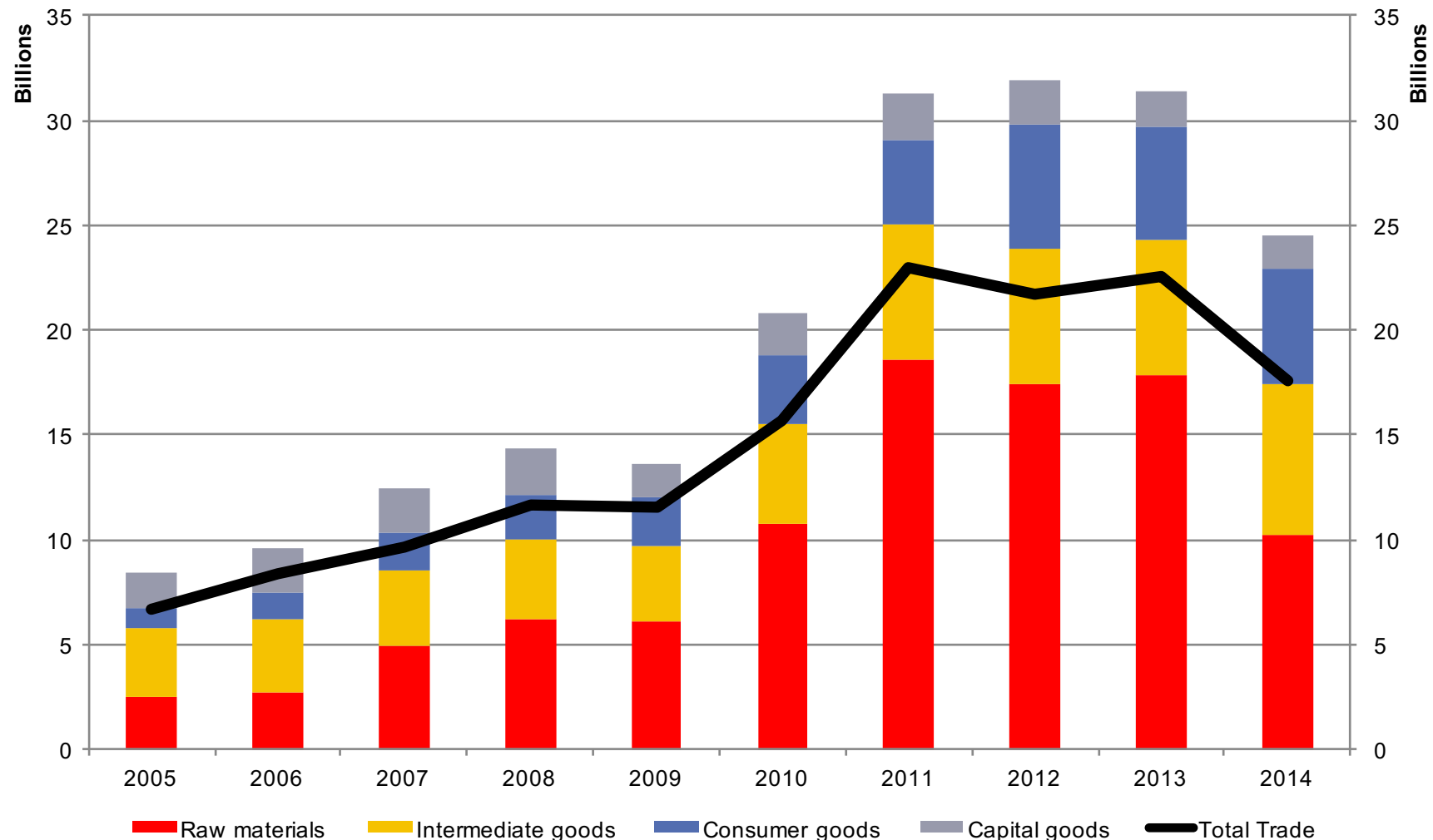


In the 2000s, while trade growth fell across the board, the largest declines were in the sub-sectors with higher degrees of vertical specialization

1990s growth driven by goods (manufacturing, machinery and transport), changing to services and commodities



From 2013 to 2014, Indonesia's total exports to China contracted 22.1% yoy. The decrease mostly in Raw Materials (decreases 42.5% yoy). Others do not change significantly.



Possible explanations for the structural slowdown in world trade

Global supply chain expansion explained “the long 1990s” when trade growth was double that of income growth: fragmented production networks and supply chain based on trade in parts and components (vertical specialization). China as hub and such trade grew faster.

Global supply chain or GVC contraction now also play a role in trade slowdown as supply chains “mature” and more local procurement. And changing nature of GVCs

Does slower trade mean reduced scope of increased productivity through specialization and diffusion of technology through trade and investment channel i.e. slower GVC expansion? Export orientation? How to take advantage of potential in services trade, and the evolution of GVCs in future?

Diversification and structural transformation: think fashion not garment

The more capabilities a country has, the more diversified the country is



Products that need more capabilities will be made by fewer countries, and products will be more ubiquitous

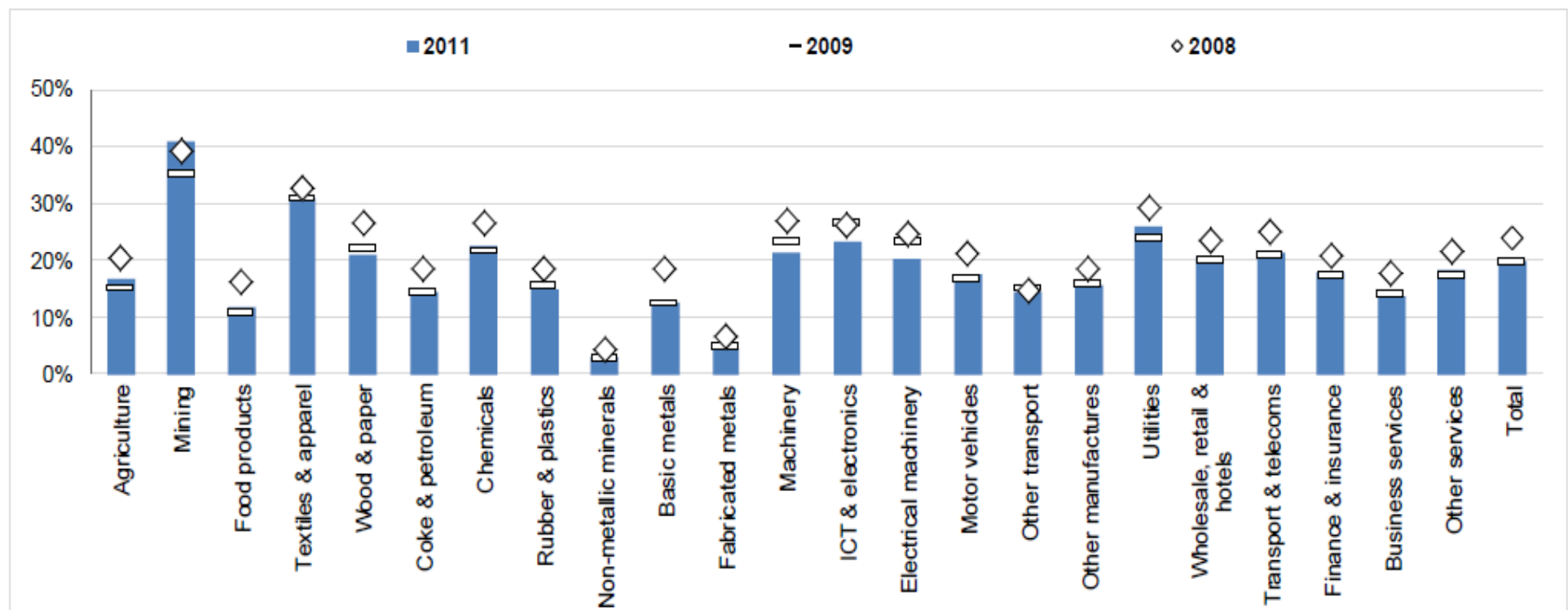


Countries with richer set of capabilities will be more diversified, and able to produce more ubiquitous products.

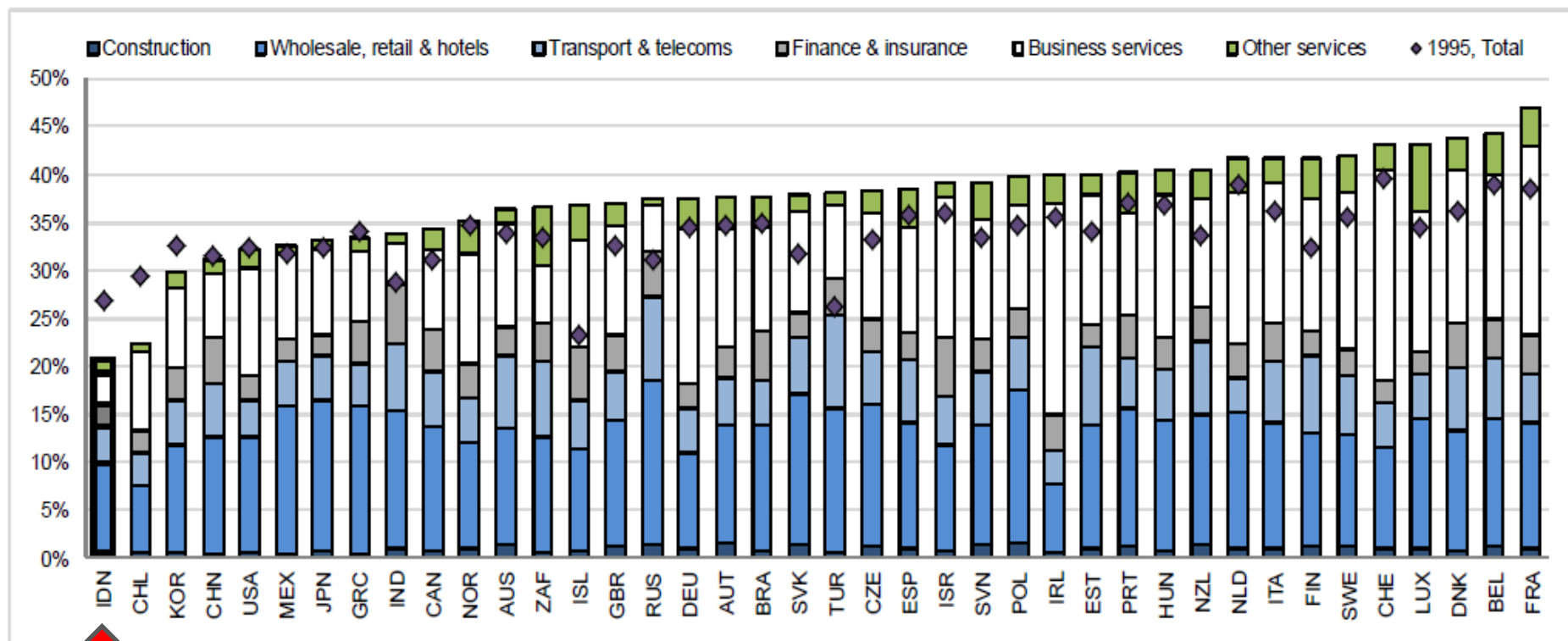


Hence, the diversification that matters is at the level of capabilities and need to be open to trade, investment and talent

Scope to increase Indonesia's participation in GVCs - share of intermediate imports used for exports is low



Indonesia – low share of services in exports



http://www.oecd.org/sti/ind/tiva/CN_2015_Indonesia.pdf

GVCs: inclusiveness and development (G20 agenda, OECD/WB study)

- GVCs have **advantage for SMEs and leap frogging**
- G20 agenda: SMEs part of export value chain (backward linkages)
 - lesser developed countries serve in agriculture, labor intensive and lower value added manufacturing and services (lower entry cost, less intensive in tangible capital).
 - Middle and higher income countries can operate in lower VA and higher skilled and specialized niche activities.
- **IMPLICATIONS:** Importance and opportunities in knowledge based capital producing services/tasks and within production processes in value chain
- (Efficient services: connectivity, human capital related (health, education, MNP))

Being an integral part of GVC for national benefit and value added

- Value added in new economy and GVC world is about competitiveness and where one is in the value chain or being hub of the value chain, depends on
 - **openness in trade and investment for goods, services and people movement.**
 - Competitiveness: infrastructure, access to internationally competitive inputs and technology, and a conducive ecosystem.
 - Its not about import substitution vs export orientation, or down stream value adding, domestic content or self sufficiency.
 - **STRUCTURAL REFORMS and INFRATRUCTURE BUILDING NEED TO CONTINUE.**
- Its also about responding to the new economy challenges and creative economy as a new source of growth and competitiveness. **CONDUCTIVE ECOSYSTEM NEEDED**
- Policies for empowerment and inclusiveness can be achieved with other policies and built in or main streamed in the policy taken.



RESPONSES AND TRADE POLICY AND ~~REFORMS FOR~~ INDONESIA

Trade and the New Normal: pessimism or new opportunities?

1. **Level of openness** highest and come back up after crisis (Import/GDP around 30%) so trade can still benefit growth
2. Developing countries can still “catch up” technology frontier & benefit from traditional goods and services integration (productivity, diffusion). Services have become more tradable and need to take opportunity in changing nature of GVCs: **trade in tasks and capabilities**. **Industrialization policy should not be end to end, local content focus but how to be competitive in the cluster around the “task”**.
3. **The cause for trade slowdown not because of increased protectionism (benign protectionism) but slowdown also because benefits of liberalization from early reforms done** (Average tariffs have come down from 30% to less than 15% in developing countries and from 10 to 5% in developed countries. ASEAN zero tariffs). **The “easy part” of reforms. Need to address other reforms (NTMS and behind border) – Unilateral, multilateral or regional**

Reforms and Impact of on Trade

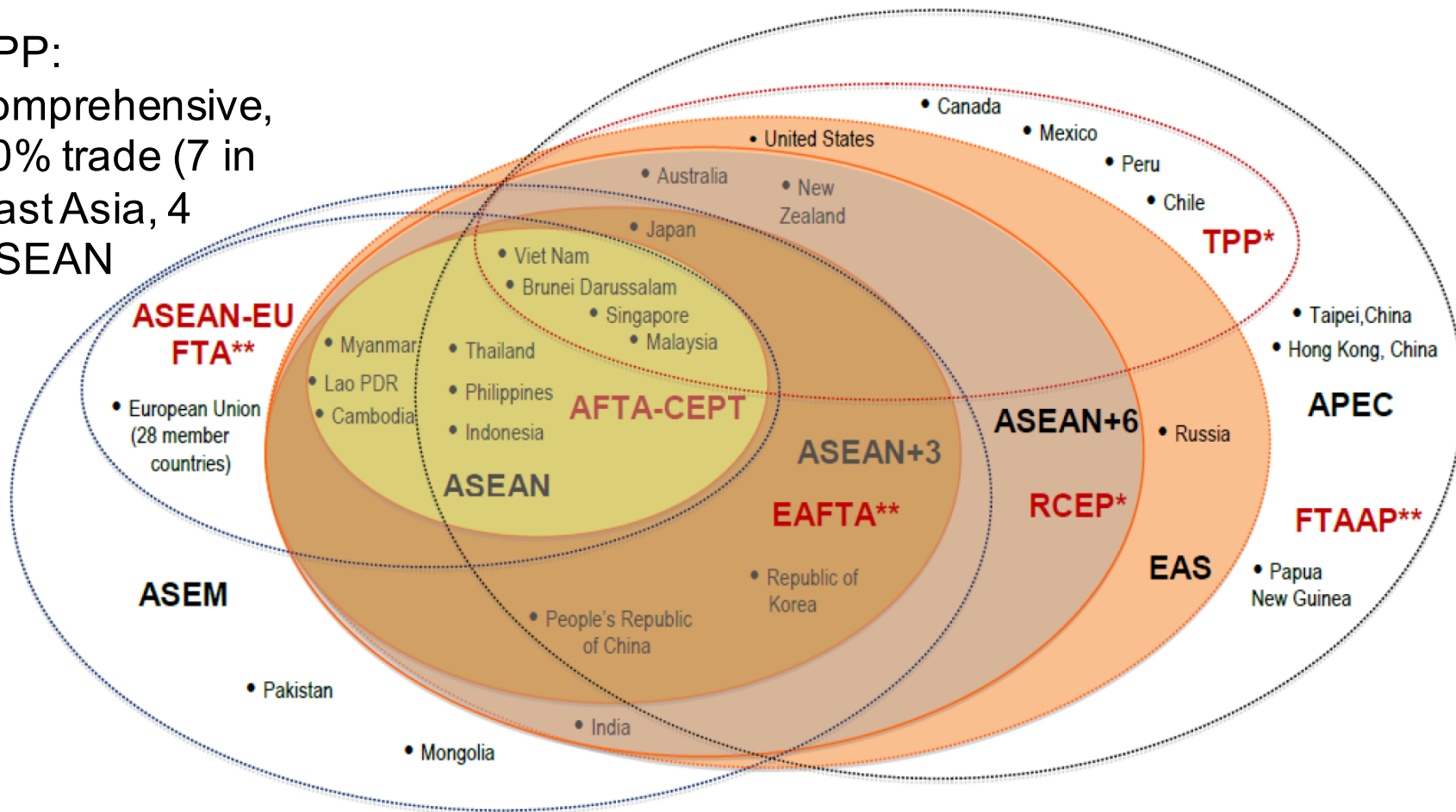
- APEC and NAFTA in 1993 vis a vis Uruguay Round
- Market driven East Asian driven by unilateral liberalization and reforms. Most of the reforms have focused on the easy cross border barriers of tariffs, investment restrictions as well as addressing infrastructure bottlenecks.
- In the 1990s till the East Asian financial crisis liberalization occurred because of a combination of WTO commitments, ASEAN trade integration, and competitive unilateral liberalization. One could attribute some role of APEC's peer pressure and concerted unilateral efforts to open up in the 1990s
- Post East Asian financial crisis the accession to the WTO of China and its opening up became an important driver to world trade and regional integration. Mattoo et al has identified the reduction of this kind of force and the maturation of GVCs has led to the slowdown of world trade post GFC.
- So now the harder parts of reforms and where will impetus come from?

Creating greater reform momentum for global trade integration could help the world avoid the adverse consequences of the global trade slowdown.

1. THE MOST IMPORTANT IS **Unilateral momentum for reforms:** political economy considerations, at a disjuncture with reality e.g rice? Domestic pressures and domestic rhetoric for limiting imports and increasing local content tends to be nationalistic rather than strategic. Has there been a Turning point: September deregulation package (10/11)
2. **Unilateral Reforms in the context of competitive liberalization model (unilateral or because international commitment) and meeting International commitments: Shaping reforms around international commitments**
 - Multilateral: Doha not going anywhere, WTO (dispute settlement, TF, plurilateral: ITA, EGS)
 - Bilateral: Priority is relaunch Australia and continue with Turkey (goods), complete negotiations with EFTA, and start with EU (Will be deeper than other)

Regional: RTAs and Plurilaterals facing Indonesia: Should TPP lead to acceleration of other mega regionals?

TPP:
comprehensive,
30% trade (7 in
East Asia, 4
ASEAN)



Source: ADB

Progress on ASEAN Economic Integration itself

- ASEAN Economic Community integration of single market and regional production base still confined to goods, services, investment mainly
 - Intra ASEAN mostly zero, low utilization, NTMs not addressed, services and MNP still shallow, investment agreement mostly adopting best practices but reservation list still have issues, TF/ASW, other issues still not deep or broad yet)
- RCEP (ASEAN Plus 6 dialog partners, China, Japan, Korea, India, Australia and NZ) similarly still focus on goods, services, investment
- In various stages of negotiations and deepening and widening (goods, investment, services, people movement, but quite different from TPP with 30 chapters which include all new issues (investment, environment, labor, state trading etc).
- Also still weak on Development Balance: capacity building, flexibilities, sharing of benefits and domestic support/ownership

TPP Chapters Cover...

GOODS AND SERVICES

- Market Access
- Agriculture
- Textiles and Apparel
- Rule of Origin*
- Cross Border Services
- Financial Services
- Telecommunication

FACILITATION , STANDARDS

Customs and Trade Facilitation

Technical barriers to Trade

Sanitary and Phytosanitary Issues

Temporary Entry for Business*

Competition and Business
Facilitation*

OTHER ISSUES, SOME ALREADY IN WTO AND OTHER AGREEMENTS

- E-Commerce*
- Environment
- Government Procurement*
- Intellectual Property
- Labor (ILO)

Investment*

Competition Policy*

Trade Remedies

Dispute Settlement

Transparency and Anti
Corruption

DEVELOPMENT, CAP BUILDING**

- Small and Medium-Sized Enterprises
- Cooperation and Capacity Building
- Development

NEW ISSUES

- State-Owned Enterprises**

Impact of TPP, Mega Regionals and Reforms

- Coverage 90% of goods and important peak tariffs. Market access benefit to members and costs to non members (Address peak tariffs - Textiles and apparel, footwear – Vietnam, Malaysia in access to US market vs other ASEAN; ROO); TC/TD and impact on GVC (textiles and apparel: yarn forward rule leading to yarn factory relocation from China and Korea to Vietnam, automotive 55% regional content rule)
- CGE model of Petri and Plummer: **15% benefit from tariff reduction, 53% from NTMs (TF, SPS, TBT), and 32% from services ---- reforms on the harder part of reforms**

Development

- Flexibilities, exceptions, and will this carry through to accession for new members like Indonesia
- ROO discriminatory and hurts LDCs like Cambodia
- Negotiations not transparent, how much of the outcome of TPP is a US template and how much input from other, especially developing country members
- Capacity building and cooperation: identification needs but delivery is not binding or concrete? And need to deal with domestic costs of adjustment (reform packages-- inland FTA (reducing negative impact from FTA domestically)).

Conclusions

- **Slow growth of world trade** permanent including commodities. **Not so much about increased protectionism, more because easy reforms (tariff) done, maturation and changing global chain**
- So answer is not to look inward and forget about export orientation but about **increasing competitiveness, productivity (innovation, creativity) and be an integral part of GVC**
 - capabilities not sectors, build cluster around task
 - cluster will have goods and services components/bundle
 - importance of best talent – MNP, people and business facilitation, and Liveable and smart cities
- Implies openness to trade, investment especially services and NTMs, and addressing new issues
- Not in political vacuum: how to address concerns? Better targeted affirmative/industrial policies that are “smart” (subsidize inputs such as R&D and training i.e. human capital, not the output/sectors; twinning leading institutions or talent with local but ensuring capacity and absorption happens) rather than through trade policies
- Political commitment so that Unilateral reforms address these with strategic longer term perspective and use international commitments/competitive liberalization to shape domestic reforms. Includes Leadership in ASEAN to accelerate AEC and RCEP as existing platforms to balance and complement TPP?